

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 200 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 can give extra time but not much.

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

A) What do you feel is the greatest problem developing countries' governments have with their budget. Explain why you feel they have this problem.

B) State owned enterprises (SOEs) can cause governments to have a budget problem. Explain why this may occur.

2) (16 points) Answer EITHER Part A OR Part B.

A) I just saw on the news (France 24 on television via MHZ Networks on PBS) that only one in four Ethiopians have a bank account. What is the problem caused by that? Why is that a problem? There is a new service in Ethiopia. It is called M-BIRR. It allows internet banking on a cell phone. You can pay bills with it and send money to a relative by texting them. It sounds like it is a lot like PayPal. Do you think this will help reduce the problem? Explain your logic.

B) Micro-finance has been touted as a way to solve a lot of problems in developing countries. Explain how it works and why it could help a country to develop.

3) (18 points) Answer EITHER Part A OR Part B.

A) The book says that a ratio of debt service/government revenue $> 10\% - 15\%$ is an indicator of too much debt. Why is that a problem? Is that a problem with illiquidity or insolvency? Is that a debt service problem, external transfer problem, or an internal transfer problem? Explain your logic for all parts.

B) When discussing the potential threat caused by a government's debt, the book distinguishes between government debt and NPV of government debt. When are they different? Which is greater in those cases? For the USA, are they different or the same? Explain your logic for all parts.

4) (18 points) The book mentions several ways to potentially stop a financial crisis where people are pulling their money out of the country. For EITHER the proposal in Part A OR the proposal in Part B, explain how that could stop the crisis. Why might it not work?

A) Borrow foreign reserves from the IMF or World Bank.

B) Try to convince foreigners to not withdraw their money while tightening fiscal and monetary policies.

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

A) Suppose you were in charge of Mexico's central bank. Would you want to have a floating exchange rate or a fixed exchange rate? Explain your logic mentioning two reasons.

B) Suppose you were the president of a central bank of a country which has a problem with chronic inflation. What does that mean? What would be your first step to solving that problem? Explain how that would reduce the problem.

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

A) Which would be a better tax for a developing country to have, import tariff or a sales tax? Explain your logic by mentioning two of the criteria of a good tax system.

B) State two of the criteria we use to determine if a tax is a good tax. Explain why we have those criteria.