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Spring 2003, Intermediate Macroeconomics, section 3

ECON 219 Quiz III

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) Changes in government spending are not likely causes of business cycles because government spending induced business cycles would counterfactually predict:
   1) countercyclical consumption; 2) procyclical consumption; 3) countercyclical employment; 4) procyclical employment.

   (b) An increase in total factor productivity shifts the production possibilities frontier (PPF):
   1) upward; 2) downward; 3) changes its slope; 4) does not change its slope.

   (c) The endowment point is the consumption bundle in which:
   1) first-period consumption is zero; 2) second-period consumption is zero; 3) the household maximizes utility; 4) consumption is equal to disposable income in each period.

   (d) An increase in the real interest rate is an example of a:
   1) pure substitution effect; 2) substitution effect and a positive income effect; 3) substitution effect and a negative income effect; 4) substitution effect and an income effect whose sign depends on whether the consumer is a borrower or a lender.

2. In the intertemporal model with two periods, explain why a positive shock to current income leads to a less than proportional increase in current consumption.

3. Explain what the Ricardian equivalence implies for consumption: state what happens to consumption after a modification in the temporal schedule of taxes, and why this happens.

4. Explain how we can verify that a particular type of shock in a particular model is a main contributor to business cycles.

5. Explain what the permanent income is.

Bonus question: Given the pattern of income through a typical American lifetime (including studies, market work, and retirement), what would the intertemporal model, expanded to more than two periods, say about the optimal level of savings through a lifetime? Make a graph.