

## Sample Midterm Questions

The exam will be in two parts. Part I will ask multiple choice questions. Part II will ask longer questions, where responses will be either analytical or in prose. The purpose of the exam is to ensure that you understand the frameworks and facts that we consider, and that you understand the key issues and features in the readings.

Here are four example questions. The first three would appear in Part I and the last in Part II.

### Part I questions

1. The argument for “Absolute Convergence” is driven by
  - a. technological progress
  - b. the discovery of natural resources
  - c. the diminishing returns to capital
  - d. trade policy

Answer: (c)

2. In comparison to U.S. firms, Mexico’s *grupos* have the following qualities:
  - a. High ownership concentration, significant financing through stock market
  - b. High ownership concentration, little financing through stock market
  - c. Low ownership concentration, significant financing through stock market
  - d. Low ownership concentration, little financing through stock market

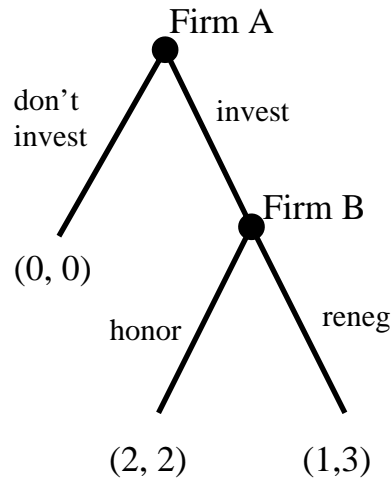
Answer: (b)

3. Mauro (1995) finds that increased corruption is associated with
  - a. Lower investment rates and lower growth rates
  - b. Lower investment rates but not lower growth rates
  - c. Higher investment rates and higher growth rates
  - d. Higher investment rates but lower growth rates

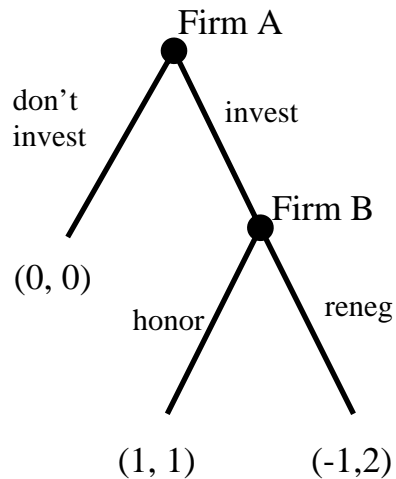
Answer: (a)

Part II question

1. Consider the following two projects. The payoffs are written (Payoff to Firm A, Payoff to Firm B).



Project #1



Project #2

- a. In which project(s) would Firm B choose to renegotiate the contract, should Firm A invest? (4 points)

Answer: B would renegotiate in both cases. In Project #1, Firm B likes 3 better than 2. In Project #2, Firm B likes 2 better than 1.

- b. In which project(s) will Firm A invest in the first place? (4 points)

Answer: Invest in Project #1, not in Project #2. Investing in Project #1, Firm A would receive 1, which is better than 0. In Project #2, investing would bring Firm A -1, so Firm A shouldn't invest.

- c. List 3 distinct strategies that can help reduce the possibility of your counterparty attempting to renegotiate an agreement. (6 points)

Answer:

1. Integrate with your counterparty as one larger firm and/or use a JV where you share the initial investment.
2. Break up the investment into smaller pieces (a repeated game) to create reputational incentives for Firm B not to renegotiate.
3. Make investment less specific, so that bargaining power is stronger (you can walk away more easily) if Firm B tries to renegotiate.