

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, there is no equation to explain.

1) (20 points) Draw the S/I diagram for a small open country with a KFA deficit. State how you know it is a KFA deficit. Illustrate the effects of the world interest rate decreasing. Explain why the curve(s) moved as drawn. What happens to the level of saving, level of investment, and the KFA deficit?

2) (20 points) Draw the S/I diagram for a small open country with a CA deficit. State how you know it is a CA deficit. Illustrate the effects of an improvement in technology. Explain why the curve(s) moved as drawn. What happens to the level of saving, level of investment, the CA deficit, and the interest rate?

3) (30 points) Draw the S/I diagram for a large open country with a KFA surplus. State how you know it is a KFA surplus. Illustrate the effects of governments in the rest of the world, increasing their spending, assuming that Ricardian equivalence does not hold. Explain why the curve(s) moved as drawn. What happens to the level of saving in both countries, level of investment in both countries, the KFA surplus, and the interest rate?

4) (30 points) Draw the S/I diagram for a large open country with a CA surplus. State how you know it is a CA surplus. Illustrate the effects of a negative supply shock in the rest of the world. Explain why the curve(s) moved as drawn. What happens to the level of saving in both countries, level of investment in both countries, the CA surplus, and the interest rate?