

## Mid-Term

15.962

**Name:** \_\_\_\_\_

**Section:** \_\_\_\_\_

**Date:** \_\_\_\_\_

The objective of this exam (at least officially) is to help in the learning process. And therefore, think of it as just another problem set. It describes a fictitious economy and asks some questions. There are a couple of things you should know:

- .- There are no trick questions. If something sounds like a trap, is just because I do not know English.
- .- If something is confusing, just STATE clearly your assumption and we will grade accordingly.
- .- In all the figures I provide the axis, but you are responsible for indicating what is in each AXIS (e/w, y, i, etc.)
- .- Please, answer in the space provided. If you need more, you are answering the wrong question. If you need more you can certainly use the back of the pages, but I cannot imagine you would.

You have 1:30 minutes. Although, I'm quite sure you will finish before that.

Good luck

Agent 15962:

**ScrewLand** used to be a nice country, with huge production of screws for the world, govern in stability and with high moral values.

The Evil professor - whose name is **Bon...** Rigo **Bon** - has created major chaos in the country. He taught a macro class to the Minister of Finance and the president of the Central Bank, and told them while they were taking the exam (just like you) the following:

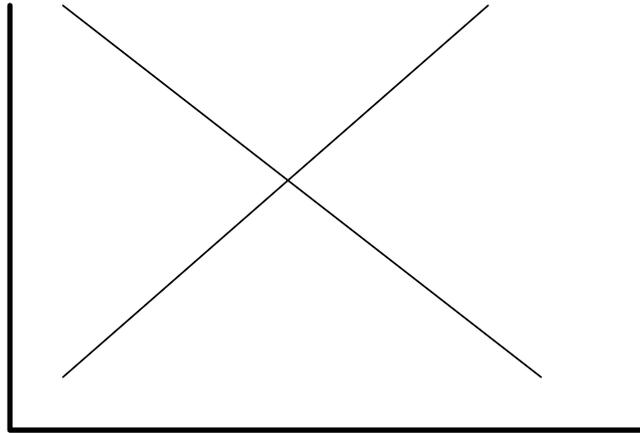
“Well, it is time to show you why you made a mistake taking this class... I know, you might have some fun, you might have learned something, you might even understand the world just a little bit better, but surely today you will suffer. The hounds have been released, and you will be crushed. HA HA HA HA HA – (evil laugh).”

After that, all macro policies have been a disaster. The expansion of fiscal expenditures has deteriorated fiscal account and now the economy has both a fiscal deficit and a current account deficit. Furthermore, increases in minimum wages have appreciated the exchange rate. Today, unemployment is small, there are no pressures to changes in the real wages, but the current account deficit is tremendous.

Your mission, if you decide to accept it, is to design policies that can help this country recover its stability and peace. If by any chance you are captured we will deny any involvement or relationship.

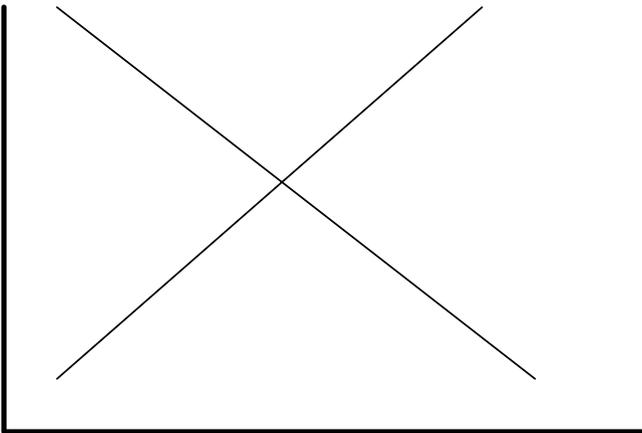
This message will self destruct in 1:30 minutes, and right after you get your grades...

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*.



