

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 appreciate all the time and effort you gave. There is an important theorem in life that says that good things always happen, the problem is that they occur mostly in the end. This was not the case in this class. We had the good things at the beginning, and, unfortunately, the bad things in the end. So, here is the exam.

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 share the room with you.

Good luck.

The exam describes a fictitious country that has some problems, and asks for your advice.

After ages of domination by the French and the Spanish, the new country of **Messedup** has been created. The expectations are high. The new president, **Screwme Allyouwant**, is an extremely charismatic leader. Indeed, he has been acknowledged internationally as one of the best leaders in the developing world. In his first speech to the nation he said:

Our country is approaching a crossroad. We have to take care of our people: the poor, the unemployed, and the uneducated. Nobody should be left behind, as Al Gore, once said. We have to increase our production and exports to solve, for once and for all, the current account deficit that has been draining our national treasures.

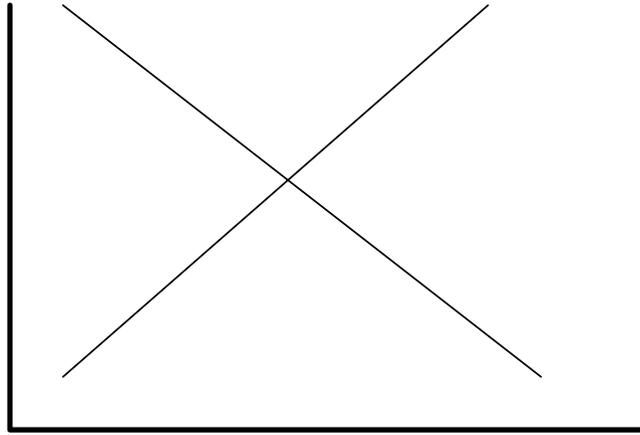
It is clear that our mayor exports are coming from the already famous **Messies**. However, we cannot progress, we cannot survive, we cannot become a respectable nation such as Venezuela (*life is so relative, no?*) if we continue our strong dependence on a single manufacturing product. We have to invest in the other things we do well, such as soap operas about **Messies**, movies about **Messies**, cloths for **Messies**, food for **Messies**, and finally, and more importantly, a male for the **Messies**.

We will take over the world! This is our future!

The first measures included the creation of a currency that was going to be fixed to the US Dollar at one to one. Obviously the Central Bank was in charge of protecting both the currency and price stability (or on other words, inflation). The president of the Central Bank, **Iam Totallygerman**, is regarded as a very responsible central banker.

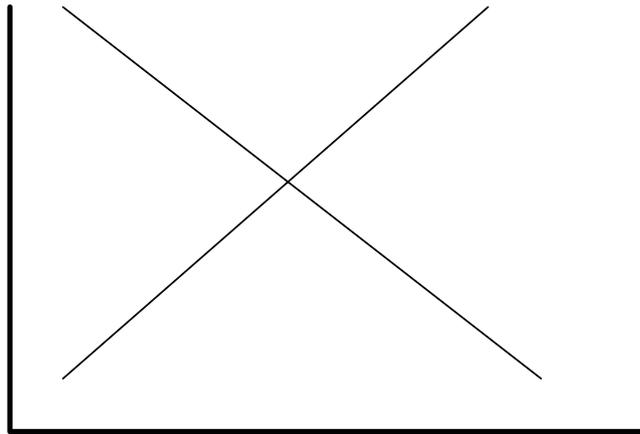
Several key appointments occurred in the administration. To take care of labor and social issues **Jean Pierre Iannotfrench**, an extremely conservative economist, took over all social aspects of the economy. He was named the Secretary of Labor. The secretary of the treasury was offered to **Guacamole Heissomexican**. He and his advisor, **Ihave Noidea**, are in charge of supervising the overall development program.

1.- [10 pts] Give a diagnostic of the current situation of the economy in the BB-NN map (no explanation is needed). The original point should be denoted as **A**.



2.- [10 pts] What would you do if you want to return immediately to the equilibrium (Hint: only talk about fiscal, monetary and exchange rate policy)? (Use the space available here. No more).

