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Spring 2003, Intermediate Macroeconomics, section 3

ECON 219 Quiz IV

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 Ricardian equivalence theorem implies that:
   1) government debt policy must be handled properly for the economy to prosper; 2) the amounts of government spending are neutral (have no impact); 3) an increase in government spending has has no effect on the economy, as long as there is an equal change in taxes; 4) the timing of taxes collected by the government is neutral.

   (b) When drawn against the real interest rate, the optimal investment schedule shifts to the right if:
   1) current total factor productivity z increases; 2) current total factor productivity z decreases; 3) future total factor productivity z' increases; 4) future total factor productivity z' decreases.

   (c) The marginal cost of investment for the firm is equal to:
   1) 1; 2) -1; 3) MP_K'; 4) $-MP_K'$.

   (d) The assumption that current-period consumption demand is negatively related to the real interest rate is justified as long as:
   1) the income effect dominates the substitution effect; 2) the substitution effect dominates the income effect; 3) the representative consumer is a borrower; 4) the representative consumer is a lender.

2. Why is labor demand independent of the real interest rate?

3. Why is investment demand negatively related to the real interest rate?

4. The government faces a budget constraint every period. How come we can use a single intertemporal budget constraint?

5. What is the consequence of a decrease in the present value of taxes (current and future) on the labor supply?

Bonus question: What is the difference between government debt and government deficit? In reality? In our intertemporal model?