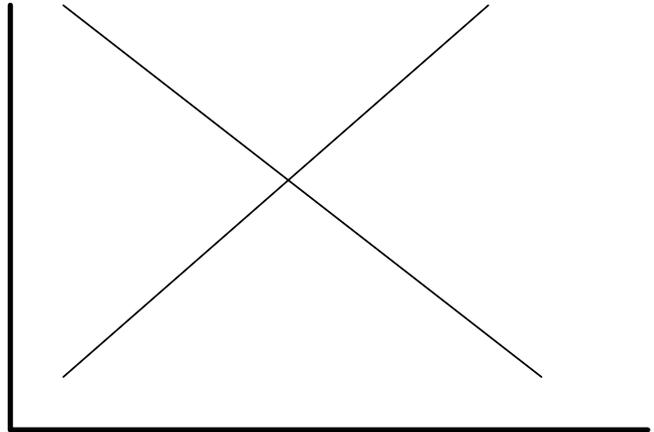
2.- [10 pts] What would you do if you want to return immediately to the equilibrium (Hint: only talk about fiscal, monetary and exchange rate policy)? (Use the space available here. No more).

3.- [10 pts] According to the ISLM, what is the cost of your fiscal or monetary policy in terms of inflation and interest rates. (just explain the policy you decided to use, only one). Draw your answer.



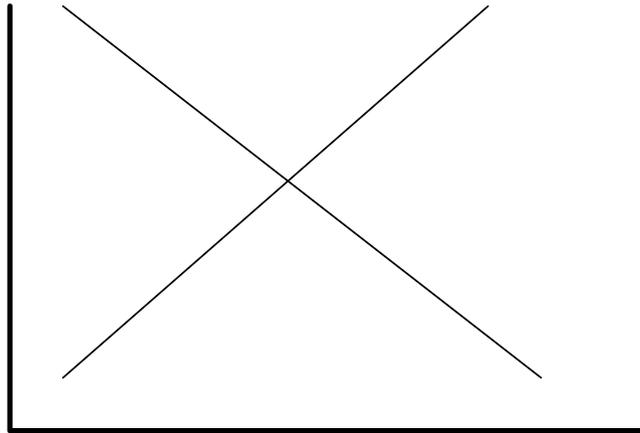
4.- [10 pts] Evil professor **Bon** has stricken back. Secretly he has been involved in a sequence of illegal and underground seminars around the country. His message is clear: “Screw the **Screwans**, you are really a bunch of **Nuts** (the neighboring country)”. The seminars have changed people’s perception of what is an acceptable standard of living. The campaign has raised their hopes, and just before President **Phillips** was going to announce the program you designed, riots exploded around the whole country.

Draw the economy in its initial point (A) and indicate what happened. Explain.



5.- [10 pts] How can you modify your program from question 2 to help the current situation? (ONLY fiscal, monetary and exchange rate policy).

6- [20 pts] In a pitiful act of total disregard for human life Evil professor **Bon** has been talking to foreign investors. Obviously the outcome was that after spending one morning with him, they decide to stop all investments in **ScrewLand**, and actually to take all their money out. What happen in the BB-NN?



What is your advise in terms of fiscal, monetary and exchange rate policy? How the current situation in terms of unemployment, standard of living and current account looks like (in comparison to before)? (Draw point A and the social peace. Assume the “curves” in the graph are the original ones – the ones before investors got pessimistic, and show how the foreigner’s change in mood can be depicted.)

7.- [20 pts] I know that the reasonable alternative is to eliminate Evil professor **Bon** from the face of the earth, but freedom of speech is one of the most regarded achievements of **ScrewLand**. President **Phillips** turns to you... “What else can be done, in terms of reforms, etc.?” Explain only ONE! And its effect in the BB-NN.

8.- [10 pts] The worst possible outcome has just happened. Evil Professor **Bon** has become French, and now they call him **Guy**... Tan **Guy**. With the renewed charm of always being ten minutes late, and the extra dose of charisma pills, he has taken his power to new levels... He spoke to congress.

*“My dearr frrends, ze prropossál frrom your advisé has no hoppe offa bean approved per mua, vou mustte rejecté it”*

which translated to **Screwlandean** means

“My dear friends, the proposal from your advisor has no hope of been approved by me, you must reject it”

That statement was enough to make Congress overturn your policy reform from question 7. What else can be done?