This review sheet is intended to cover everything that could be on the exam; however, it is possible that I will have accidentally left something off. You are still responsible for everything in the chapters covered except anything that I explicitly say you are not responsible for. Therefore, if I left something off of this sheet, it can still be on the exam. There will be no multiple-choice questions. Most of the questions will be like the ones in the homework assignments, and possibly a few definition questions, but I am more likely to ask questions that make you use the definitions rather than recite them. I will probably ask one of the questions from the book at the end of the chapters.

The review session will be Tuesday, 3/9, at 4:00, in the normal room.

You will be given a pair of equations and asked to explain one of them. The equations at the end of the chapters will help you prepare for this part of the exam.

Chapter 4's appendix (pages 156 - 159 and 164 - 168 only): What is the inter-temporal budget constraint? Why does a change in r cause a strange movement of it (shown on page 168)? Why does that mean that r may have an uncertain effect upon current consumption? Ignore the indifference curves. What is the *Permanent Income Theory* and the *Life-Cycle Model*? Their conclusions are virtually the same, but they are different. How do they affect our model of consumption? How do they relate to Ricardian Equivalence? What effects do durable goods and borrowing constraints have on the models? You can either put a ^{f} on the future income and consumption or you can put $_t$ on the current values and $_{t+1}$ on the future values. The former is how the book does it, and the latter is how I did it in class.

Chapter 4: What determines desired savings and desired consumption? What is the MPC and why is it important? How do current income, expected future income, wealth, and r affect consumption? What is r_{a-t} and why does it matter? How do government spending and taxes affect national savings? Why might they not affect it? What determines uc? What will move that curve? Why is where it crosses MPK^f the desired level of K? Why is there an "^{f}" on the MPK? What moves the MPK^f line? How does K* relate to I? Why might a change in the depreciation rate have uncertain effects upon investment? Why might the market take time to adjust? What moves the S^d and I^d lines on the graph? Why should they yield the equilibrium level of S and I?

Chapter 5: What is the current account (CA)? How is it calculated? What is the capital financial account (KFA)? Why should the CA + KFA = 0? How do NFP and unilateral transfers enter the equation? Do not worry about *official reserves* or *official settlements balance*. Note that the summary on page 175 does a great job of showing how all the terms relate to each other. Why does $S^d = I^d + CA$ or more easily put $S^d + KFA = I^d$? Be able to manipulate the S/I diagram for small **but not large** open economies. Be able to show what moves the curves, and know how to find a CA deficit or a KFA deficit. Personally, I think that you can figure out KFA easier and more directly because if there is excess savings, what do we do with it? We buy foreign stocks and bonds. If we have excess investment, how do we finance it? We export bonds and stocks, i.e., we borrow from abroad. Know how government policy and shocks affect the diagram. **Do not worry about** how are the twin deficits related? (That topic and large countries will be on the next test.)

This is the non-graded Assignment #4A that will be gone over with Assignment #4.

1) (25 points each) Illustrate the following events on the S/I diagram for a small open economy with a trade surplus. Explain how you know there is a trade surplus and why the curve(s) moved as drawn. What happens to the level of savings, level of investment, trade surplus, and the interest rate?
A) The government increases spending.
B) The corporate tax rate increases.
C) There is a temporary adverse productivity shock.
D) The world real interest rate increases.