

Place your name on the back of this sheet of paper and nowhere else. Staple your answers face up on the front of this sheet of paper. Failure to follow these directions will cost you 10 points. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to type it will cost you 10 points. If you use double-sided printing or print on the back of scrap paper, I will give you one additional point.

- 1) (20 points) Draw the S/I diagram for a small open economy with a KFA surplus. Explain how you know that the graph shows a KFA surplus. Illustrate the effects of an increase in government spending without Ricardian Equivalence. Explain why the curve(s) moved as drawn. What happens to level of saving, level of investment, the interest rate, and the size of the KFA surplus? Briefly state how you knew those changes.
- 2) (20 points) Draw the S/I diagram for a small open economy with a CA surplus. Explain how you know that the graph shows a CA surplus. Illustrate the effects of a decrease in the price of capital. Explain why the curve(s) moved as drawn. What happens to level of saving, level of investment, the interest rate, and the size of the CA surplus? Briefly state how you knew those changes.
- 3) (20 points) Draw the S/I diagram for a small open economy with a KFA deficit. Explain how you know that the graph shows a KFA deficit. Illustrate the effects of a temporary negative supply shock. Explain why the curve(s) moved as drawn. What happens to level of saving, level of investment, the interest rate, and the size of the KFA deficit? Briefly state how you knew those changes.
- 4) (40 points) Draw the S/I diagram for a large open economy with a CA deficit. Explain how you know that the graph shows a CA deficit. Illustrate the effects of a population increase in the rest of the world. Explain why the curve(s) moved as drawn. What happens to level of saving in both countries, level of investment in both countries, the interest rate, and the size of the CA deficit in the large country? Briefly state how you knew those changes.