

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 100 points (to be scaled up to 160 points) and is scheduled to take 50 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 12-point question should take 6 minutes. Because of classes after yours, I cannot give extra time.

1) (10 points) For EITHER the event in Part A OR the event in Part B, determine what happens to the capital financial account balance and the current account balance. Explain your logic.

A) An American sells Ticonderoga (US made) pencils to Germany.

B) An American buys shares of Volkswagen.

2) (10 points) Answer EITHER Part A OR Part B.

A) Given an example of an increase in “US owned assets abroad.” Does that enter the KFA calculations in a positive or negative manner? Explain your logic.

B) Give an example of an increase in “net lending abroad.” Does that enter the KFA calculations in a positive or negative manner? Explain your logic.

3) (12 points) Explain EITHER $r_{a-t} = (1-t)i - \pi^e$ OR $uc = (r + d)p_K$.

4) (12 points) Answer EITHER Part A OR Part B.

A) Why might a decrease in the income tax rate have no effect on total savings in the country? Explain your logic.

B) Why might a decrease in the depreciation rate have no effect on investment in the country? Explain your logic.

5) (24 points) Answer EITHER Part A OR Part B.

A) Draw the S/I diagram for a large country with a capital financial account deficit. Explain how you know it shows a capital financial account deficit. Illustrate the effects of a stock market crash in the rest of the world. Explain why the curves moved as drawn. What happens to the interest rate, level of investment in both countries, level of savings in both countries, and the large country’s capital financial account deficit?

B) Draw the S/I diagram for a large country with a capital financial account surplus. Explain how you know it shows a capital financial account surplus. Illustrate the effects of an increase in government spending in the rest of the world (without Ricardian Equivalence). Explain why the curves moved as drawn. What happens to the interest rate, level of investment in both countries, level of savings in both countries, and the large country’s capital financial account surplus?

6) (32 points) Answer EITHER Part A OR Part B.

A) Draw the S/I diagram for a small open economy with a current account deficit. Also draw the MPK^f/uc_K diagram for the same country. How do you know your diagram shows a current account deficit? Illustrate the effects of an increase in the corporate tax rate. Explain why the curve(s) moved as drawn. What happens to the interest rate, the level of investment, the level of savings, the size of the current account deficit, the user cost of capital, and the desired amount of capital?

B) Draw the S/I diagram for a small open economy with a current account surplus. Also draw the MPK^f/uc_K diagram for the same country. How do you know your diagram shows a current account surplus? Illustrate the effects of an increase in the corporate tax rate. Explain why the curve(s) moved as drawn. What happens to the interest rate, the level of investment, the level of savings, the size of the current account surplus, the user cost of capital, and the desired amount of capital?