

Place your name on the back of this sheet of paper and nowhere else. Staple your answers face up on the front of this sheet of paper. Failure to follow these directions will cost you 10 points. 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 there is no equation to explain.

1) (35 points) Draw the S/I diagram for a large country which has a capital-financial account surplus and the corresponding graph for the rest of the world. How do you know it is a surplus? Illustrate the effects of a temporary adverse supply shock in the rest of the world. Explain why the curve(s) moved as drawn. What happens to the level of investment in both countries, the level of saving in both countries, the surplus, and the world interest rate?

2) (35 points) Draw the S/I diagram for a large country which has a current account surplus and the corresponding graph for the rest of the world. How do you know it is a surplus? Illustrate the effects of an increase in the corporate tax rate in the rest of the world. Explain why the curve(s) moved as drawn. What happens to the level of investment in both countries, the level of saving in both countries, the surplus, and the world interest rate?

3) (35 points) Draw the S/I diagram for a large country which has a balanced current account and the corresponding graph for the rest of the world. Illustrate the effects of an event which would cause the large country to have a government deficit without Ricardian Equivalence. Explain why the curve(s) moved as drawn. What happens to the level of investment in both countries, the level of saving in both countries, the domestic current account, and the world interest rate?

4) (5 points) In all of the questions for this chapter, especially Questions #2 & #3 on the previous homework, we assumed something about the travel of money across borders. What did we assume? Even though that is not completely realistic, it is still a logical assumption. Why is it logical?