UNIVERSITY PAPER SOLUTIONS

APRIL 2019

Time : 3 HoursMarks : 100

N.B.: 1. All questions are compulsory.

2. Figures to the right indicate full marks.

3. Draw neat diagrams wherever necessary.

Q.1 (A) Select the right answers and rewrite the statements : (Any 10) (10)

1. According to the modern theory of international trade, ______ is responsible for international trade.

(a) Factors endowments (b) Labour

(c) Money (d) None of these

2. ______ refers to the rate at which a country's exports exchange against its imports.

(a) Foreign exchange (b) Balance of payments

(c) Terms of trade (d) Investment rate

3. Marshall and Edgeworth introduced a geometrical device to explain the gains from trade which is known as ______.

(a) Indifference curve (b) Isoquant curve

(c) BOP curve (d) Offer curve

4. A protectionist policy has the following drawbacks ______.

(a) Consumers have to pay higher price

(b) Producers get higher profits

(c) Quality of goods may be affected

(d) All of these

5. A tariff ______.

(a) increases the volume of trade

(b) reduces the volume of trade

(c) has no effect on volume of trade

(d) none of these

6. _____ occurs when a group of countries agree to have free movement of factors of production.

(a) Free trade area

(b) Customs union

(c) Common market

(d) Preferential trade agreement

7. Rich countries have balance of payments deficit _____.

(a) Sometimes

(b) Never

(c) Always

(d) Every year

8. The official reduction in the value of a currency with respect to other currencies is known as _____.

(a) Revaluation

(b) Appreciation

(c) Devaluation

(d) Depreciation

9. The _____ declaration recognised that the TRIPs agreement should protect public health.

(a) Bali

(b) Doha

(c) Bandung

(d) Singapore

10. Foreign exchange market is _____.

(a) grouping, by electronic means

(b) located only in London

(c) located only in New York

(d) none of these

11. Hedgers enter into a foreign exchange market to _____.

(a) Speculate

(b) Promote exports

(c) Cover risks

(d) Promote imports

12. Holding everything else constant, an increase in interest rates in India will lead to _____.

(a) Capital inflows into India

(b) Depreciation of the INR

(c) Capital outflows from India

(d) A decrease in demand for goods and services

Illustration

Q.1 (B) State whether the following statements are True or False : (Any 10) **10)**

1. Adam Smith gave the first classical theory of international trade.
2. Net barter terms of trade is also known as commodity terms of trade.
3. If the cost ratios are equal there will be gain to both the countries and there will be trade.
4. The cheap foreign labour argument is a legitimate argument against free trade because the cheap labour leads to low costs of production.
5. If a country increases its tariff then imports will be more expensive.
6. Nepal is a founder member of the European Union.
7. A surplus in the current account of BOP implies that the country is lending to foreigners more than foreigners lending to it.
8. Monetary and fiscal policies are used to correct BOP disequilibrium.
9. The IMF has been given the mandate to negotiate multilateral rules in services.
10. Majority of retail foreign exchange trading happens in forward market.
11. If the U.S. dollar appreciates relative to the Swiss franc, Swiss chocolate will become cheaper in the U.S.A.
12. Sterilised intervention is done through open market operations.

Q.2 Attempt any two of the following : **(15)**

(a) Bring out the differences between the Ricardian theory of international trade and the modern theory of international trade.

(b) What are the factors affecting terms of trade ?

(c) Discuss the J.S. Mill's theory of reciprocal demand.

Q.3 Attempt any two of the following : **(15)**

(a) Discuss the arguments in favour of the policy of free trade.

(b) Explain the economic effects of import tariffs.

(c) What are the reasons for Britain exiting (Brexit) the European Union?

Q.4 Attempt any two of the following : **(15)**

(a) Discuss the structure of balance of payments of a country.

(b) Explain different measures to correct deficit in the balance of payments.

(c) Discuss the WTO agreements with references to GATs.

Q.5 Attempt any two of the following : **(15)**

(a) Discuss the factors influencing demand for and supply of foreign exchange.

(b) Discuss the absolute and relative versions of the purchasing power parity theory.

(c) Explain managed flexible exchange rate system in India.

Q.6 **Write short notes on any four of the following :** **(20)**

(a) Shortcomings of the Heckscher-Ohlin theory of international trade.

(b) Objectives of commercial trade policy

(c) The Marshall-Lerner condition

(d) Spot and forward exchange rates

(e) Types of economic integration

(f) Functions of foreign exchange market

ANSWERS

Answer 1 (a) :

(1) - (a), (2) - (c), (3) - (d), (4) - (d), (5) - (b), (6) - (b), (7) - (a), (8) - (c), (9) - (b), (10) - (d), (11) - (c), (12) - (a)

Answer 1 (b) :

True : 1, 2, 5, 8, 11, 12 ; False : 3, 4, 6, 7, 9, 10

Answer 2 :

(a) Both the Ricardian theory and the modern theory explain the factors responsible for international trade.

Differences : Refer Chapter - 2 : 2.5.

(b) The rate at which commodities are exchanged between countries is called terms of trade.

Factors affecting terms of trade : Refer Chapter - 3 : 3.7.

(c) J.S. Mill's concept of reciprocal demand was presented by Alfred Marshall and Francis Edgeworth through offer curves. An offer curve is a geographical representation of reciprocal demand indicating various quantities of exports a country is going to offer for various quantities of imports as a succession of possible terms of trade.

Theory of Reciprocal Demand through Offer Curves : Refer Chapter - 4 : 4.3.

Answer 3 :

(a) A commercial trade policy refers to a government's policy in relation to a country's international trade. It includes all the policies adopted by the government of a country while negotiating international trade agreements. Commercial trade policies can be those promoting free trade or those following protectionism.

Arguments in favour of free trade policy : Refer Chapter-5 : 5.2.

(b) A tariff is a tax imposed on commodities that are traded across the national border of a country. Tariffs are generally imposed on imports, though they can also be imposed on exports. Tariffs have several economic effects.

Economic effects of import tariffs : Refer Chapter - 6 : 6.2 [B].

(c) *Refer Chapter - 7 : 7.4 (Brexit).*

Answer 4 :

(a) The balance of payments of a country is a systematic record of all economic transactions between the residents of the reporting country and the residents of foreign countries during a given period of time.

Structure of balance of payments : Refer Chapter - 8 : 8.3.

(b) *Refer Chapter - 9 : 9.4.*

(c) *Refer Chapter - 10 : 10.3 (GATS).*

Answer 5 :

(a) The rate of exchange of a currency is said to be in equilibrium if there is no excess supply of or demand for it in the foreign exchange market. It is the rate at which the demand for and the supply of a foreign currency are equal.

Factors determining demand and supply for foreign exchange: Refer Chapter - 12 : 12.3 and 12.4.

(b) The Purchasing Power Parity (PPP) theory was developed by Gustav Cassel in 1918 to explain the determination of long term equilibrium exchange rates based on relative price levels of two countries.

Absolute and Relative Versions of PPP theory : Refer Chapter- 13 : 13.2 and 13.3.

(c) *Refer Chapter - 14 : 14.7.*

Answer 6 :

(a) *Refer Chapter - 2 : 2.4*

(b) *Refer Chapter - 5 - 5.1*

(c) *Refer Chapter - 9 - 9.4 (Expenditure Switching Policies)*

(d) *Refer Chapter - 11 - 11.4*

(e) *Refer Chapter - 7 - 7.2*

(f) *Refer Chapter - 11 - 11.3*