

# Review Sheet 1: Trade Integration

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## 1 Import Substitution Industrialization

For what motives and when did Latin America pursue Import Substitution Industrialization (ISI)? Outline three arguments in favor of ISI.

What were key objectives of ISI? Argue for or against the success of ISI with regard to those objectives. There are alternative policies to ISI that might achieve key objectives differently. Argue for or against their possible success in Latin America.

## 2 Trade Patterns and Gains from Trade

The *Ricardian* and *Heckscher-Ohlin* theories of international trade stress different aspects of *comparative advantage*. [You may use numeric examples, graphs, or clear verbal arguments for any of your answers.]

1. Discuss prime differences between the *Ricardian* and the *Heckscher-Ohlin* theory of trade. State their main predictions for the pattern of trade.
2. *Ricardian trade*. Ecuador and Oregon grow bananas and produce cars. Ecuador's workers can produce 300,000 cars and grow 15 million bananas, while Oregon's workers can produce 1 million cars and grow 20 million bananas. In your argument, start from a point of autarky and open markets to international trade. What are Ecuador's and Oregon's opportunity costs of car manufacturing in terms of bananas? What is the pattern of trade? If the world price is 1 car for 30 bananas, how many cars will Ecuador make, and how many cars will Oregon make? In your analysis, demonstrate that there are gains from trade for both Oregon and Ecuador.
3. *Heckscher-Ohlin trade*. What will happen to real wages for banana growers and car-making workers in Ecuador and Oregon under the assumption that banana growing is low-skill intensive, car manufacturing is high-skill intensive, Ecuador is low-skill labor-abundant and Oregon is high-skill labor-abundant?

### 3 Inequality and Trade

International trade affects the distribution of incomes within trading countries. [You may use numeric examples, graphs, or clear verbal arguments for any of your answers.]

1. Explain the difference between measures of poverty and income inequality. Can poverty decline in the presence of increasing income inequality?
2. By many measures, *income inequality* in Latin America has become more extreme over the past decades. Discuss two reasons [of your choice] why international trade may have been a cause. Offer two alternative reasons [of your choice] why international trade may not have been the cause for worsening income inequality.

### 4 Growth and Trade

Given differences in per-capita incomes, trade may not suffice to bridge the gap in consumption levels between unequal regions. Consider Ecuador and Oregon. Ecuador has a lower per-capita income than Oregon. [You may use numeric examples, graphs, or clear verbal arguments for any of your answers.]

1. Explain how Ecuador could attempt to bridge the consumption gap that remains to Oregon.
2. How do the terms of trade respond when Ecuador increases its labor productivity in the export sector? Will it still reap gains from trade?
3. The possibility of “immiserizing growth” causes concern in Ecuador. Explain how “immiserizing growth” may come about. Will Ecuador still reap gains from trade under “immiserizing growth”?

### 5 Trade in Primary and Agricultural Goods

Trade in primary commodities and agricultural merchandize poses special challenges to an exporting country. Discuss three reasons [of your choice] why world markets for these commodities are different from other markets. For the three causes you discuss, offer economic policies that could alleviate or remove the challenges.

### 6 External Economies

Give two examples of external economies of scale. [You may try to avoid examples from class; as is generally the case, thinking of own examples helps solidify ideas.]

Brazil has a large domestic consumer market and wants to launch a micro-processor chip industry. No entry occurs although average Brazilian production costs would be lower than anywhere else in the world at any given scale. The Brazilian government hires you as a consultant. Explain why the Brazilian market is empty. What policy options can you offer the Brazilian government? What are their advantages and disadvantages? For how long should the policies remain in place? [You may use numeric examples, graphs, or clear verbal arguments for your answers.]