1) Consider the following policies designed to increase savings and investment in the United States. For each policy, explain the impact on savings, investment and the interest rate. Also, for each policy, what would be the impact on GDP in the short run (Keynesian analysis) and prices in the long run (classical analysis)?

a) Investment tax credits

*Investment tax credits lower the user cost which will increase investment. Higher investment raises the interest rate and increases savings.*

*The increase in investment shifts IS to the right. In the short term, GDP increases (IS/LM). In the long term, prices rise.*
b) Lowering the tax on interest income.

*Lower taxes will increase savings. Higher savings lowers the interest rate and increases investment.*

The increase in savings shifts IS to the left. *In the short term, GDP falls (IS/LM). In the long term, prices fall.*