Quiz 5

3/3/11

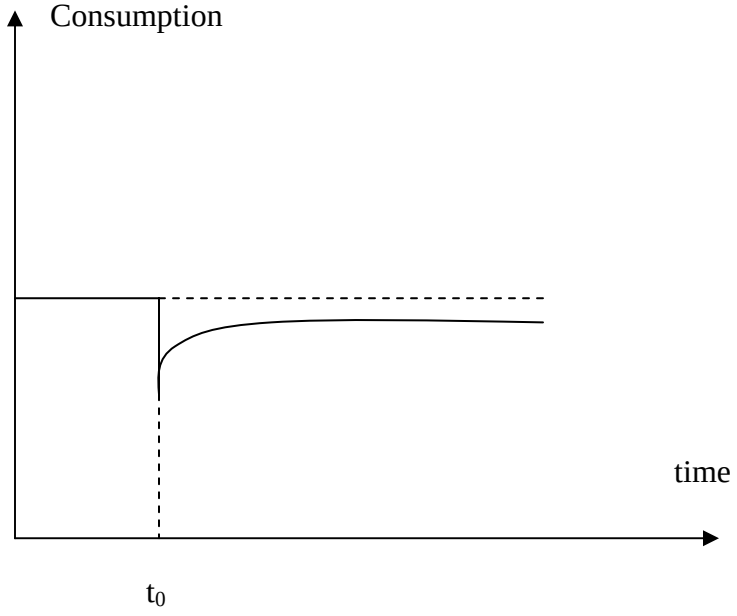
1. Suppose an economy is currently at a steady state. If saving rate increases, then:
A) per capita income first decreases then increases.
B) per capita capital stock first decreases then increases.
C) per capita consumption first decreases then increases.
D) total amount of income first decrease then increases.

Answer: C)
Note: one student asks me this question: if the saving rate is already higher than the Golden-Rule saving rate, is C) still correct?

The answer is: yes, C) is still correct. But the new steady state consumption is NOT as high as before the increase of the saving rate.

In the following graph, at t_0, saving rate increases. First consumption drops, and then increases because total output increases. The steady state consumption, however, never reaches the earlier level.

This is the case where the saving rate before the increase is already higher than the Golden Rule saving rate (like the case in China).



2. If the production function is $Y = K^{0.4}L^{0.6}$. What is the per worker production function?
A) $y = k^{0.4}$
B) $y = k^{0.6}$
C) $Y = K^{0.4}$
D) $Y = L^{0.6}$

Answer: A

3. A steady state for a country is achieved when:
A) the country's saving rate is high.
B) the country's saving = investment.
C) the country becomes rich.
D) the country's investment = depreciation.

Answer: D