

Place your name on the back of this sheet of paper and nowhere else. Staple your answers face up on the front of this sheet of paper. Failure to follow these directions will cost you 10 points. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to type it will cost you 10 points. If you use double-sided printing or print on the back of scrap paper, I will give you one additional point.

- 1) (15 points) Explain $c = b_p y_p + b_t y_t$. Since the b 's are coefficients, you do not need to explain what happens when they change. However, I would like an estimated value for both and explain how you reached that conclusion for the value.
- 2) (15 points) Draw the inter-temporal budget constraint. Illustrate the effects of a temporary tax cut. Explain why the curve moved as drawn.
- 3) (15 points) Draw the inter-temporal budget constraint. Illustrate the effects of a decrease in the interest rate. Explain why the curve moved as drawn.
- 4) (20 points) An increase in the interest rate has two effects upon saving. What are they? Which do we assume is bigger? Explain how that relates to the shape of the saving line.
- 5) (25 points) Draw Modigliani's Life-Cycle model. Illustrate the effects of a temporary tax cut. Explain why the curve(s) moved as drawn. What happens to the level of saving? Explain your logic.
- 6) (10 points) What do Questions #1 and #5 implicitly assume about human behavior? Do you think that is a valid assumption? Explain your logic.