

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 240 points (to be scaled down to 215 points) and is scheduled to take 120 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 12-point question should take 6 minutes. I CANNOT give extra time because of a review session after your class.

- 1) (10 points each) Use the table supplied to answer TWO of these questions. **BRIEFLY** explain your answer and show all calculations.
- A) What is the value of the current account? Is that a deficit or surplus?
- B) What is the value of the capital account? Is that a deficit or a surplus?
- C) What is the value of the goods and services account? Is that a deficit or a surplus?

Exports of goods, services, and income	
Goods	719
Services	279
Income receipts from abroad	284
Imports of goods, services, and income	
Goods	-1146
Services	-210
Income payments on foreign assets in US	-269
Unilateral transfers, net	-49
US-owned assets abroad, net (increase/outflow (-))	-371
Foreign-owned assets in the US, net (increase/inflow (+))	753
Statistical discrepancy	11

- 2) (14 points) Answer EITHER Part A OR Part B.
- A) Suppose the exchange rate between the US dollar and the euro was US\$1.5/€ and the exchange rate between the British pound and the euro was £0.5/€. What should be the exchange rate between the US dollar and the British pound? Show all work. If the actual exchange rate is US\$2.8/£, then how could you make money by trading currencies?
- B) What is meant by absolute PPP? Why does it not hold?

- 3) (16 points) Answer EITHER Part A OR Part B.
- A) The Maastricht Treaty states that countries wanting to use the euro must have long-term interest rates which do not exceed the average interest rates of the three countries with the lowest interest rates by more than two percentage points. Why?
- B) Do you think a fixed exchange rate system would work in the 2008 economy? Explain your logic.

- 4) (16 points) Answer EITHER Part A OR Part B.
- A) Explain how a financial crisis in Hong Kong, could cause problems for Brazil, even if Brazil's economic situation is quite stable.
- B) Jagdish Bagwati says that developing countries should have free trade in goods, but trade restrictions on international capital flows. What is the reason for restricting international capital flows?

- 5) (18 points) Answer EITHER Part A OR Part B.
- A) Draw the Swan diagram. Choose a point off of both lines and explain what the economic situation is.
- B) Draw the EB/IB diagram. Choose a point off of both lines and explain what the economic situation is.

6) (18 points) Answer EITHER Part A OR Part B.

A) What would be the advantages of a government's switching to a currency board controlling the money supply?

B) What would be the advantages of a government's ignoring the exchange rate when controlling the money supply?

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

A) Draw a supply and demand for the British pound. Place a fixed exchange rate below the equilibrium. What will happen to the British pound automatically which will fix the problem? Explain your logic.

B) Illustrate an increase in the Japanese GDP on the supply and demand for yen. Explain why the curve(s) moved as drawn. Which currency appreciates? Explain how you reached that conclusion.

8) (20 points) Draw the 45° diagram, a.k.a. Keynesian cross diagram. On it, illustrate EITHER an increase in the marginal propensity to import OR the marginal income tax rate. Explain why the curve(s) moved as drawn. What happens to GDP?

9) (20 points) Answer EITHER Part A OR Part B.

A) Draw the SRAS/LRAS/AD diagram for a closed economy. Illustrate an improvement in the GDP of their biggest trading partner. Explain why the curve(s) moved as drawn. What happens to GDP and prices?

B) Draw the SRAS/LRAS/AD diagram for a closed economy. Illustrate an increase in the interest rates. Explain why the curve(s) moved as drawn. What happens to GDP and prices?

10) (36 points) Answer EITHER Part A OR Part B.

A) Draw the supply and demand for American **imports** priced in euro. Put scales on both axes. Have the diagram correspond to an exchange rate of \$1.50/euro. Show how it moves if the exchange rate changes to \$3.00/euro. Explain why the curve(s) moved as drawn. Does this information give you points on the supply or the demand for euros? Why did you choose that? Use this information to find two points on the supply/demand (which ever one you said you could get) diagram for euros. Explain how you got those two points.

B) Suppose that in the Gambia they produce 4 hats per hour of labor and 12 computers per hour of labor. In Macedonia, they produce 7 hats per hour of labor and 14 computers per hour of labor. Who has the absolute advantage in each good? Who has the comparative advantage in each good? Who will export which good and what will the price be? Draw the PPF/CPF for ONE of the two countries. Explain how you reached each conclusion and how you got the endpoints on the two graphs. How does your graph show that the country gains from trade?

11) (44 points) Answer EITHER Part A OR Part B.

A) Draw an IS/LM/BP diagram with the BP line flatter than the LM curve. Start with all three curves crossing at one point and assume a flexible exchange rate. Draw an increase in money supply. Show the initial movement(s) and explain why the curve(s) moved as drawn. Show the movement(s) back to equilibrium. Explain why the curve(s) moved as drawn.

B) Draw an IS/LM/BP diagram with the LM line flatter than the BP curve. Start with all three curves crossing at one point and assume a fixed exchange rate. Draw an increase in the income tax rate. Show the initial movement(s) and explain why the curve(s) moved as drawn. Show the movement(s) back to equilibrium. Explain why the curve(s) moved as drawn.