

NAME:

STUDENT ID:

Economics 161 — Fall 2004

Latin American Economic Development

Midterm Exam

November 2, 2004

Time: 80 minutes

Total score: 80 points

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1 Patterns of Trade: 10 minutes

Ricardian causes of trade Brazil and Venezuela refine oil and manufacture airplanes. Brazil can produce 80,000 barrels of oil and 4,000 airplanes. Venezuela can produce 100,000 barrels of oil and 10,000 airplanes. What is Brazil's opportunity cost of oil in terms of airplanes? Describe the pattern of trade between Brazil and Venezuela. Why?

Heckscher-Ohlin causes of trade Brazil is high-skill labor abundant and Venezuela is low-skill labor abundant. Oil production is low-skill labor intensive and airplane manufacturing is high-skill labor intensive. Describe the pattern of trade between Brazil and Venezuela. Why?

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2 Trade, Poverty and Inequality: 10 minutes

Name and use a suitable trade model to provide a reason why trade may affect income *inequality*.

Distinguish *inequality* and *poverty*. Could the same model also explain changes in *poverty* after trade?

3 Productivity Change and Trade: 10 minutes

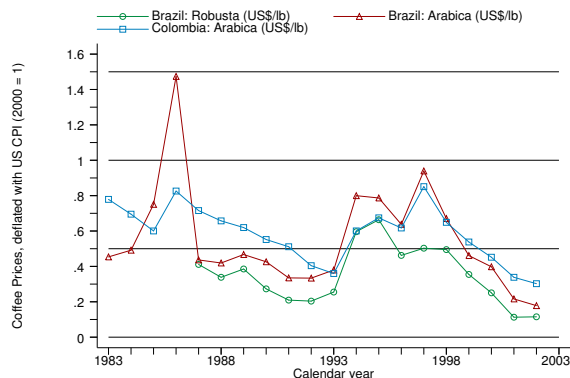
Argentina and its trading partners specialize in the production of goods where they have a comparative advantage. Argentina experiences productivity growth in its *import* sector. How do Argentina's terms of trade change? Why? Are Argentina's gains from trade larger or smaller after this productivity shock? Why?

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4 Trade in Agricultural Goods: 10 minutes

Discuss the graph on agricultural production in Latin America below and offer two key arguments for why the market for agricultural products has been different from the market for manufacturing products.



5 Preferential Trade Agreements: 10 minutes

Briefly describe the difference between a free trade area, a customs union, and an economic union citing an example for each from the Americas. If no example exists in the Americas, use an example from another world region.

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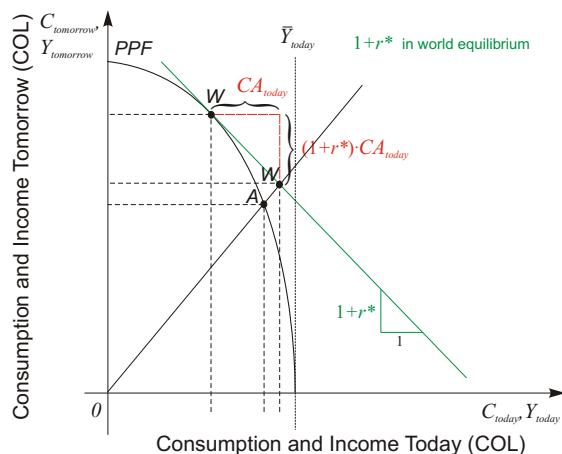
6 Current Account and Interest: 10 minutes

Consider Colombia, an open economy and a borrower on international capital markets at present (“today”). In a borrower country, do residents save more or less than their productive sector invests? So, is Colombia running a current account surplus or deficit?

Suppose world interest rates increase (so that $1+r^*$ increases). Will Colombia’s productive sector invest more or less? Does the savings decision of Colombia’s residents matter for this change in investment?

Typically, Colombia’s savings would increase in response to an interest rate increase. So, how does Colombia’s current account at present (“today”) change in response to the interest rates increase?

You may but need not use the graph below to find your answers.



[Consider the depicted interest rate as the initial interest rate *before* the increase. The ratio of consumption choices in the graph is such that savings do increase indeed in response to an interest rate increase.]

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7 Capital Mobility: 10 minutes

“The case for free international capital markets is the same as the case for free trade but for the subsists.”

For this statement to be true, what do the “traded goods,” the “terms of trade” and the “production possibility frontier” have to be or describe?

Name a characteristic of capital markets that invalidates the statement. Why?

8 Latin American Development: 10 minutes

Fernández-Armesto lists several “unconvincing arguments” for Latin America’s stunted economic development compared to North America’s advance. Among the “unconvincing arguments” in his view are those about religion, culture, character, mind-set, and climate. Choose two out of these five “unconvincing arguments” and explain why Fernández-Armesto considers them inadequate.