KENYATTA UNIVERSITY

UNIVERSITY EXAMINATIONS 2016/2017

SECOND SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF ECONOMICS

EAE 307: INTERNATIONAL ECONOMICS I

DATE: Wednesday, 10th May 2017 **TIME: 8.00 a.m. - 10.00 a.m.**

INSTRUCTIONS:

Question ONE is Compulsory (30 Marks)

Answer any other TWO (2) questions. (20 Marks each)

Question One

a) Given county A (Uganda) and country B (Kenya) as trading partners. Suppose Uganda's resource and technology endowment results in input coefficient a_{lx} for good X (maize) and a_{ly} for good Y (cement), while Kenya's input coefficients are b_{lx} and b_{ly} for maize and cement respectively. Suppose further

$a_{lx} < a_{ly}$; $b_{lx} < b_{ly}$ such that

$a_{lx} = 2$ $b_{lx} = 8$

$a_{ly} = 5$ $b_{ly} = 10$

Uganda's labour endowment is 140 units; Kenya is 360 units of labour.

Required:

i) Draw a production possibilities frontier (PPF) for each country. Be sure you label carefully showing which country has an absolute advantage in autarky. (10 Marks)

ii) Use the concept of opportunity cost (OC) to demonstrate that Uganda and Kenya can gainfully exploit their respective comparative advantage to benefit from trade with each other. (10 Marks)

b. i) List any five (5) of the Ricardian model assumptions. (5 Marks)

ii) Give four (4) properties of community indifference curves. (4 Marks)

iii) Use an algebraic expression to show that good X in country A is labour intensive and good Y in country B is capital intensive. (1 Mark)

Question Two

a) With the help of numerical examples, demonstrate that David Ricardo's theory of comparative advantage was an improvement on Adam Smith's theory of absolute advantage. (10 Marks)

b) With the help of a sketch drawing demonstrate that the neo-classical theory of trade was an improvement on the Ricardian model. (10 Marks)

Question Three

a) Use Paul Samuelson's factor price equalization theory to show that international trade in goods or mobility of labour across countries may equalize wage differences between two countries. (10 Marks)

b) The Heckscher-Ohlin (H-O) theory of international trade explains well some patterns of trade but not others. Explain the extent to which the following theories improve on the H-O theory of trade.

i) Taste-bias that dominates the production bias. (5 Marks)

ii) Intra-industry and product differentiation strategy. (5 Marks)

Question Four

When a small country imposes an import duty on a foreign good, there are tariff effects. Use an appropriate sketch diagram to show the tariff effects on domestic consumers, producers and suppliers of the imported good affected by the tariff. (20 Marks)

Question Five

a) If the price of an imported Dell computer is US$1000 under free trade, and the domestically assembled Mecer computer is made using US$500 worth of imported hardware and US$200 worth of imported software:

i) Calculate the effective rate of protection (ERP) for the Mecer computer if a 10% tariff is imposed on imported Dell computer, 5% tariff on imported hardware and 8% tariff on imported software used to assemble Mecer computers in Kenya. (10 Marks)

ii) What is the policy implication of imposing a tariff on imported inputs. (2 Marks)

b. i) Give the price-based definition of dumping. (2 Marks)

ii) Name and explain three types of dumping. (6 Marks)