Wilfrid W. Csaplar Jr., Ph.D.   Economics 302   Exam #2   2018/10/30

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 transfer $100 from your checking account to your savings account.
B) You get a loan for a new car.
C) You take $50 cash out of your checking account using an ATM.

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 equation for the Quantity Theory of Money. Explain why V might be constant.
B) I showed you a graph which had the quantity theory of money over time for M1. Why has it become unstable while M2 remains stable? Explain your logic.

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_{Max}. 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 increase in the population 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 the Federal Reserve increasing interest 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 decrease in foreign owned assets in the USA. 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.

B2) Suppose an American student pays for rent while doing foreign exchange in Japan. 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 decrease in the stock market 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 postive supply shock 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 capital-financial account in both countries?