

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 100 points (to be scaled up to 160 points) and is scheduled to take 50 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 12-point question should take 6 minutes. I can't give extra time, but I won't give much.

1) (12 points) Explain EITHER $r_{a-t} \approx (1-t)i - \pi^e$ OR $uc_K = (r+d)p_K$. I realize these are simplified versions.

2) (16 points) For EITHER the event in Part A OR the event in Part B. Do the double entry bookkeeping entries for the USA. State why you put the entries as you did. What happens to the NX, CA, short-term KFA, long-term KFA, and KFA?

A) The USA store Best Buy imports Samsung televisions from Mexico which are made in Mexico. The combined value is \$40,000.

B) An American sells \$10,000 worth of stock in BP. BP is a British company. Assume it is bought from a British resident.

3) (16 points) Answer EITHER Part A OR Part B.

A) Give an example of an increase in foreign assets in the USA. Explain why it fits that definition. Is that entry a debit or credit for the KFA of the USA? Explain your logic.

B) Use the S/I diagram for a small open economy to explain the twin deficits. Explain why the curve(s) moved as drawn and why it is called the twin deficits.

4) (28 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 people expecting that the income tax will be higher in the future. Explain why the curves moved as drawn. What happens to the interest rate, user cost of capital, desired amount of capital, and levels of saving and investment?

B) Draw the MPK^F/uc_K diagram and the S/I diagram for a closed economy. Illustrate the effects of a crash of the stock market. Explain why the curves moved as drawn. What happens to the interest rate, user cost of capital, desired amount of capital, and levels of saving and investment?

5) (28 points) Answer EITHER Part A OR Part B.

A) Draw the S/I diagram for a large open economy with a capital-financial account deficit. State how you know your diagram has the correct deficit. Illustrate the effects of an increase in the price of capital in the rest of the world. What happens to the world interest rate, the levels of saving in both countries, and the level of investment in both countries.

B) Draw the S/I diagram for a large open economy with a current account deficit. State how you know your diagram has the correct deficit. Illustrate the effects of an increase in the marginal productivity of capital in the rest of the world caused by increased use of AI. Explain why the curve(s) moved as drawn. What happens to the world interest rate, the levels of saving in both countries, and the level of investment in both countries.