

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 150 points (to be scaled up to 225 points) and is scheduled to take 75 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 14-point question should take 7 minutes. Because of the class that follows yours, I cannot give extra time.

- 1) (10 points) For EITHER the IMF OR the World Bank. Explain what they do.
- 2) (12 points) Answer EITHER Part A OR Part B.
 - A) Explain why fixed exchange rate systems tend to fall apart.
 - B) What is seigniorage? Why might a country want to do it?
- 3) (12 points) Answer EITHER Part A OR Part B.
 - A) Is the AD diagram flatter with a closed economy or with an open economy with a fixed exchange rate? Explain your logic, including an explanation of why AD slopes down.
 - B) Suppose we had high unemployment. How would the economy self-correct? It will be easiest to refer to the SRAS/LRAS/AD diagram, but there is no need to draw it.
- 4) (14 points) Answer EITHER Part A OR Part B.
 - A) The book says Costa Rica has a crawling peg. What does that mean? Why would they have a crawling peg? Costa Rica is a small, developing, Central American country.
 - B) The book says Fiji has a currency that is pegged to a composite of currencies. What does that mean? Why would they have a crawling peg? Fiji is a small island country in the South Pacific.
- 5) (14 points) Answer EITHER Part A OR Part B.
 - A) Explain why Jagdish Bhagwati feels that developing countries should not open the financial markets to freer trade.
 - B) Explain how having a fixed exchange rate can, and some economist say will eventually, cause a financial crisis.
- 6) (16 points) Answer EITHER Part A OR Part B.
 - A) The Maastricht Treaty says the “long-term interest rates must not exceed by more than two points the average interest rate of the three countries with the” interest rates. (The book says “inflation rates” at the end of the sentence, but I believe that is a typographical error.) Explain why there is an upper bound on long-term interest rates. Why is there no lower bound?
 - B) The Maastricht Treaty says the “inflation rate must not exceed by more than 1.5 percentage points the average rate of the three Community nations with the lowest rate.” Explain why there is an upper bound on long-term interest rates. Why is there no lower bound?
- 7) (18 points) Suppose that a government heard about your grade in this course and asked you to recommend an exchange rate regime for that country. It is a country you know nothing about. What two questions would you ask them? Explain why you would ask those questions and how you would use the information provided.
- 8) (18 points) Answer EITHER Part A OR Part B.
 - A) Draw the internal balance/external balance for government policy. Place a point where there is inflation and a trade surplus. Explain how you know the point is in the correct spot.
 - B) Draw the internal balance/external balance for government policy. Explain why both curves have their respective slopes and why one has a flatter slope than the other slope.
- 9) (38 points) Illustrate EITHER the event in Part A OR the event in Part B on the IS/LM/BP diagram AND the LRAS/SRAS/AD diagram. Use the same event in both graphs and assume the exchange rate is ~~fixed~~. Oops, I mean flexible.
 - A) Suppose the country has an increase in government spending. Keep moving the lines until all markets except the labor market, are in equilibrium. Explain why the curve(s) moved as drawn.
 - B) Suppose the country has an improvement in technology. Keep moving the lines until all markets except the labor market, are in equilibrium. Explain why the curve(s) moved as drawn.