

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.

The review session will probably be Thursday, 2/22, at a time and place to be determined.

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: What determines desired saving 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 saving? Why might they not affect it? What determines uc_K ? What will move that curve? Why is where it crosses MPK^f the desired level of K ? Why is there an “ b ” 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? 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, including the double entry bookkeeping? What is the **capital-financial account (KFA)**? It is the sum of the capital account and the book’s financial account (FA). 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 177 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 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. Be able to manipulate the S/I diagram for **large open economies**. Be able to show what moves the curves, and know how to find a CA deficit or a KFA deficit. How are the **twin deficits** related?

Non-graded Assignment #5A to be reviewed with Assignment #5.

- 1) (10 points each) For each of these events, what are the debit and the credit for the USA? State how you reached those conclusions. What happens to NX , CA , short-term FA , long-term FA , and KFA ?
- A) An American buys \$10,000 worth of stock in BP. BP is a British company. Assume it is bought from a British resident.
- B) An American sells \$400 worth of clothing they made, to an Argentinian.
- C) A Australian buys \$20,000 worth of stock in Ford. Ford is an American company. Assume it is bought from an American resident.
- D) The American company Starlink sells internet services to an Italian.

2) (20 points) Draw the S/I diagram for a small country with balanced trade. Illustrate the effects of an increase in government spending. Explain why the curve(s) moved as drawn. Use your diagram to explain the term “twin deficit”. What happens to the levels of S, I, and the real interest rate?

3) (20 points) Draw the S/I diagram for a large country with a KFA deficit. Explain how you know it is a KFA deficit. 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 S and I in the two countries, and the world interest rate?

<https://www.reuters.com/business/countries-backs-global-minimum-corporate-tax-least-15-2021-07-01/>

4) (20 points) Draw the S/I diagram for a large country with a CA deficit. Explain how you know it is a CA deficit. Illustrate the effects of an increase in the marginal productivity of capital in the rest of the world. Explain why the curve(s) moved as drawn. What happens to S and I in the two countries, and the world interest rate?