

DEVELOPMENT ECONOMICS

TIME: 4 Hours

MAXIMUM POSSIBLE SCORE: 240 Points

I. (30 Pts.) Write an essay on how one should incorporate the value added tax in the calculation of the economic opportunity cost of foreign exchange.

II. (20 Pts.) Show why the Harris-Todaro model overpredicts the urban unemployment rate in developing countries and how this defect can be remedied.

III. (30 Pts.) Evaluate critically the following argument:

“In the current world of highly mobile international capital, it is better to have either a hard peg (i.e., a currency board or a completely dollarized economy) or a fairly clear flexible exchange rate. Anything in between is not advisable.”

As you may know, this argument has become very fashionable in policy circles. Discuss: (i) its practical origins; (ii) its conceptual underpinnings (or lack thereof); and (iii) any relevant practical evidence.

IV. (30 Pts.) Write an essay on the rationale behind using a “weighted average” method for arriving at the social opportunity cost of foreign exchange, of capital, and of labor.

- a) Explain how the weights in the weighted average can be described as “sourcing coefficients”. In the theory of the subject, what do these sourcing coefficients mean? How, ideally, would you “derive” them?
- b) What are the items that these weights multiply in each of the three cases mentioned -- foreign exchange, capital and labor? Present two versions of your answer to this question, and indicate which version is more appropriate (more rigorous), and why.
- c) Can you think of situations in which, given “sourcing coefficients” that add up to one, you would want also to include in the calculation activities that are not directly covered by these “sourcing coefficients”? If so, give examples. If not, explain why the “sourcing coefficients” cover all relevant activities.

- d) In the case of the social opportunity cost of capital, explain the relative merits of basing the "sourcing coefficients" on a taxation exercise versus a "capital market exercise".

V. (20 Pts.) Using a three good model of an open economy show why a terms of trade improvement in Argentina in the late 1940s and early 1950s led to the need for a depreciation of the real exchange rate and the rise of Peronism.

VI. (25 Pts.) Evaluate critically (empirically and theoretically) the following statement: "The banking system in developing countries is inefficient and unstable and exacerbates booms (by providing 'too much' credit in good times) and magnifies recessions (but cutting off credit abruptly in bad times)".

VII. (20 Pts.) Critically assess the relative merits of the direct and indirect routes to poverty alleviation.

VIII. (25 Pts.) It has now been four years since the Asian crises erupted. Hundreds of articles have been written, thousands of opinions have been uttered. State at least three lessons that you think we have learned from the Asian crises and discuss their conceptual and practical (i.e., policy) implications.

IX. (20 Pts.) Suppose you are asked to evaluate two run-of-the-stream hydroelectric projects, located in different countries.

- a) In country A, the rest of the system consists of homogeneous thermal capacity, and there is a well-defined "demand peak" of 2000 hours per year.
- b) In country B, the system consists of heterogeneous thermal capacity, with marginal running costs of 2¢, 4¢, 6¢ and 8¢ per kwh for the different types of capacity.

Explain how you would evaluate the run-of-the-stream project in each of these two cases. Feel free to develop your answers in terms of numerical examples.

X. (20 Pts.) Critically assess the "Asian" model of development.