SIMON FRASER UNIVERSITY
Department of Economics

Econ 305 Prof. Kasa
Intermediate Macroeconomic Theory Fall 2015

PROBLEM SET 1
(Due October 29)

The first four questions are True, False, or Uncertain. Briefly explain your answers. No credit without explanation. (5 points each).

1. According to Ricardian Equivalence, government budget deficits are irrelevant.
2. Higher interest rates increase saving.
3. According to Friedman's Permanent Income Hypothesis, the marginal propenisty to consume should be smaller for farmers than for government bureaucrats.
4. Taxing profits reduces investment.
5. (30 points). Suppose household preferences are described by the utility function

$$U(C_0, C_1) = \sqrt{C_0} + \sqrt{C_1}$$

where C_0 stands for current consumption and C_1 stands for future consumption. Suppose the household has current income of $Y_0 = 10$ and future income $Y_1 = 220$. Assume the market interest rate is $r = 10\%$.

(a) Write down the households intertemporal budget constraint.

(b) Calculate the household's optimal consumption in each period. Is the household a saver or borrower? Explain why.