

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 150 points (to be scaled up to 210 points) and is scheduled to take 75 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) For EITHER the method of resolving a debt crisis in Part A OR the method in Part B, explain how it works and why a creditor might be willing to do it.

- A) Reducing the debt.
- B) Rescheduling the debt.

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

A) There is a moral hazard problem with doing what is described in Question #1, Part A. Explain what the moral hazard is and why it may cause problems in the future.

B) When we calculated comprehensive wealth, we used the term “intangible capital”. What does that mean and why is it important for the economy in the future?

3) (14 points) For EITHER the tax in Part A OR the tax in Part B, determine if you think it is a good tax. Make sure you discuss whether it meets two of the requirements for a good tax. You can choose which two.

- A) general sales tax on all products
- B) property tax

4) (14 points) For EITHER the situation in Part A OR the situation in Part B, explain why it is a potential problem. Also determine if it is an illiquidity problem or a insolvency problem. Explain your logic.

- A) NPV of debt/GDP is 55%.
- B) Short-term foreign debt/foreign exchange reserves is nearly 1:1.

5) (14 points) Answer EITHER Part A OR Part B.

A) What is meant by the ANS Gap? Write the formula for it and state why each term is important.

B) How can tradable permits to permit (cap-and-trade) achieve the optimal amount of pollution? Would you recommend this method to a developing country? Explain your logic.

6) (14 points) Answer EITHER Part A OR Part B.

A) What is the difference between current expenditures and recurrent expenditures? Which is a bigger problem for the budget? Explain your logic.

B) What are SOEs? How do they affect the budget? Why do they have that impact?

7) (14 points) For EITHER the exchange rate regime in Part A OR the exchange rate regime in Part B, explain what that means. Explain why a developing country might want that type of exchange rate.

- A) wide band system
- B) pegged exchange rate

8) (16 points) Answer EITHER Part A OR Part B.

A) Explain how interest rate ceilings can cause shallow finance. Why is shallow finance bad for the

economy?

B) One of the tools of the central bank is the required reserve ratio. Explain how the central bank could use that to fight inflation. Why would it have the desired effect?

9) (16 points) For EITHER the item in Part A OR the item in Part B, define it and state both how it can help the developing country and how it can hurt the developing country.

A) Tax holidays

B) Domestic content laws.

10) (24 points) Answer EITHER Part A OR Part B.

A) Draw the MEC/MAC diagram the way I drew it in class. Explain why the MEC line looks as drawn. Explain why points to the right of where the curves cross are not optimal.

B) Draw the Environmental Kuznets Curve for the introduction of new toxins. Explain why it takes its shape. Do you think this is a likely scenario? Explain your logic.