(I) ISI, Protection, Exchange rates

(5 pts) (1) Discuss briefly one negative consequence of ISI (Import Substitution Industrialization).

(8 pts) (2) Discuss briefly the relationship between currency overvaluation and capital flight and identify two different forms of capital flight.

(12 pts) (3) Consider the following fictitious information in year 0 and 1 about two countries (say US and Mexico). Mexico’s currency is the peso.

<table>
<thead>
<tr>
<th></th>
<th>Mexico’s price level</th>
<th>US price level</th>
<th>Number of pesos needed to buy one dollar</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(in pesos)</td>
<td>(in dollars)</td>
<td></td>
</tr>
<tr>
<td>Year 0</td>
<td>200</td>
<td>100</td>
<td>2</td>
</tr>
<tr>
<td>Year 1</td>
<td>400</td>
<td>100</td>
<td>3</td>
</tr>
</tbody>
</table>

Calculate the real exchange rate for Mexico in both years. Did the value of the Mexican peso with respect to the dollar increase or decrease?

(II) Tariffs, Effective Rate of Protection

The production of computers in Costa Rica requires parts and labor. One unit of parts is needed to produce one computer. In the world market, a computer sells for $100 and one unit of parts sells for $50. Assume that the computer industry in Costa Rica is perfectly competitive, that the domestic demand and supply curves have the usual shape and that Costa Rica imports some computers. Assume further that the parts industry is also perfectly competitive, that the domestic demand and supply curves have the usual shape and that Costa Rica imports some computer parts from the rest of the world.

Suppose the government imposes a $15 tariff on parts and there is no tariff on computers.

(10 pts) (1) Calculate the effective rate of protection on computers.

(7 pts) (2) Are the domestic producers of parts happy with this measure? Justify fully.

(III) Capital Goods, Investment Demand, Argentine economic growth

(12 pts) (1) Briefly explain the link between the investment demand and: (a) the real interest rate, (b) the price of capital goods.
Taylor argues that most of the decline in Argentina’s relative economic position after 1913 can be attributed to unfavorable conditions for capital accumulation.

Identify the two phases in Argentine economic decline after 1913 and the main obstacle to capital accumulation in each phase. Justify fully using diagrams.

(IV) Debt

(6 pts) (1) Briefly explain why at the beginning of the debt crisis banks were “forced” by the international organizations and developed countries government to keep lending to the debtor countries.

(12 pts) (2) Consider the following hypothetical third country buy back of Peruvian debt (all the amounts are in dollars). Before the buy back the total market value of Peruvian debt was 50 millions. Peru receives a gift of 20 millions and uses it to buy back its debt. After this operation the total market value of Peruvian debt is 42 million.

Explain how Peru and the banks holding Peruvian debt benefited from this gift.

(Note: you need to calculate the specific amounts).

(V) Seignorage, Dollarization, Inflation.

(6 pts) (1) Can a government always collect more seignorage by letting the money supply grow faster? Justify.

(6 pts) (2) Briefly explain what is the relationship between dollarization and the ability of the local government to collect seignorage.