

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.

I am sorry to disappoint you, but the only equations in this material were already covered, so there is no equation to explain on this assignment.

1) (30 points) Draw the S/I diagram for a large country and for the rest of the world. Show the rest of the world having a capital financial account surplus. Explain how you know they have a surplus. Illustrate the effects of a temporary negative supply shock in the rest of the world. Explain why the curve(s) moved as drawn. What happens to the levels of investment in both countries, levels of savings in both countries, and the interest rate.

2) (30 points) Draw the S/I diagram for a large country and for the rest of the world. Show the rest of the world having a current account surplus. Explain how you know they have a surplus. Illustrate the effects of an increase in government spending the rest of the world. Explain why the curve(s) moved as drawn. What happens to the levels of investment in both countries, levels of savings in both countries, and the interest rate.

3) (30 points) Draw the S/I diagram for a large country and for the rest of the world. Show the large country having a current account surplus. Explain how you know they have a surplus. Illustrate the effects of a drop in wealth in the rest of the world. Explain why the curve(s) moved as drawn. What happens to the levels of investment in both countries, levels of savings in both countries, and the interest rate.

4) (10 points) Without drawing the graphs, explain the economic logic behind the “twin deficits.”