(I) Latin America

At the end of the 80’s many Latin American countries engaged in a process of economic reform.

(1) (6 pts) Briefly identify two of the main characteristics of the reforms.

(2) (6 pts) Briefly characterize the regional trade agreement among Southern Cone Nations (Mercosur)

(II) Use the national income identity for an open economy given below to answer the following questions.

\[ P_y - P (C_t + I_t + G_t) + R_{t-1} B_{t-1}^f = (B_{t-1}^f - B_{t-1}^f) + (H_t - H_{t-1}) \]

where

- \( P_y_t \) = gross domestic product at \( t \)
- \( R_t \) = interest rate at time \( t \)
- \( B_{t-1}^f \) = net holdings of foreign bonds by domestic residents at time \( t \)
- \( P C_t \) = consumption expenditures at time \( t \)
- \( P I_t \) = private domestic gross investment at time \( t \)
- \( P G_t \) = government purchases of goods and services at time \( t \)
- \( H_t \) = stock of international currency at time \( t \)

Notice that the left hand side of the equation is the current account

\[ CA = P_y_t - P (C_t + I_t + G_t) + R_{t-1} B_{t-1}^f \]

and that the trade balance is \( P y_t - P (C_t + I_t + G_t) \).

(1) (8 pts) Consider the case of a country that had no previous holdings of foreign bonds (i.e. \( B_{t-1}^f = 0 \)) and that received a substantial inflow of foreign funds at time \( t \). Assume further that the country is not accumulating international currency. Can you tell whether the country will have a surplus or a deficit in the current account? Justify.

(2) (8 pts) Consider a country that has borrowed from the rest of the world for a number of years (so it has a substantial foreign debt) and that at time \( t \) shows a balanced current account (i.e. \( CA = 0 \)). Can you tell whether the country has a positive or negative trade balance? Justify.

(III) (12 pts) Mexico

When foreign investors fled Mexico at the beginning of the 1994/95 crisis the Mexican government had a substantial amount of foreign reserves. Explain how two government policies: the fixed exchange rate and the actions aimed at preventing an increase in the domestic interest
(IV) (6 pts) Soviet Union and Eastern Europe under Central Planning

Under central planning industrial firms were very diversified (i.e. produced a variety of goods) and in many instances served huge market areas. Briefly explain why this happened under central planning.

(V) (14 pts) Use the material from the Fischer- Easterly reading and the tables below to answer the following question.

What caused the declining growth rates in output in the USSR starting around 1970? Specifically, can the slowdown be attributed to (1) changes in TFP, (2) increases in the capital output ratio, (3) increases in the defense expenditures or (4) something else? Justify fully.

Table 1. Capital Output ratio

<table>
<thead>
<tr>
<th>Country</th>
<th>Period</th>
<th>Annual per cent change in capital output ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>USSR</td>
<td>1950-87</td>
<td>2.53%</td>
</tr>
<tr>
<td>Japan</td>
<td>1957-90</td>
<td>3.19%</td>
</tr>
<tr>
<td>South Korea</td>
<td>1960-90</td>
<td>3.50%</td>
</tr>
</tbody>
</table>

Table 2. Data on GNP and TFP growth in USSR (in percentages)

<table>
<thead>
<tr>
<th>Period</th>
<th>GDP Growth</th>
<th>TFP Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950-59</td>
<td>5.8</td>
<td>1.09</td>
</tr>
<tr>
<td>1960-69</td>
<td>3.0</td>
<td>1.10</td>
</tr>
<tr>
<td>1970-79</td>
<td>2.1</td>
<td>1.16</td>
</tr>
<tr>
<td>1980-87</td>
<td>1.4</td>
<td>1.09</td>
</tr>
</tbody>
</table>

(VI) (10 pts) Trade /CMEA

How did world prices compare to prices used in CMEA trade? (I am not looking for an exact number but for a qualitative comparison). How did the dissolution of CMEA affect the economies of the Eastern European countries and the former Soviet Union?

(VII) (10 pts) Eastern Europe.
Briefly contrast the situation of Poland and Czechoslovakia before they started the transition and the approach used in each country.