WRITTEN PRELIMINARY Ph.D EXAMINATION

Department of Applied Economics

Summer – 2007

Trade, Development and Growth

For students electing

Macro (8701) & New Trade Theory (8702) option

Instructions

- Identify yourself by your code letter, not your name, on each question
- Start each question's answer at the top of a new page
- You are requested to answer a total of FOUR questions
- Answer ONE question from Set One
- Answer THREE questions from Set Two
- You have four hours to complete this examination
SET ONE

Required Question; Answer ONE Question (I or II but not both)

I. Evolution of Theory

Consider the evolution of the theory of international exchange. Over time, four distinctive bodies of literature have emerged, including: (1) traditional theories of comparative advantage, (2) factor-content theory, (3) New Trade theory, and (4) trade and multinationals theory. Consider this evolution of the literature to answer the questions below.

(a) What are the key assumptions of each body of literature?

(b) What real-world observations prompted the initiation of each of the four bodies of literature?

(c) What are the implications of each body of literature for theory predictions in terms of the patterns of exchange?
II. Agriculture's Role in Economic Growth

The World Bank's forthcoming 2008 Word Development Report (WDR) will be the first to focus on agriculture as an engine of economy-led growth since the WDR of 1982. Numerous papers since the 1982 report have explained and documented agriculture's effect on growth, particularly for countries in the early stages of development. This question focuses on anticipating some of the report's main themes. Consider the following environment. Most workers are in agriculture, a large share of income is spent on food so that households are at subsistence levels, and international capital markets are not available. Use your knowledge of growth theory to explain agriculture's likely role in such a country's transition to higher real worker income. You need not develop a specific model, but be analytical in your answers to the following questions.

Drawing upon your knowledge of growth accounting and growth theory,

1) Explain at least three of the likely "main sources" of growth of the economy.

2) Discuss how the initial conditions (low returns to labor and land, and a high proportion of income spent on food) might act as a constraint to the growth of the economy.

3) As the country proceeds in transition growth, that is, as the initial conditions discussed in (2) become less of a constraint

   a) Explain how the activities of rural households engaged in agriculture can provide the conditions for growth of the rest of the economy,

   b) Explain/discuss how the activities discussed in (a) above might cause and/or contribute to the growth of the manufacturing and service sectors

   c) How can the growth of the manufacturing and service sectors impact the transition path of the agricultural sector?

4) How will a policy of import substitution - industrialization likely affect the structure of the economy and "slow down" a country's transition to long-run growth?
SET TWO

Answer THREE of the following four questions (III to VI)

III. Stylized Facts

Consider the following changes in the patterns of international trade and foreign direct investment (FDI):

(a) Since the late 1980s, FDI has grown worldwide.
(b) Developed countries are the predominant sources and recipients of FDI.
(c) FDI tends to be horizontal rather than vertical.
(d) A majority of world trade is intra-firm trade.

Use your knowledge of trade and multinationals theory to explain the above stylized facts. Be sure to discuss key assumptions and features of the models in this literature.

IV. Trade and Multinationals Models

A primary effort of the theory research on trade and multinationals is to explore firms’ decisions about how to service foreign markets. These decisions include servicing via trade, FDI, licensing, or joint ventures.

(a) Discuss at least three features of the models that explain the servicing decision?
(b) Discuss the links between these modeling features and the concepts of ownership, location, and internalization of Dunning’s eclectic paradigm.
V. Static Trade Theory

The Heckscher-Ohlin-Samuelson model of international trade gave rise to the so called factor endowments theory of comparative advantage. Use such a model for a single, competitive, small and open economy to address the following questions.

1) What are the structural features of this economy relative to its trading partner(s) that predict which good will be exported and which good will be imported?

2) What is the economic "meaning" of this result?

3) What implication does your answer to (1.) above have regarding factor payments, say wages (w) and capital rental (r), when

   a) The country employs the same technology as its trading partners?

   b) The technology employed in the home country only differs from its partners by its rate of labor augmenting technological change?

4) Suppose the country imposes a tariff to help protect (i.e. raise the price of) the good it is importing. What effect does the tariff have on

   a) Factor payments to labor and capital (explain the economic meaning of this effect)?

   b) Explain how the tariff affects the country's comparative advantage?
VI. Economic Growth and Macroeconomic Imbalances

Many of the world's economies, including the U.S., are characterized by fiscal and trade "imbalances". These "imbalances" often cause economic crises (which force a change in policy), or induce an externality on the rest of the world (the case of the U.S.) that seems to persist for consider lengths of time. This question focuses on the economics of these imbalances in the context of transition growth. For purpose of this question, consider a stylized competitive, small and open economy those stock of capital in period \( t = 0 \) is less than it's long-run equilibrium value in the absence of an "imbalanced" economy. You may use a graphic analysis to answer this question, but use more analytical constructs when ever possible.

1) Define and describe the nature of the imbalance in period \( t = 0 \) on the

   a) The production of goods,

   b) Foreign trade and

   c) Factor payments.

2) Now, consider transition growth \( (t > 0) \) for the case where, in each \( t \), the imbalance persists. Discuss and explain the effect on

   a) The production of goods?

   b) Foreign trade?

   c) Factor payments?

3) Suppose this imbalance eventually precipitates a "crises." Discuss and explain the adjustments in

   a) The production of goods

   b) Foreign trade and

   c) Factor payments

   that are necessary to eventually bring the economy into a "balanced" long-run equilibrium.