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University ID \_\_\_\_\_



**ECON 4311 – Fall 2021 Final**  
**Economy of Latin America**  
December 15, 2021

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**Examiner:** Luis Perez, email: perez766@umn.edu

**Allowed utensils:** Pen, paper, eraser, and calculator.

**General Instructions:**

- You have 1 hour and 15 minutes (from 17:00 to 18:15) to complete the exam.
  - The exam consists of 25 multiple choice questions (each worth 2.8 points) and 8 free-response questions, (each worth 3.75 points).
  - There is only one (1!) valid answer per multiple choice question (MCQ), and no points will be subtracted for wrong answers.
  - Answer all MCQ questions in the sheet provided below.
  - If you make a mistake in answering a MCQ and want to change the answer, do cross the 4 options (A, B, C, D) and clearly write on the right of box D the letter of your final answer.
  - Be short and to the point in the free-response questions.
  - Do not remove the staple from your examination sheets.
  - Make sure to submit all pages of your examination.
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Good luck!

# MCQ Answer Sheet

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How to answer:

- A  B  C  D

Questions:

- 1.  A  B  C  D
- 2.  A  B  C  D
- 3.  A  B  C  D
- 4.  A  B  C  D
- 5.  A  B  C  D
- 6.  A  B  C  D
- 7.  A  B  C  D
- 8.  A  B  C  D
- 9.  A  B  C  D
- 10.  A  B  C  D
- 11.  A  B  C  D
- 12.  A  B  C  D
- 13.  A  B  C  D
- 14.  A  B  C  D
- 15.  A  B  C  D
- 16.  A  B  C  D
- 17.  A  B  C  D
- 18.  A  B  C  D
- 19.  A  B  C  D
- 20.  A  B  C  D
- 21.  A  B  C  D
- 22.  A  B  C  D
- 23.  A  B  C  D
- 24.  A  B  C  D
- 25.  A  B  C  D

## Multiple Choice Questions (MCQ): 70 points

1. Select the correct answer. Adam Smith challenged the view that countries could increase welfare with mercantilism. To challenge this view, he used the concept of:
  - (a) Absolute advantage.
  - (b) Comparative advantage
  - (c) Both (a) and (b) are correct.
  - (d) None of the above.
2. What is the connection between ISI and Trade in Latin America?
  - (a) ISI pushed for autarky trade policies.
  - (b) Resources were diverted from industries with comparative advantage to disadvantaged industries.
  - (c) Resources were diverted from industries with absolute advantage to disadvantaged industries.
  - (d) All of the above.
3. According to the Heckscher–Ohlin model, what causes differences across countries in opportunity costs of producing goods?
  - (a) Factor abundance.
  - (b) Factor intensity.
  - (c) Changes in the distribution of wages.
  - (d) Both (a) and (b) are correct.
4. Select the correct answer. NAFTA:
  - (a) Trade agreement that took effect in 1994, encouraging trade between Mexico, Canada, and the United States, and is still guiding trade relationships between the three countries involved.
  - (b) Was renegotiated into the US-Canada-Mexico agreement.
  - (c) Following NAFTA, the share of employment in the Mexican manufacturing sector decreased.
  - (d) Both (a) and (c) are correct.
5. Select the correct answer. The Bretton Woods' system (1944–1971):
  - (a) Linked foreign currencies to the US dollar, and the US dollar to gold.
  - (b) It was a dollar-pegged exchange rate system.
  - (c) Forced currencies to be kept within 1% of the fixed exchange rate.
  - (d) All of the above.

6. Select the correct answer. Exchange controls:
- (a) Aim to restrict acquisition of foreign currency.
  - (b) Cannot force holders of foreign exchange to sell it to the government.
  - (c) Are still common practice on current accounts, but not on the financial account.
  - (d) Both (b) and (c) are correct.
7. Select the correct answer. La Década Perdida (The Lost Decade):
- (a) Has its roots in the large amounts of money that Latin American countries borrowed in the early 1930s to favor ISI.
  - (b) Is a domestic debt crisis that resulted in a decade of missed growth.
  - (c) Is essentially a sovereign debt crises.
  - (d) All of the above.
8. Which of the following occurred in the 1980s and compromised the position of Latin American countries in international markets:
- (a) Higher commodity prices.
  - (b) Political instability in East Asia.
  - (c) Volcker shock.
  - (d) None of the above.
9. Select the correct answer. Governments borrow money in international markets through:
- (a) Bond issuance.
  - (b) Loans from commercial banks and loans from multilateral institutions.
  - (c) All of the above.
  - (d) (a) and loans from multilateral institutions.
10. Why should we (1) expect higher FDI investments in Latin America than in high-income economies, and (2) why has there been scarce FDI investment?
- (a) (1)  $MPK(\text{Latin America}) > MPK(\text{high-income economies})$ , and (2) due to corruption and high criminal activity.
  - (b) (1)  $MPK(\text{Latin America}) < MPK(\text{high-income economies})$ , and (2) due to corruption and high criminal activity.
  - (c) (1)  $MPK(\text{Latin America}) > MPK(\text{high-income economies})$ , and (2) due to political instability and ISI policies.
  - (d) None of the above.

