

Final Exam

15.012

Name: _____

Section: _____

Date: _____

It was a pleasure to spend time with you guys this semester. I learned a lot from our discussions and I really appreciate all the time and effort you gave. I hope that this exam will contribute to your learning process in the same way that the course has.

You have 1 hour and 20 minutes. The points of each question are indicated in *italic-bold* at the beginning of each of them. The total points in the exam are 100. Answer all questions in the space provided. I really do not think that you need more. However, if you need more space you can use the back of the pages.

I hope our paths will cross again (at least for a coffee) and remember that wherever your decisions might take you, I'm always an e-mail-away. It was an honor to have the chance to share the room with you.

Good luck.

The exam describes a fictitious country that has some problems, and asks for your policy advises in several circumstances.

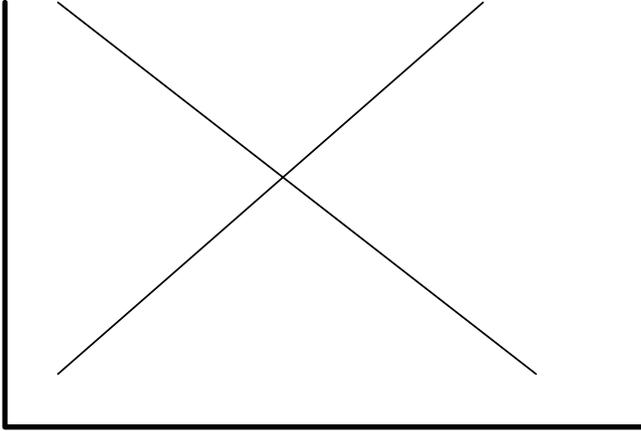
Double 0, Twelve, this is Mother.

Bonnet_land is a country that has performed appropriately in the last decades. Its major (exporting) industry is the manufacturing of hats. The growth rate of the GDP per capital has been quite acceptable. Moreover, all this growth has been achieved with responsible fiscal behavior (deficits are usually smaller than 1 percent of GDP), and low unemployment. This has allowed the monetary authority to maintain a fixed exchange rate for a long time. The economy has had low inflation and relatively low interest rates. Finally, the exports of hats to its neighbor country, Unumbrella_land, are strong and the current account has been in equilibrium for years. In other words, Bonnet_land was a paradise.

However, in 2001, a major accident occurred. A new advertising campaign against the use of hats in Unumbrella_land has been televised, sponsored by the Evil_Empire. It has been argued that the mind behind this master plan is the CEO of Hate_Hat Inc., Just_Yank_the_Cap. Their spoke person, Justin_I'm_a_Yank, has denied everything, but we know him...

Your mission is, if you decide to accept it, to provide the advice to the president of Bonnet_land, Cap Boater, to handle this major international crisis. This document will self-destruct the day you get your grades back. Good luck and God speed 00-12.

1.- [15 pts] Assume that Bonnet_land was in equilibrium in 2000. In the BB-NN map drawn below, assume that the schedules provided indicate the situation in December of 2000. Show where the economy was, and draw how the Ad campaign affected the economy. (Hint: Remember that the horizontal axis is the domestic demand and the vertical access is the inverse of the wage in dollars)

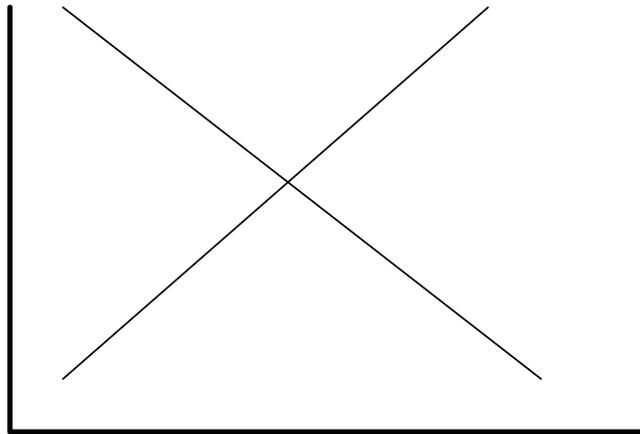


Explain:

2.- [15 pts] What would you do to return to equilibrium in terms of monetary, fiscal, and exchange rate policy?

3.- [20 pts] Just after the government implemented the policies the capital experienced riots. People are starting to complain. The head of the Union, Pissed My Hood, is quite frustrated with the situation of their workers: "We cannot accept this situation. The workers are dying, the people are hungry. What you expect them to do? Their economic situation is so bad that we are looking day by day more similar to Shirt_land" (Shirt_land is a really crummy country in some place you do not want to know)

Draw the situation of the economy and the social peace line.



How you would change the fiscal monetary and exchange rate policies you advised before? (no reforms yet!!!)

4.- [25 pts] Is there an alternative that will make the situation sustainable? Which reform or strategy would you implement and why? IMPORTANT: please only indicate one reform or strategy, and use only the space available below (You could right a thesis on this topic, we want a summary of that.)

Policy: _____

Explain:

5.- [25 pts] On top of all these problems, a hurricane wipes out half of the established capital. International markets have closed and the situation of unemployment has aggravated dramatically. The Prof. Know_a_lot_busch has said that the solution should be to Dollarize the economy. A dollarization would imply to adopt the Dollar as the only currency in the country and eliminate the domestic currency. The Prof. Parrot_man has said that the devaluation and the shift to a flexible regime are the only viable policies.

What would you do: To Fix or Not To Fix?

Explain indicating the benefits and costs of your policy (please no more than two of each).