

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 210 points) and is scheduled to take 75 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 12-point question should take 6 minutes. I can give some extra time, but not much.

1) (10 points each) For TWO of the following, determine what happens to M1 and M2. Explain why that occurs.

- A) You pay for your tuition bill with a check from an American bank.
- B) You pay for a new computer with a credit card.
- C) You move \$75 from your money market account to your checking account.

2) (12 points) Answer EITHER Part A OR Part B.

- A) Why does the S/I diagram for a small open economy have only one graph while the same economy for a large country have two graphs side-by-side?
- B) Without using a graph, explain the twin deficit. How does one cause the other?

3) (14 points) Answer EITHER Part A OR Part B.

- A) Write the Quantity Theory of Money and use it to explain why some economists feel the only effect of increasing the money supply faster is to increase the inflation rate.
- B) I showed you a graph which had the quantity theory of money over time for M1. Why did it grow for several decades? Explain how that would cause it to grow.

4) (14 points) Answer EITHER Part A OR Part B.

- A) Explain the difference between real money demand and nominal money demand. Which one changes when the price level increases? Explain why the other one does not move.
- B) When we went through a lot of examples of events which affected M1, but almost none of them affected M2. Why wasn't M2 affected? What did affect M2? Why was that different from the other examples?

5) (14 points) Answer EITHER Part A OR Part B.

- A) President George W. Bush cut the tax on capital gains. Use the Endogenous Growth Model to determine if that was a good or bad policy. Explain your logic.
- B) When we drew the Solow Growth Model diagram, we first found two points. One of those points was  $k_G$ . How did we find that and why didn't we worry about it later?

6) (14 points) Explain EITHER the equation in Part A OR the equation in Part B.

$$A) \frac{\Delta Y}{Y} = \frac{\Delta A}{A} + a_K \frac{\Delta K}{K} + a_N \frac{\Delta N}{N}$$

$$B) \frac{\Delta Y}{Y} = sA - d$$

7) (18 points) Answer EITHER Part A OR Part B.

- A) Draw the Solow Growth Model diagram. Illustrate the effects of a decrease in the depreciation rate.

Explain why the curve(s) moved as drawn. What happens to the equilibrium capital-labor ratio and output per worker?

B) Draw the Solow Growth Model diagram. Illustrate the effects of a increase in the tax rates. Explain why the curve(s) moved as drawn. What happens to the equilibrium capital-labor ratio and output per worker?

8) (18 points) Answer EITHER Part A OR Part B.

A) Give an example of an increase in USA owned assets abroad. Explain why that fits the definition. Is that the debit or credit in the balance sheet? Is that a long-term or short-term financial asset? Explain your logic for all parts.

B) Suppose an British student pays tuition in the USA. What are the debit and the credit for the USA? What happens to the CA and the KFA for the USA? BRIEFLY explain your logic.

9) (26 points) Answer EITHER Part A OR Part B.

A) Draw the S/I diagram for a large country and the rest of the world where the large country has a current account deficit. State how you know it has a current account deficit. Illustrate the effects of an increase in the corporate tax rate for the rest of the world. Explain why the curve(s) moved as drawn. What happens to the level of saving in both countries, the level of investment in both countries, the world interest rate, and the current account in both countries?

B) Draw the S/I diagram for a large country and the rest of the world where the large country has a capital-financial account deficit. State how you know it has a capital-financial account deficit. Illustrate the effects of a negative supply shock the rest of the world. Explain why the curve(s) moved as drawn. What happens to the level of saving in both countries, the level of investment in both countries, the world interest rate, and the capital-financial account in both countries?