Economics 161 — Spring 2010

International Integration of Latin American Economies

Review Sheet 2: International Capital Flows

May 4, 2010

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1 Savings, Investment, and the Current Account

If Chile's current account is in deficit today (period 1), what does this mean for the relationship between Chile's income, consumption, and investment (including both households and the government)? The world ends tomorrow (in period 2). Will Chile be a net exporter or net importer of goods and services tomorrow (in period 2)? Will Chile be a net exporter or net importer of capital tomorrow (in period 2)?

2 Intertemporal Trade

Present a brief explanation for why the theory of international capital investment can be recast as a theory of international trade. What are key differences between trade in commodities and the exchange of capital? What gains from international capital investment are there beyond those of intertemporal trade? What are the risks to intertemporal trade?

3 Capital Market Integration

Consider the effects of capital market integration.

1. Colombia has an endowment of income of Y_{today} and invests a positive amount of that income I1 for future consumption. Draw Colombia's production possibility frontier and demonstrate today's consumption, today's investment, tomorrow's consumption, and tomorrow's income in a closed economy.

2. Now assume Colombia has access to international capital markets at the world interest rate $(1+r^*)$. What will this do to Colombia's consumption and investment decisions? Again, draw Colombia's production possibility frontier and demonstrate today's consumption, today's investment, tomorrow's consumption, and tomorrow's income in an open economy.

4 Foreign Direct Investment as a Source of Financing

Foreign direct investment (FDI) is an important source of current account financing in Latin America. What are specific characteristics of FDI that set it apart from other forms of capital? What are advantages and disadvantages of this kind of investment over other types of capital flows? Why? Under what conditions can a country be both a net exporter of goods and services, and simultaneously attract foreign direct investment? Can a country be both a net exporter of goods and services and a net importer of capital?

5 Offshoring, Intra-firm Trade and the Boundary of the Firm

Discuss three reasons why a firm wishing to enter a new market abroad would want to own multinational assets rather than engage in a contractual relationship.

Explain how offshoring of intermediate production stages with different relative skill requirements can simultaneously raise demand for relatively more skilled workers in the offshoring and the inshoring location.