

Place your name on the back of this sheet of paper and nowhere else. Staple your answers on the front of this sheet of paper. Failure to follow these directions will cost you 1 point. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to type it will cost you 10 points. If you use double-sided printing or print on the back of scrap paper, I will give you one additional point.

- 1) (15 points) In Friedman's Permanent Income Hypothesis, which would have a bigger effect on savings, a temporary tax cut or a permanent tax cut? Why? Why do we care about the impact on savings?
- 2) (25 points) Draw the diagram I drew for Modigliani's Life-cycle model. Illustrate the effect of a temporary increase in income. Explain why the curve(s) moved as drawn. What happens to their consumption and savings? Explain your logic.
- 3) (20 points) According to Ricardian Equivalence, what will happen to a country's total savings if the government does a temporary tax cut? Why does this occur? Do you believe it will happen in a developing country? Explain your logic.
- 4) (20 points) Some people say that foreign direct investment (FDI) is a blessing to a developing country, but others say it is a curse. Explain both sides. Do you think it is more often a blessing or a curse? Explain your logic.
- 5) (20 points) U2's lead singer Bono Vox, has stated that there should be loan forgiveness for highly indebted countries. Why does he feel that? Why do some oppose him? Which side do you take? Why do you take that side?