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ECON 4311 – Spring 2022 Final
Economy of Latin America
May 11, 2022

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Allowed utensils: Pen, paper, eraser, and non-graphic calculator.

General Instructions:

- You have 1 hour and 15 minutes (from 17:00 to 18:15) to complete the exam.
 - Do NOT remove the staple from your examination sheets.
 - 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.
 - 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 *incorrect* answer.
 - (a) During ISI, Latin America substituted domestic production with imports.
 - (b) Comparative advantage is a trade concept explained in terms of the opportunity costs of producing goods.
 - (c) The Heckscher–Ohlin model attributes differences in the opportunity costs of producing goods between countries to factor abundance and factor intensity.
 - (d) Adam Smith challenged mercantilism policies.
2. The terms of trade of Mexico in 2021 is defined as Mexico's
 - (a) Import prices divided by export prices times 100.
 - (b) Export prices divided by import prices times 100.
 - (c) Export prices divided by the sum of export and import prices times 100.
 - (d) Import prices divided by the sum of export and import prices times 100.
3. Most countries in the world learned a lesson from the trade war of the 1930s and started liberalizing their economies, but Latin America did not. Why?
 - (a) Structuralism.
 - (b) Old tradition of high tariffs and quotas.
 - (c) Latin America already enjoyed a liberalized economy.
 - (d) Both (a) and (b) are correct.
4. According to the article "The North American Free Trade Agreement (NAFTA)" by Villareal and Ferguson (2017), NAFTA:
 - (a) Took effect in 1994.
 - (b) Was renegotiated into the US-Canada-Mexico (USMCA) agreement in 2020.
 - (c) Withdrawal from NAFTA is permitted if a written notice of withdrawal is provided to the other partners six months prior.
 - (d) All of the above.
5. Select the correct answer. The balance of payments:
 - (a) Keeps detailed records of all money inflows and outflows out of a country, and it has two components: the current account and the financial account. The former records differences in asset holdings between foreign and domestic residents, and the later records international transactions that include trade.
 - (b) Keeps detailed records of all money inflows and outflows out of a country, and it has two components: the current account and the financial account. The former records international transactions that include trade, and the later records differences in asset holdings between foreign and domestic residents.
 - (c) Has two components with unbalanced money records.
 - (d) None of the above.

6. Select the correct answer. Exchange controls:
- (a) Cannot force holders of foreign exchange to sell it to the government.
 - (b) Are still common practice on current accounts, but not on the financial account.
 - (c) Both (a) and (b) are correct.
 - (d) None of the above.
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. Flexible exchange rates:
- (a) Are rates of exchange between local and foreign currencies determined by market conditions.
 - (b) Are rates of exchange between local and foreign currencies determined by a "pegged system" to another currency or basket of currencies.
 - (c) Were adopted by countries which participated in the system of Bretton Woods.
 - (d) None of the above.
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. Which of the following plans played a fundamental role in helping Latin American countries escape the Lost Decade:
 - (a) The Baker plan, which offered new loans on conditional on structural reforms.
 - (b) The Nixon plan, which reduced interest rates for responsible countries.
 - (c) The Brady plan, which emphasized debt forgiveness.
 - (d) The Clinton plan, which offered refinancing of loans for Latin American governments at a zero percent interest rate.

12. How has capital flow historically into the Latin America region?
 - (a) Mostly in the form of debt.
 - (b) Mostly in the form of FDI.
 - (c) Mostly in the form of portfolio capital.
 - (d) None of the above.

13. Which of the following claims is *incorrect*?
 - (a) Portfolio capital flows are essential for economic development.
 - (b) Inflows and outflows of portfolio capital can destabilize the economy.
 - (c) Uncontrolled capital flows are best for attracting investments and mitigating exchange-rate shocks.
 - (d) None of the above.

14. An interesting fact about the Latin America region is that from 1990 to 2014, remittances as a share of the world total:
 - (a) Have grown, almost doubling.
 - (b) Have shrank, almost halving.
 - (c) Have remained roughly constant.
 - (d) None of the above.

