

Do not write your name on the assignment. Write your name only on the back of this sheet of paper and staple your answers on the front of this sheet of paper. Failure to follow these directions will cost you 1 point on the assignment.

- 1) (15 points) Bethany College gave all employees a \$500 bonus at Thanksgiving. According to Friedman, would you expect there to be a small or large increase in the spending by employees? Explain your logic.
- 2) (20 points) Explain how the existence of durable goods can cause problems in estimating the MPC.
- 3) (25 points) On page 255, the book says that “a movement to more equality in distribution of income will raise the level, and possibly the slope too, of the consumption function. . . This deduction is based on the fact that studies of income and its disposition at the level of the household show that families in the lower-income brackets have a higher average propensity to consume than families in the higher-income brackets.” As described, neither the slope of the consumption function nor the level of consumption need to increase. Use the consumption function that we had from Keynes and use it to explain how a higher APC for the poor does not mean that a redistribution of income will change consumption.
- 4) (20 points) Use the discount formula (a.k.a. the PV formula) to explain why there is more investment when interest rates are low.
- 5) (20 points) Which MPC, the short-run or the long-run MPC, is important for fiscal policy? Explain your logic.