

Place your name on the back of this sheet of paper and nowhere else. Staple your answers on the front of this sheet of paper. Failure to follow these directions will cost you 1 point. 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.

1) (15 points) Explain $uc_K = \frac{(r+d)p_K}{1-\tau}$

2) (20 points each) Illustrate the effects of the following events on the MPK^f/uc_K diagram. Explain why the curve(s) moved as drawn. What happens to the user cost of capital and the desired amount of capital?

- A) The labor force increases.
- B) Interest rates increase.

3) (20 points each) For each of the following events, illustrate the effects on the S/I diagram. Explain why the curve(s) moved as drawn. What happens to the interest rate and the level of saving & investment?

- A) The government increases taxes. Assume no Ricardian Equivalence.
- B) The price of capital increases.

4) (5 points) Explain why an increase in the depreciation rate will have an ambiguous effect upon the amount of investment.