15. Regarding “The Lessons from the Monetary and Fiscal History of Latin America”, which of the following is correct.
 - (a) It is an article which examines the causes of instability in all the economies of Latin America.
 - (b) Argues that the lack of fiscal discipline by Latin American governments has been the main driver of financial instability in the region over the last quarter century.
 - (c) Points to corruption and crime as the main driving forces behind the financial instability in the region over the last quarter century.
 - (d) Argues that to avoid future crises, Latin American governments should adopt fixed exchange rates.

16. 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.
17. 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.
18. Which of the following is true about dollarization?
- (a) Dollarization always means substituting domestic currency by USD.
 - (b) There are two types of dollarization: de facto or unofficial and de jure or official.
 - (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” by Quispe-Agnoli (2002):
- (a) The most common indicator of dollarization is the share of foreign currency deposits in the money supply.
 - (b) Examples of countries with partial dollarization in Latin America are: Panama, Ecuador, and El Salvador.
 - (c) A benefit of dollarization is that imposes restrictions on exchange-rate policy.
 - (d) All of the above.
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) Inequality in Mexico, as measured by the dispersion of earnings, has decreased since 2016.
 - (b) Having the first job in the informal sector is associated with a sizable, negative effect on future earnings.
 - (c) Higher levels of informality can have significant negative effects on employment status.
 - (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) The authors study the experience of Argentina by only taking into account administrative data.
 - (b) Argentina experienced solid, positive wage growth throughout the period of study (1996–2015).
 - (c) Argentina’s shift from a low- to a high inflation economy was associated with increasing income inequality.
 - (d) Argentina’s income inequality has decreased over time due to successful policies by its central bank regarding inflation targeting.
23. When looking at poverty and inequality data for Latin America, which of the following is correct?
- (a) Latin America is plagued by large economic inequality and substantial levels of poverty.
 - (b) Latin America is the world’s region with the most evenly distributed income.
 - (c) Absolute poverty in Latin America has increased substantially since the 1990s.
 - (d) All of the above.
24. According to “Informality: Causes and Consequences for Development” by Ulysea (2020), which of the following is correct?
- (a) Existing studies indicate that reducing the cost of entry into the formal sector is not the most effective way to reduce informality.
 - (b) The most effective way to reduce informality is to intensify enforcement.
 - (c) Informality is a micro phenomenon that results from individual agents maximizing their payoffs, but has important macro consequences.
 - (d) All 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 quotas) and explain the effects of a quota on quantity, prices, welfare, and government revenue. *You need to indicate what each object in the graph is.*

2. Explain what a exchange control is, and give two examples of exchange controls: one for the current account, the other for the financial account. *Bonus points if you can provide examples that relate to what we are witnessing today in the world economy.*

3. Suppose the Mexican government has committed to a fixed exchange rate of $2P/\$$. A medical study has discovered that avocados are bad for health, which have caused American consumers to stop demanding avocados from Mexico. Since avocado revenues represent a big share of Mexico's export revenues, this change in demand affects the exchange rate. Illustrate this effect in a graph, and also illustrate what the Mexican government needs to do to keep a fixed exchange rate. *You need to indicate what each object in the graph is, and discuss policy actions in words.*

4. Suppose money velocity is constant over time, and output grows at 5% per year. At what rate would the money supply have to grow for the price level to grow at 2% per year? (*Hint: use the equation of exchange.*) *Show every step of your calculations.*

5. Explain the concept of anchor currency, and specify which currency is the world's nominal anchor, explaining why people refer to this currency as the world's nominal anchor.

6. Explain what the Gini coefficient is, how to measure it, which values can it take, and how to interpret it. *Bonus points if you can list two or more economic variables for which using the Gini coefficient can be informative.*

7. Explain why wages are generally increasing in educational attainment.

8. List three or more causes of poverty and inequality in Latin America.