Answer ALL questions. Answers must be typed, but if needed, graphs may be drawn by hand.

1. Other things being equal, a rise in a country's terms of trade increases its welfare. What would happen if we relax the \textit{ceteris paribus} assumption, and allow for the law of demand to operate internationally? \[4\]

2. Japan primarily exports manufactured goods, while importing raw material such as food. Using the standard trade model, \textit{graphically} analyze the impact of the following events on Japan's terms of trade:
   (a) A famine in South Asia disrupts the world food supply.
   (b) Korea develops the ability to produce automobiles that it can sell in the rest of the world. \[3+3=6\]

3. In practice much foreign aid is “tied”, i.e., it comes with restrictions that require that the recipient spend the aid on goods from the donor country. For example, France might provide money for an irrigation project in Africa, on the condition that the pumps, pipelines, and construction equipment be purchased from France rather than from Japan. How does such tying of aid affect the transfer problem analysis? Does tying of aid make sense from the donor’s point of view? \[4\]

4. Home is an exporter of cloth and an importer of food. The marginal propensities to spend (MPS) on cloth and food at Home are 0.3 and 0.7 respectively. Foreign, which is Home’s trading partner, has a MPS of 0.5 on each good. Now suppose that Home makes an “untied” aid transfer to Foreign.
   (i) Calculate the effect of this transfer on the national division of world spending on food and cloth. What happens to the world relative demand for cloth?
   (ii) Using an appropriate graph, depict the effect of the transfer on Home’s terms of trade. Is Home better-off or worse-off after the transfer?
   (iii) Relate your answer to part (ii) to the “Transfer Problem” debate between Keynes and Ohlin. \[2x3=6\]