

Write your name on the cover of the test booklet and nowhere else. Enclose this sheet with the booklet. Failure to follow these directions will cost you 1 point. The test has 100 points (to be scaled up to 150 points) and is scheduled to take 50 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 12-point question should take 6 minutes. I cannot give extra time because of the class which follows yours.

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

A) Give an example of how the costs of a project using market prices may higher than if the costs are calculated using shadow prices.

B) What is meant by *tax incidence*? Use a corporate profit tax as an example in your explanation.

2) (14 points) Answer EITHER Part A OR Part B.

A) Suppose that a project will cost \$1000 this year and \$1090 next year. When the company is running, starting in two years, they will make \$400 a year for 6 years. Set up the calculation which will determine the *Benefit - Cost Ratio* (BCR) for the project if the interest rate is 9%. Do not worry about doing the actual calculation. How can you tell if the project is worthwhile to do?

B) Suppose that the nominal interest rate is 10%, the tax rate on interest income is 30%, and the inflation rate is 5%. What is the real interest rate? Show all work and briefly explain how you chose each number in your calculation.

3) (14 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? (State your country.)

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

4) (20 points) Answer EITHER Part A OR Part B.

A) In Friedman's *Permanent Income Hypothesis*, what would happen to a country's savings if the economy turned down? Explain your logic. Which of the seven components of S (S_{gb} , S_{ge} , S_{pc} , S_{ph} , S_{fo} , S_{fpd} , or S_{fpe}) is that? Why did you make that choice?

B) What do you feel is the greatest advantage of S_{fpe} ? Why do you feel that? What do you feel is the greatest disadvantage of S_{fpe} ? Why do you feel that?

5) (20 points) Answer EITHER Part A OR Part B.

A) *Conditional aid* is becoming more common. What is it and why is it more common than it used to be? Economists often say that sometimes, there is no difference between conditional aid and unconditional aid. Why do they feel that?

B) China gives a lot of aid to African countries in the form of *technical assistance*. What is that? Why do you think they give that type of aid?

6) (20 points) Answer EITHER Part A OR Part B.

A) Both high interest rates and low interest rates cause problems for economic development of an economy. Explain how they both can cause problems.

B) A lot of developing countries, and former communist countries, have been privatizing (selling off) state-owned enterprises (SOEs). If you were the leader of a country, how would you determine which SOEs you would sell off and which you would not? Explain your logic.