

14.05 Midterm: practice questions

1. Solow.

- (a) What would be the effect of hurricane Katrina on growth in New Orleans, assuming that it destroyed a lot of capital but did not cause any migration?
- (b) How would your answer to (1) change if the hurricane caused migration?

2. Ramsey.

Analyze the following events in the framework of the Ramsey model (what happens to the curves in the k - c space and to the dynamics of consumption and capital):

- (a) A permanent change in productivity.
- (b) The government taxes output at 5
- (c) Wasteful government spending that is financed by lump sum taxation.

3. Consumption.

- (a) Write down the conditions under which consumption is constant across time.
- (b) Explain: when the interest rate r is higher than the subjective discount rate ρ (where $\rho = \frac{1}{\beta} - 1$), agents have an increasing consumption path. What prevents agents from consuming their entire lifetime income right before their death, and consuming nothing beforehand?

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