This homework is designed to introduce you to the sort of reasoning that is used in studying macroeconomics. There is no expectation that you will answer these “correctly.” What I want each student to do is to think about the problems and formulate answers that reflect your current understanding of macroeconomics. Grading will be done on the basis of effort.

1. The federal government wishes to stimulate aggregate consumption in the US by reducing personal income taxes. Under plan 1, personal income taxes will be reduced by 10% in 2005 and returned to the current level starting in 2006. Under plan 2, personal income taxes will be reduced by 10% from 2005 to 2015 before returning to current levels. Compare how each of these two plans would affect consumption in 2005, i.e. which one will stimulate consumption more in 2005?

2. The federal government wishes to stimulate aggregate investment in the US. Under plan 1, a 10% investment tax credit (ITC) is implemented for 2005. (By ITC, assume that corporate tax liabilities may be reduced by 10% of a firm’s expenditures on investment goods). Under plan 2, a 10% ITC is implemented for each year from 2005 to 2015. Compare how each of these two plans would affect investment in 2005, i.e. which one will stimulate investment more in 2005?

3. Suppose you are worker at Ford motor company. Assume that stock in the Ford Motor company has an expected return of 5%; however, with probability .5 the return is 4% and with probability .5 the return is 6%. In contrast, Honda stock has an expected return of 5%; with probability .5 the return is 3.8% and with probability .5 and 6.2% with probability .5. Which stock would you buy? Would you answer differ if you were a college professor? Think about how you would assess risk in evaluating investments.

4. Suppose that in 1932, i.e. during the Great Depression, the US government decided to spend $1 billion on road construction. What would the equilibrium effect have been on unemployment? What if the spending was done in 1944, i.e. in the middle of World War II?