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**Fall 2007, Intermediate Macroeconomics, section 2**

## **ECON 219 Quiz II**

**General recommendations:**

- Read questions thoroughly.
- Please respond on this copy.
- You have 20 minutes.
- Work individually.
- There are two pages.
- Good luck!

**Your name:**

1. Circle the appropriate answer on each of the following items. Circle multiple items if necessary:
  - (a) The following aggregate(s) do(es) not behave in a consistent manner across countries: 1) the relative volatility of total hours and output; 2) the relative volatility of average hours and employment; 3) the cyclicalities of government expenses; 4) the relative volatility of investment and output.
  - (b) What did we assume about the firm?: 1) it needs bank credit to operate; 2) it varies the amount of capital according to the business cycle; 3) it behaves competitively; 4) it negotiates wages with a labor union.
  - (c) If there is a technological improvement, labor demand: 1) increases, 2) decreases; 3) does not change; 4) changes in an ambiguous way.
  - (d) Capital in the production function is: 1) money; 2) know-how; 3) machinery; 4) structures.
2. Why do we assume that the household is representative?
3. Graph an indifference curve and explain why it has this curvature.

4. Graph the production function and the labor cost function of the firm. Show where it maximizes profits.

5. What is the difference between the income effect and the substitution effect for the representative household? Explain in words only.

Bonus question: Suppose that the household does not pay a lump-sum tax, but rather a tax proportional to labor income. Explain what the impact of an increase in the tax rate would be on the labor supply.