

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 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.

- 1) (15 points) Explain  $I_t = K_{t+1} - K_t + dK_t$ . Note that the last term has two variables which need to be explained.
- 2) (20 points) Draw the S/I diagram. Illustrate the effects of an increase in the tax rate assuming that Ricardian Equivalence does not hold. Explain why the curve(s) moved as drawn. What happens to the real interest rate and the levels of S & I?
- 3) (20 points) Draw the S/I diagram. Illustrate the effects of a decrease in the price of capital. Explain why the curve(s) moved as drawn. What happens to the real interest rate and the levels of S & I?
- 4) (20 points) Draw the S/I diagram. Illustrate the effects of a decrease in the corporate tax rate. Explain why the curve(s) moved as drawn. What happens to the real interest rate and the levels of S & I?
- 5) (10 points) Why does an increase in the depreciation rate have an ambiguous effect upon investment?
- 6) (15 points) Do you think that Ricardian Equivalence holds for increases in government spending? Explain your logic.