3.- [10 pts] However, because the president did not take this class, he was unable to implement your policy. He, on the other hand, decided to follow the advise of his Secretary of Treasury and the internationally recognized economist Prof. **Ihave Noidea**. They pushed for an aggressive fiscal expansion to take care of social problems. What happens to the economy? Where is it moving and what happens to unemployment and the current account immediately? Denote the new point of the economy as **B**.



Unemployment goes: up down

Current Account Deficit goes: up down

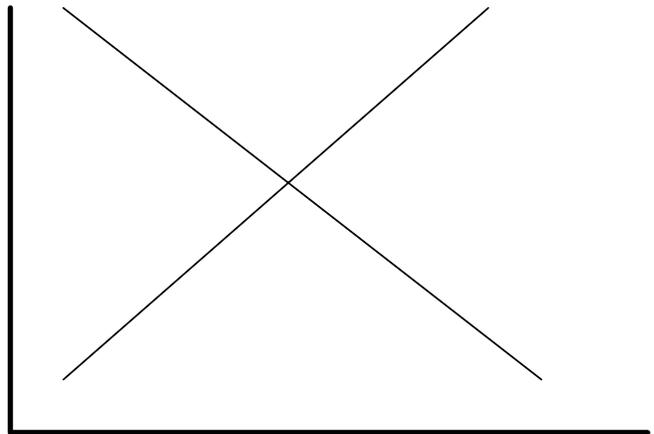
4.- [10 pts] If the economy continues in this strategy, what is going to happen?

5.- [15 pts] President **Allyouwant** reacted to this situation in the following manner

Professor **Noidea** screwed all our country, even me. I have asked the resignation of **Heissomexican**. We are disappointed. And certainly something has to be done. The degree of poverty of our nation has increased to intolerable levels. Our young nation has to change direction; the direction of prosperity. I'm calling **You** to solve the problems of our great country.

By the way, **You** is you. Yes, you, the one that is answering the exam.

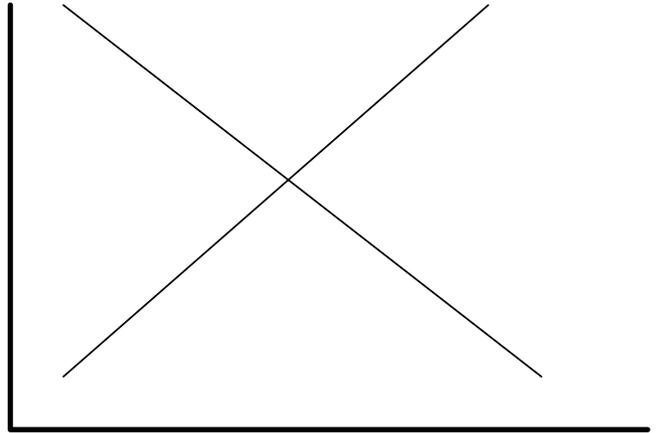
What would **You** do in terms of monetary, fiscal and exchange rate policy? Denote the new equilibrium as **C** and assume the schedules drawn are the original ones. (explain)



6.- [15 pts] Actually, when you presented your program before congress, the reaction of the Spanish descendent **Maria Unioneta**, head of the labor union, said

The program is unacceptable. We are not striking right now because is lunch time, and our tradition suggests that we have to wait until after the Siesta. But we will! We Will!

What would you do in terms of reforms (do not name more than ONE reform)? What would be the effect of this in the BB-NN model? Denote the new equilibrium as **D** and assume the schedules drawn are the original ones.



7.- [30 pts] The bad luck of the **Messedupeans** continues. There has been a terrible disaster. The Secretary of Labor suddenly became French. He implemented a dramatically damaging policy:

“Frrom now onn, evrery budy in the labor markét weel have to eat due pieces of lovely French cheese”.

Which translated to **Messdupean** means

“From now on, everybody in the labor market will have to eat two pieces of bad French cheese”.

What is the implication of this policy if it is actually binding? In other words, assume that now workers and consumers are forced to eat more cheese than before. What are the consequences, and what would you do in terms of fiscal, monetary and exchange rate policy? (So, we cannot kick the guy out of the country).