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 I have a class after your class.

1) (12 points) For EITHER the action in Part A OR the action in Part B, determine whether the action will lead to shallow finance or financial deepening. Explain your logic.
A) Implementing interest rate ceilings.
B) Lowering the required reserve ratio from 20% to 10%.

2) (16 points) Answer EITHER Part A OR Part B.
A) What is a *public good*? Explain why the government must supply it.
B) What are *state owned enterprises* (SOEs)? Why are they normally costly to the government?

3) (16 points) Answer EITHER Part A OR Part B.
A) Why does $\Delta D = iD + M - X$? In other words, how do iD and $X - M$ create ΔD?
B) Why is a *debt service/exports* ratio of over 20% - 25% a bad sign for the economy?

4) (18 points) Answer EITHER Part A OR Part B.
A) Suppose the inflation rate is 100%, what is the rate of the *inflation tax*? What does that tax rate mean?
B) What are the three functions of money? For ONE of them, does M1, M2, or M3 do the best job? Explain your logic.

5) (18 points) For either an *income tax* OR a *tax on electricity*, determine whether it is a good tax for a developing country to use. Make sure you discuss TWO of the criteria which determine whether a tax is a good tax or not.

6) (20 points) Answer EITHER Part A OR Part B.
A) Although emergency aid is considered by most economists to help the country grow in the long run. However, that may not be true in all cases. What might cause emergency aid to be of little or no help to the country? Explain your logic.
B) What is the *principal-agent* problem? How does it relate to why the IMF <u>may</u> not do what is best for a developing country?