

Place your name on the back of this sheet of paper and nowhere else. Staple your answers on the front of this sheet of paper. Failure to follow these directions will cost you 1 point. 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) (10 points) Explain $KFA = -CA$.

2) (10 points) Give an example of “an increase in US owned assets abroad.” Is that going to increase or decrease the KFA? Explain your logic.

3) (10 points) Give an example of “a decrease in foreign owned assets in the USA.” Is that going to increase or decrease the KFA? Explain your logic.

4) (25 points) Draw the S/I diagram for a small open economy with a KFA surplus. State how you know they have a KFA surplus. Illustrate the effects of an increase in the future marginal productivity of capital. Explain why the curve(s) moved as drawn. What happens to the level of savings, the level of investment, the interest rate, and the size of the KFA surplus?

5) (25 points) Draw the S/I diagram for a small open economy with a CA surplus. State how you know they have a CA surplus. Illustrate the effects of an increase in government spending assuming Ricardian Equivalence does not hold. Explain why the curve(s) moved as drawn. What happens to the level of savings, the level of investment, the interest rate, and the size of the CA surplus?

6) (10 points each) For each event, determine what happens to the current account and the capital-financial account for the USA. Explain your logic. Remember your answer to Question #1.

A) A foreign student pays his tuition at Bethany College.

B) An American buys a German government bond.