Homework #4 - Due March 12


3. Why is the IS curve flatter than the investment demand curve?

4. You are given the following information for the economy of Freedonia:
   \[
   c = 100 + 0.8(Y - T) \\
   i = 500 - 5r \\
   G = 400 \\
   T = 400
   \]
   a. Find the equation of the IS curve.
   b. Show that the slope of the IS curve is the same as the slope of the investment demand curve multiplied by one minus the marginal propensity to consume.

5. Prove that a 1 unit increase in government expenditures shifts the IS curve to the right by \( \frac{1}{1 - b} \) units.

6. Why does the demand for money depend on the nominal rate of interest rather than the real rate of interest?


10. In 1968, Congress passed a temporary surcharge on the personal income tax that raised taxes by 10%. The purpose was to restrict household consumption temporarily in order to offset the increased government expenditures due to the Vietnam War. Similarly, in 1974 at the trough of the recession, President Ford’s administration pushed for a tax rebate and social security bonus in order to stimulate consumption demand. Predict the effects of these policies.

11. Describe the evidence that was consistent with Keynes' conjectures of consumption behavior and the evidence that was inconsistent with them. How did Milton Friedman's permanent income hypothesis reconcile the two sets of data?

12. Mankiw, p. 311, Question 1.