

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 74 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) Answer EITHER Part A OR Part B.

A) What is meant by “a decrease in foreign owned assets in the USA”? Give an example. What does that step do to the KFA by itself? Explain your logic.

A) What is meant by “a decrease in US owned assets abroad”? Give an example. What does that step do to the KFA by itself? Explain your logic.

2) (12 points) Explain EITHER the equation in Part A OR the equation in Part B.

A) $\Delta Y/Y = sA - d$

B) $c = y - (n + d)k$. This comes from the Solow growth model diagram.

3) (12 points) For EITHER of the following events, tell me which account is debited and which is credited. Briefly state how you reached that conclusion. What happens to the NX, CA, short-term KFA, and the long-term KFA?

A) A British company sells \$100 worth of scissors to a US citizen.

B) An American company provides accounting services for a Canadian company.

4) (12 points) Answer EITHER Part A OR Part B.

A) What are the twin deficits? Explain how they are related. You do not need to draw a graph.

B) What is the effect of an increase in the depreciation rate on the level of investment? Explain your logic.

5) (14 points) Answer EITHER Part A OR Part B.

A) President George W. Bush cut the taxes on dividends and capital gains. Using the Endogenous Growth Model, was this a good idea or a bad idea? Explain your logic.

B) President George W. Bush ran a big government deficit. Using the Endogenous Growth Model, was this a good idea or a bad idea? Explain your logic.

6) (14 points) Answer EITHER Part A OR Part B.

A) Draw the Solow Growth Model diagram. Why is it unlikely that we will be at the optimal point? Explain your logic.

B) Using the Endogenous Growth Model, how does enforcing patents affect the long term growth of the economy? Explain your logic.

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

A) Draw the Solow Growth Model diagram. Use it to explain why I think that in your lifetime, the USA will no longer be the most powerful economy in the world – in other words, why we will not have the highest GDP per capita and highest capital-labor ratio.

B) Draw the Solow Growth Model diagram. Use it to prove Chairman Mao wrong when he said that China needed to have the population grow faster to become an economically powerful country.

8) (26 points) Answer EITHER Part A OR Part B.

A) Draw the S/I diagram for a large open economy with a current account surplus. State how you know it is a surplus. Illustrate the effects of an increase in the future marginal productivity of capital in the rest

of the world. Explain why the curve(s) moved as drawn. What happens to the interest rate, the level of saving in both countries, the level of investment in both countries, and the size of the surplus?

B) Draw the S/I diagram for a large open economy with a capital financial account surplus. State how you know it is a surplus. Illustrate the effects of an expected increase in the income tax rate in the rest of the world. Explain why the curve(s) moved as drawn. What happens to the interest rate, the level of saving in both countries, the level of investment in both countries, and the size of the surplus?

9) (32 points) Answer EITHER Part A OR Part B.

A) Draw the MPK^f/uc_K diagram and the S/I diagram for a closed economy. Illustrate the effects of a decrease in government spending. (Assume Ricardian Equivalence does not hold.) Explain why the curve(s) moved as drawn. What happens to the user cost of capital, desired amount of capital, interest rate, level of saving, and level of investment?

B) Draw the MPK^f/uc_K diagram and the S/I diagram for a closed economy. Illustrate the effects of a decrease in the price of capital. Explain why the curve(s) moved as drawn. What happens to the user cost of capital, desired amount of capital, interest rate, level of saving, and level of investment?