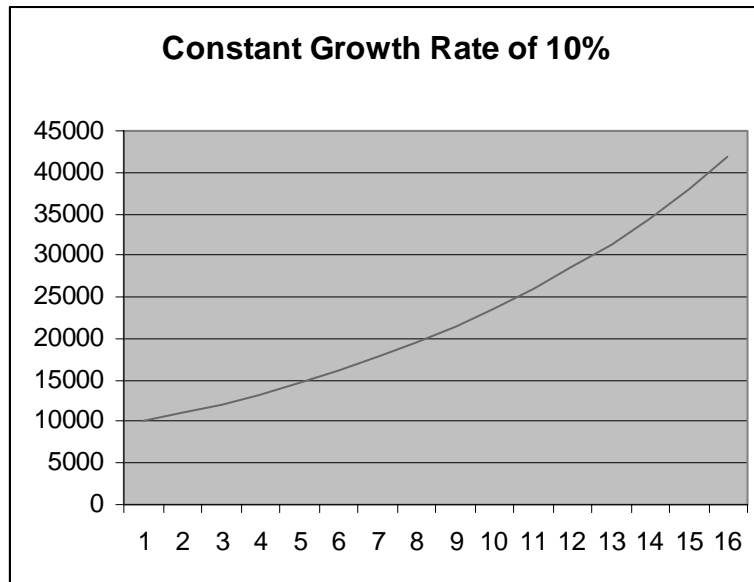


Problem Set 2

I have not finished grading and creating a solution set for pset 2 yet, but it is mostly not very relevant for the exam so don't worry about it. Here are a few comments about things that many of you made mistakes with that on problem set 2 are relevant for the exam though:

- 1) Growth rate is expressed as a percentage, so a constant growth rate will create an exponential graph, not a linear one.



- 2) The Solow model assumes that the rates of savings, population growth, depreciation, and technology growth, are all constant, and the model only makes sense in that context. Therefore, when drawing the graph you should use the averages that you calculated. So the investment curve should be some constant times the output curve, and the $(n+d)*k$ line should be precisely linear, because it is a constant times the value on the x-axis.
- 3) The level of technology should never be negative—you need to assume that A_0 is some positive constant, and even if the growth rate is always negative the LEVEL of technology will remain positive, it will simply get closer and closer to zero. (See graph on reverse.)

Growth rate of -5%

