Economics 161 — Fall 2013

Global Integration of Latin America

Review Sheet 1: Trade Integration

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Instructor: Marc-Andreas Muendler
E-mail: muendler@ucsd.edu

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 differ-
ent 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.* Mexico and California grow avocados and produce mo-
   torcycles. Mexico's workers can produce 300,000 motorcycles and grow 15
   million avocados, while California's workers can produce 1 million motor-
   cycles and grow 20 million avocados. In your argument, start from a point
   of autarky and open markets to international trade. What are Mexico's
   and California's opportunity costs of motorcycle manufacturing in terms
   of coffee? What is the pattern of trade? If the world price is 1 motorcycle
   for 30 coffee, how many motorcycles will Mexico Mexico make, and how
   many motorcycles will California make? In your analysis, demonstrate
   that there are gains from trade for both California and Mexico.

3. *Heckscher-Ohlin trade.* What will happen to real wages for avocado grow-
   ers and motorcycle-making workers in Mexico and California under the
   assumption that avocado growing is low-skill intensive, motorcycle man-
   ufacturing is high-skill intensive, Mexico is low-skill labor-abundant and
   California is high-skill labor-abundant?

3   Trade and Inequality

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 pronounced over the 1990s but less extreme over the 2000s. Discuss two reasons [of your choice] why international trade in final goods 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.

3. Outlook on *International Capital Markets*: Offer an explanation why foreign direct investment and trade in intermediate goods may overturn the rationale from trade in final goods.

4   Trade in Primary 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.

5   External Economies

Give two examples of sources for 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 microprocessor 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.]

6   Growth and its Effects on Trade

Given differences in per-capita incomes, trade may not suffice to bridge the gap in consumption levels between unequal regions. Consider Mexico and California.

Mexico has a lower per-capita income than California. [You may use numeric examples, graphs, or clear verbal arguments for any of your answers.]

1. Explain how Mexico could attempt to bridge the consumption gap that remains to California.

2. How do the terms of trade respond when Mexico increases its labor productivity in the export sector? Will it still reap gains from trade?

3. The possibility of "immiserizing growth" causes concern in Mexico. Explain how "immiserizing growth" may come about. Will Mexico still reap gains from trade under "immiserizing growth"?

7 Trade and its Potential Effects on Growth

State three main sources of growth. Which of the three is arguably the most lasting source?

There are several mechanisms by which trade may affect productivity change. [You may use numeric examples, graphs, or clear verbal arguments for any of your answers.]

1. Suppose there are external economies of scale, driven by free entry into industrial clusters. Explain how comparative advantage changes over time as entrants join a cluster.

2. Suppose there is learning by doing in a model with multiple goods and productivity differences across countries. Explain how the pattern of comparative advantage changes over time as each trading partner learns by doing.

3. Define the Balassa (1965) measure of comparative advantage. Applying it to Latin American economies, does there appear to be lock-in of comparative advantage?

4. What is the impact of adjustment costs and temporarily idle production factors after trade reform on growth?

8 Trade and Incentives for Efficiency and Innovation

State the principal-agent problem when there is uncertainty over both a project's return and an agent's effort. In which ways can foreign trade affect competition, product-market shares and a project's return? How can foreign trade therefore alter incentives for efficiency and innovation?