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**Fall 2003, Intermediate Macroeconomics, section 2**

## **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) We use a two period model because:
    - 1) the business cycle has two phases: contraction and recovery;
    - 2) it is the simplest dynamic model;
    - 3) we want to make a distinction between young and old households;
    - 4) we want to analyse investment.
  - (b) For a borrower in a  $(c, c')$  graph, the optimal consumption bundle is:
    - 1) to the left of the endowment point;
    - 2) to the right of the endowment point;
    - 3) on the endowment point;
    - 4) it depends;
  - (c) Savings in our model are:
    - 1) durable consumption;
    - 2) non-durable consumption;
    - 3) postponed consumption;
    - 4) money.
  - (d) The Ricardian Equivalence says:
    - 1) whatever the level of government expenses, consumption is the same;
    - 2) whatever the timing of the taxes, consumption is the same;
    - 3) higher government expenses reduce consumption;
    - 4) more taxes sooner and fewer taxes later reduce consumption.
2. Imagine that the present value of taxes increases. What does this mean for the lifelong wealth? For consumption today and tomorrow?

3. Explain why the Ricardian Equivalence does not hold if people cannot borrow at their optimal levels.

4. Consumption is less volatile than output in the data. Does our two-period model yield this? Why?

5. Suppose current income increases. Is a borrower better off? A lender? Why?

**Bonus question:** Ricardian Equivalence applies to Federal, State and Local taxation as long as there is no migration. Explain why migration may lead the Ricardian Equivalence to fail.