

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 Sunday, 2/28, 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 “ f ” 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? What is the **capital financial account (KFA)**? 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. Even though we will have started the large country S/I diagram, it will not be on the exam.

Non-graded Assignment #4A to be reviewed with Assignment #4.

1) (15 points each) For each of the following events, find the debit and the credit. Briefly state how you knew what they were. Find the values for NX, CA, short-term KFA, long-term KFA, and KFA.

A) You decide to sell \$500 worth of shares of the Chinese company Huawei because you predict other countries will follow Trump’s banning them from entering the market.

B) I buy a \$15 CD directly from an Australian company.

C) Last semester Bethany College paid the Arabic professor for teaching online from Gaza.

3) (20 points) Draw an S/I diagram for a small open economy with a KFA deficit. Explain how you know your graph shows a KFA deficit. Illustrate the effects of an increase in the corporate tax rate. Explain why the curve(s) moved as drawn. What happens to the level of S , level of I , and the KFA deficit?

4) (20 points) Draw an S/I diagram for a small open economy with a CA deficit. Explain how you know your graph shows a CA deficit. Illustrate the effects of a decrease in government spending. Explain why the curve(s) moved as drawn. What happens to the level of S , level of I , and the CA deficit?

5) (15 points) Why must $CA = -KFA$? Why didn’t the interest rate change in your answers to 3 & 4?