

Write your name on the cover of the test booklet and nowhere else. Failure to follow these directions will cost you 1 point. The test has 150 points (to be scaled up to 180 points) and is scheduled to take 75 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 14-point question should take 7 minutes. I can give some extra time, but not much.

1) (12 points) Answer EITHER Part A OR Part B.

A) What is the exchange rate regime of the country you are writing your report on? Why do you think your country chose that type of exchange rate?

B) Is it common for a developing country to have a free floating exchange rate? Why or why not?

2) (12 points) Answer EITHER Part A OR Part B.

A) Suppose that Ricardian Equivalence does **not** hold. What would happen to total savings in an economy when the government decreases taxes without decreasing spending? Explain your logic.

B) Does Friedman's *Permanent Income Hypothesis* apply to developing countries? Explain your reasoning.

3) (14 points) For EITHER S_{ph} OR S_{ge} , explain what it is. For a developing country, is it normally large or small? Explain your logic.

4) (14 points) Answer EITHER Part A OR Part B.

A) Suppose a government could undertake a project which would cost \$3000 this year and yield benefits of \$1331 a year for three years, starting next year. Would this project be worth doing if the desired rate of return for the government is 10%? Show all work and explain your logic.

B) Suppose the government finds that doing a calculation like the one in Part A, results in the project's being financially not worthwhile. What economic reasons might the government use for doing the project anyhow?

5) (18 points) Answer EITHER Part A OR Part B.

A) For EITHER an income tax OR a sales tax (what the book calls "domestic goods and services taxes"), determine if a developing country or a developed country is more likely to use that tax for a large proportion of its revenue. Explain why developing countries are more or less likely to use that type of tax. Give at least two reasons.

B) Many developing countries have interest rate ceilings. Explain BOTH one positive result of them AND one negative result of them. Explain how the interest rate ceilings have those effects.

6) (18 points) Answer EITHER Part A OR Part B.

A) The required reserve ratio in the USA is 10%. In Russia, it is 20%. Using only this fact, do you think Russia is more likely to have financial deepening or shallow finance in the future? Explain your logic. Why do you think Russia has such a high requirement?

B) Why is financial deepening normally a desirable occurrence for a developing country? Explain your logic with at least two reasons.

7) (18 points) Answer EITHER Part A OR Part B.

A) MNCs are often accused of exploiting developing countries. However, the benefits of them are often ignored. What are two of the benefits of MNCs to developing countries, **other than** transfer of capital and employment?

B) Joint ventures have both positive and negative aspects as a way of getting foreign capital. Explain one advantage and one disadvantage.

8) (20 points) A recent article on the BBC's web page says that many of the sub-Saharan African countries have over 35% of the population undernourished. Use this information to answer EITHER Part A OR Part B. (From the map, it looks like the only countries outside of Africa with that problem are Mongolia, Tajikistan, and Afghanistan.)

A) If you were one of those governments, what would you do about the problem. Why do you choose to do that? How would that help resolve the problem?

B) What are some of the other problems which these countries are facing because of the large number of undernourished citizens? State at least two problems and explain how it causes those problems.

9) (24 points) Answer EITHER Part A OR Part B.

A) Use the supply and demand for gasoline to determine if a tax on gasoline would be a good tax for a government to use. Make sure you explain why the curve(s) take its (their) shape and explain why the curve(s) move as drawn. Also, explain how your diagram can be used to determine if the tax is desirable.

B) Use the supply and demand for oranges to show a sales tax on oranges. Illustrate on it the tax incidence, and the dead weight loss (excess burden). Explain how you found those areas.