

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 160 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 some students have a class after your class.

1) (14 points) Answer EITHER Part A OR Part B.

A) Would low or high real interest rates lead to *shallow finance*? Explain your logic.

B) What is meant by *financial deepening*? Why is that desirable?

2) (14 points) For EITHER *buybacks* OR *rescheduling*, explain what it means and why a creditor might be willing to do it.

3) (16 points) Answer EITHER Part A OR Part B.

A) What is meant by *financial intermediation*? Why do we use *financial intermediaries*?

B) What is meant by a *crawling peg*? Explain the advantage if that type of exchange rate regime.

4) (16 points) Answer EITHER Part A OR Part B.

A) What types of economic reforms might stop a creditor panic? Explain how it might stop the panic.

B) What is the *principal-agent problem*? How does it relate to the IMF? Explain your logic.

5) (18 points) For ONE of the following criteria of potential debt problems, tell me whether it is a problem of illiquidity or insolvency. Explain how that criterium signifies a problem and why you chose illiquidity or insolvency. Is it a debt service problem, external transfer problem, or an internal transfer problem? Explain your logic.

A) Short-term foreign debt/foreign exchange reserves is 1:1.

B) NPV of debt/exports is 300%.

6) (22 points) Answer EITHER Part A OR Part B.

A) Would you say “foreign aid normally helps the recipient country” or would you say “foreign aid normally does nothing or hurts the recipient country”? Explain your logic using **two** lines of reasoning. Note: you could **not** choose the school of thought that says that foreign sometimes helps and sometimes does nothing.

B) Explain how recipient participation affects the effectiveness of foreign aid. What is meant by harmonization of aid? Why is that important?