Regrade policy: If you would like your test regraded, please submit a written statement to explain why. Your entire test will be regraded, so there is a possibility that points could be lost rather than gained.

Multiple Choice:
Version A: 1) d  2) c  3) b  4) c  5) b  6) c  7) a  8) d
Version B: 1) d  2) a  3) d  4) c  5) c  6) b  7) c  8) b

Problem 1: Neoclassical Model
a) \( Y^s = 12 \times 1000^{1/3} \times 1000^{2/3} = 12 \times 1000 = 12,000 \).
\( Y^d = C + I + G = [1000 + 0.6(12,000-2000)] + [3000 - 1000r] + 2200 \)
setting \( Y^s = Y^d \): \( 12,000 = 12,200 - 1000r \)
so \( -200 = -1000r \) so \( r = 0.20 \)
\( W/P = MPL = 12(2/3)K^{1/3}L^{-1/3} = 8 \times 1000^{1/3}1000^{1/3} = 8 \)
The equilibrium condition is that investment must equal saving.

b) Version A: a,a,b,a,c,c  Version B: b,b,a,b,c,c

c) Version A: b,b,a,b,a,b  Version B: a,a,b,a,b,a

Problem 2: Solow Growth Theory
a) golden rule condition: \( MPK = \delta + n \)
Plugging in: \( k^*_{gold}^{1/2} = 0.10 \) so \( k^*_{gold}^{1/2} = 10 \) and so \( k^*_{gold} = 100 \).

b) steady state condition: \( s f(k^*) = (\delta+n) k^* \)
plugging in: \( s 2k^*^{1/2} = 0.10k^* \)
solve for \( s \): \( 2(100)^{1/2} = 0.10(100) \) so \( 20s = 10 \), so \( s = 0.5 \).
Solve for consumption: \( c = (1-s)y = (1-s)2k^*^{1/2} = (1-0.5)2(100^{1/2}) = 0.5*20 = 10 \).

c) A saving rate lower than 0.5 would result in less saving and investment, so that only a smaller capital stock could be maintained as a steady state. Although a larger fraction of output is used for consumption, the total level of output would be so much lower that this is actually a smaller amount of consumption.

A saving rate higher than 0.5 would lead to more saving and investment, so that a larger capital stock can be maintained. But because capital has a diminishing marginal product, the extra level of output is too small to make up for the fact that a smaller fraction of this output is used for consumption.