

Ec 320, Fall 2008

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MIDTERM EXAMINATION

October 23 2008

Please write only your ID number on your blue books, not your name.

Number blue books consecutively if you use more than one, and write the number of blue books used on the cover of the first one.

1. (5*6=30 marks) Indicate whether you agree, partially agree, disagree or partially disagree with the following statements. State any necessary qualifications or modifications. In each case explain your answer with appropriate reasoning, facts and cite all sources used.

- (a) The Harrod-Domar model states that a country's growth rate of per capita income depends on its rate of savings, whereas the Solow model states that it does not.
- (b) The hypothesis of unconditional convergence can be empirically tested by plotting the growth rate of different countries over the period 1960-85 against their growth rates over the period 1950-60 and checking if there is a downward sloping relation between the two variables.
- (c) The available statistical evidence concerning the experience of any given country over time indicates no relationship between per capita income and income inequality.
- (d) The available statistical evidence concerning the experience of any given country over time indicates no relationship between per capita income and poverty (as measured by the head count index).
- (e) The Lewis model predicts that opening a country to free trade in agricultural products will slow down the rate of growth.

2. (10 marks) Consider the Lewis model of a labor surplus economy with a traditional and modern sector, which is currently in the first phase of development. Suppose that the government mandates a minimum wage (which exceeds the wage currently paid) which must be paid by all employers in the modern sector. Describe the effect of this policy on (i) the extent of migration from the traditional to the modern sector; (ii) the rate of growth of per capita income in the economy. (You may restrict your attention to the short run impact, when the country continues to operate in the first phase with surplus labor in the traditional sector.)

3. (10 marks) Comment on the following statement (substantiate your argument with appropriate reasoning and facts):

“The chief purpose of economic development is to raise per capita income and lower poverty, and we know the latter objective is best served by faster growth. Hence LDC governments ought to focus mainly on raising savings and technical progress, rather than trying to reduce inequality or spend on social programs.”