

- (ii) Use the model to analyze how the pace of job creation and destruction will vary over the business cycle. How does the serial correlation of σ_t affect your answer?
- (iii) Suppose there are barriers to job destruction (e.g. a firing tax). How would you model this? What impact would such barriers have on aggregate consumption, unemployment, and productivity? Use the model to analyze and discuss these issues.
- (iv) Discuss the impact of assuming that workers can pool idiosyncratic risk. If workers could not pool idiosyncratic risk, how might that change your answer to question (iii).

DRAZEN

Question 3. Consider a world where individuals differ in their income and where the government provides public education at the same level to all individuals who choose to become educated.

- a) If all costs of education were covered by the government, financed by a proportional tax on income, show how the public provision of education could act like a transfer from rich to poor. Show how the level of education would be determined in a median voter model.
- b) Now, suppose that education requires a private input as well. Under what conditions could government provision of education act like a reverse transfer, that is, from poor to rich? Demonstrate, when the level of education is exogenous.
- c) Show how this could arise endogenously in a majority voting system, when both the tax rate and the level of education are endogenous.

CALVO

Question 4. Consider a closed economy where

- the government runs a constant real fiscal deficit g , $g > 0$, from 0 to T , $0 < T < \infty$;
- moreover, the government announces, and everybody believes, that the fiscal deficit will become zero starting at time T .

Analyze in terms of a micro-founded monetary model the equilibria that would emerge in the following alternative scenarios:

- i. The fiscal deficit is financed by issuing government bonds.
- ii. The fiscal deficit is financed by issuing high-powered money.

Can these equilibria be Pareto-ranked? Discuss.