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KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY

UNIVERSITY EXAMINATION, 2024/2025ACADEMIC YEAR
FOURTH YEAR, FIRST SEMESTER EXAMINATION
FOR THE DEGREE OF BACHELOR OF SCIENCE
(BUSINESS ADMINISTRATION)

Date: 14th August, 2024
Time: 8.30am –11.30am

KBM 2402 INTERNATIONAL ECONOMICS 1

INSTRUCTIONS TO CANDIDATES

ANSWER **QUESTION ONE (COMPULSORY)** AND **ANY OTHER TWO** QUESTIONS

QUESTION ONE (30 MARKS)

ECONOMIC IMPACT OF FREE TRADE

Two countries hypothetical countries (Alpha and Beta) engages in trade. Alpha is believed to be a highly industrialized country with advanced technology and efficient production processes while Beta is a developing country with abundant natural resources and lower cost of labour. Alpha produces electronics and beta produces agricultural products. Alpha produces 10 units of good A and 4 units of good B per unit of labour while Beta produces 2 units of good A and 8 units of good B per unit of labour. The varying factor prices boost production specialization between the trading countries enabling the consumers to consume goods of their choice hence more satisfaction among the members of the community. The production process is also facilitated by factor endowment and technological advancement between the two countries. Alpha is more advantaged compared to Beta in in production of the two goods in all dimensions, then the question is, is there need to engage in trade between the two countries?

a) Given a country Beta (Brazil) and country Alpha (USA) as trading partners. Suppose Brazil's resource and technology endowment results in input coefficients alx for good X (Soybeans) and aly for good Y (Electronics) while USA's input coefficients are blx and bly for Soybeans and Electronics, respectively. Suppose further that the level of technology in the two countries are as given below;

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

so that

$a_{lx} = 2$ $\quad$ $b_{lx} = 8$
$a_{ly} = 5$ $\quad$ $b_{ly} = 10$

Brazil's labour endowment is 140 units, while USA's is 360 units of labour

i) Draw a production possibility frontier (PPF) in each country. Be sure you label carefully showing which country has an absolute advantage in autarky. **(5 marks)**

ii) Use the concept of opportunity cost (OC) to demonstrate that Brazil and USA can gainfully exploit their respective comparative advantage to benefit from trade with each other **(6 marks)**

b) The ancient theories of international trade were first developed by Adam Smith and David Ricardo by making several assumptions. Explain any five assumptions of Ricardian model based on the above scenario **(5 marks)**

c) Indifference curves are used in international trade to measure the welfare of the society. Discuss four properties of community indifference curves that allow them to be used to measure wellbeing of the community in the two countries **(4 marks)**

d) The two countries are endowed with various resources with varying prices. Explain the sources of differences in relative prices of the resource endowed by the two countries **(4 marks)**

e) Most Africa countries are in the category of developing nations which rely heavily on imports in order to supplement their consumption. Discuss factors that trigger the development of import substitution strategies in country Beta **(6 marks)**

<u>QUESTION TWO (20 MARKS)</u>

a) Describe Leontiff paradox **(2 marks)**

b) Discuss five major competing explanations for the Leontiff paradox **(10 marks)**

c) Kenya experiences dumping of goods from Japan which is a more developed nations. As a student of international economics, discuss the reasons why Japan may carry out persistent dumping in Kenya **(8 marks)**

<u>QUESTION THREE (20 MARKS)</u>

a) Describe Paul Samuelson's factor price equalization theory **(3 marks)**

b) Use factor equalization theory to show that, in theory, with resurrection of East Africa Community, wages and interest rates in five member countries should be the same **(7 marks)**

c) Explain why in practice factor prices in the East African Community will not be same for many years **(4 marks)**

d) Using a well labelled diagram show the consumption and production gains from free trade a country enjoys as a results of engaging in trade **(6 marks)**

<u>QUESTION FOUR (20 MARKS)</u>

a) Use appropriate diagram to show the tariff revenue effects following the imposition of a tariff on and imported good by a small country **(10 marks)**

b) Countries normally engage in trade in order to gain, however, transport costs cause certain inefficiencies in the process. Discuss the effect of transport costs on trade between trading partners **(4 marks)**

c) The neo-classical model of Heckscher-Ohlin have assumed that labour across countries is homogenous and equally important in production. However, in real world this is not true, explain these assumptions giving examples in each case **(6 marks)**

<u>QUESTION FIVE(20 MARKS)</u>

a) Use a numerical example to show that Adam Smith's Theory of absolute advantage was improved by David Ricardo's theory of comparative advantage **(10 marks)**

b) Briefly outline David Hume's specie-flow mechanism **(5 marks)**

c) Countries impose tariffs on goods and services on crossing their national borders. Explain reasons why such tariffs are imposed on goods and services **(5 marks)**