11. Economists believe portfolio capital to be essential for the economic development of a country. Why? Portfolio capital:
  - (a) Brings capital to credit-constrained firms or governments and allows to carry out profitable investments.
  - (b) Helps stabilizing a country.
  - (c) Eventually, loans become partially converted into “gifts”.
  - (d) All of the above.
12. What is the goal of Inter-American Development Bank (IDB):
  - (a) Help ensure accountability of the different central banks in Latin America.
  - (b) Provide loans, grants, and assistance for the economic development of Latin America.
  - (c) Supervise that the current- and financial accounts of the different countries are balanced.
  - (d) All of the above.
13. Which of the following claims is *incorrect*?
  - (a) A country can finance a current-account deficit by devaluating its currency.
  - (b) A country can sell foreign reserves to finance current-account deficits.
  - (c) A country can finance a current-account account by borrowing from international capital markets.
  - (d) None of the above.
14. Regarding “The Lessons from the Monetary and Fiscal History of Latin America”, which of the following is correct.
  - (a) US economic policies and regulatory bodies contributed to and worsened the Latin America debt crises in the 1980s.
  - (b) More rapid liberalization could have prevented the banking crises.
  - (c) The authors use a budget-accounting framework to understand the common experiences of Latin American countries.
  - (d) Both (a) and (c) are correct.
15. The banking multiplier is the multiple by which:
  - (a) A change in the money supply translates into a change in the monetary base.
  - (b) A change in the reserves requirement translates into a change in the money supply.
  - (c) A change in the reserves requirement translates into a change in the monetary base.
  - (d) A change in the monetary base translates into a change in the money supply.

16. Debt monetization consists in:
- (a) Selling more bonds or raise further taxes to finance public spending.
  - (b) Borrowing more money from the central bank to finance public spending.
  - (c) Borrowing more money from international markets to finance public spending.
  - (d) Both (b) and (c) are correct.
17. The equation of exchange establishes that:
- (a) The velocity at which money travels is inversely related to the price level.
  - (b) Nominal expenditures are equal to the monetary base times the velocity of money.
  - (c) The money supply is inversely related to the price level.
  - (d) None of the above.
18. Which of the following is true about dollarization?
- (a) Dollarization always means substituting domestic currency by USD.
  - (b) Dollarization in Latin America emerged as a response to escape the Lost Decade.
  - (c) An example of dollarization is the Eurozone, by which many countries in the European Union adopted a common currency.
  - (d) None of the above.
19. According to “The Costs and Benefits of Dollarization”:
- (a) Dollarization can provide short-term stability and help control inflation.
  - (b) Dollarization could serve to achieve long-term economic prosperity in Latin America.
  - (c) Dollarization is typically measured as the ratio of foreign currency deposits to total deposits.
  - (d) Both (a) and (c) are correct.
20. Economists say that most stabilization plans in Brazil were unsuccessful because:
- (a) They did not have much of an effect on inflation rates.
  - (b) They were heterodox plans.
  - (c) They were not able to stabilize inflation at low levels for long time periods.
  - (d) All of the above.

21. According to “Income Dynamics and Inequality: The Case of Mexico”, which of the following is correct?
- (a) Transitions out of formal employment can be costly because there are long-term wage penalties when returning to formal employment.
  - (b) The first type of job (formal vs. informal) of a worker has no significant impact on lifetime earnings.
  - (c) Macroeconomic conditions during a worker’s entry into the workforce have significant effects on initial employment status but not lifetime income.
  - (d) All of the above.
22. According to “The Evolution of the Earnings Distribution in a Volatile Economy: Evidence from Argentina”, which of the following is correct?
- (a) Income inequality increased during the period 2003–2007.
  - (b) Collective bargaining agreements in Argentina were more successful in raising minimum wages for those in lower percentiles of the earnings distribution.
  - (c) Wage changes are mainly caused by transitory wage changes.
  - (d) Economic mobility in Argentina has been high for people above the 40th percentile of income and low for people below it.
23. When looking at measures of poverty, which of the following is correct?
- (a) Latin America has high absolute poverty rates compared to the rest of the world.
  - (b) The population share in relative poverty is much higher than that given by any of the two famous poverty lines.
  - (c) The Gini coefficient is a good measure to measure relative poverty.
  - (d) None of the above.
24. Applied to wealth, what does the Gini coefficient measure?
- (a) Deviations of the actual wealth distribution from relative poverty.
  - (b) Deviations of the actual wealth distribution from absolute poverty.
  - (c) Deviations of the actual wealth distribution from perfect equality in wealth.
  - (d) None of the above.
25. Which of the following is true about the Gini coefficient of income in Latin America?
- (a) Latin America is the most unequal region in the world, and features large dispersion in Gini coefficients.
  - (b) The Gini coefficient of the region has experienced sharp increases since the 2000s.
  - (c) Latin America is the most unequal region in the world, and features little dispersion in Gini coefficients.
  - (d) Both (b) and (c) are correct.

## Short Questions: 30 points

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1. Use diagram(s) to compare two situations (free-trade vs. trade with tariffs) and explain the effects of a tariff on quantity, prices, and welfare..  
*You need to clearly indicate what each object in the graph is.*

2. Explain each of the following concepts of multilateral trade negotiations (MTNs), free-trade agreements (FTAs), and regional trade agreements (RTAs) in 1–2 lines each, and give an example of a real-world agreement for each concept.



3. Explain what the balance of payments is, and its main components. Give specific examples of what is included in each component.
  
4. Explain the most common two types of exchange-rate systems. Give examples of countries in Latin America that have or have had one or the other exchange-rate regime.
  
5. Explain what an exchange control is, and give two examples of exchange controls: one for the current account, the other for the financial account.
  
6. Explain how the government of a Latin American country with a dollar-pegged exchange rate should act to keep the exchange rate fixed in the presence of commodity booms and busts.

7. Explain the concepts of, and fundamental differences between, debt and equity. Give one example of each type.

8. Suppose money velocity grows at a constant rate of 3% per year, and output does grow at 2% per year. At what rate would the money supply have to grow for the price level to be constant over time?

*(Hint: use the equation of exchange.) Show every step of your calculations.*