In-class review questions:

*Consumption and Saving.*

1. If the Ricardian equivalence holds true, the federal government will be prevented by the size of the deficit from taking any action to stimulate the economy any further.
   a. What fiscal action would the government take to stimulate the economy?
   b. Explain why this type of action may be ineffective if there is a large budget deficit.

2. We saved 17 percent of our disposable income during the recession, the highest rate since World War II. The level of saving has fallen off since then to less than 10 percent of disposable income.
   a. Would the higher saving rate have eased or exacerbated the recession? Explain why.
   b. Explain how the saving rate reflects our future income expectations and how it relates to future consumption (after retirement.)

3. Even if Ricardian equivalence does not hold true, a high level of debt per household may render tax cuts ineffective to increase the overall level of economic activity.
   a. Justify this statement. Under what circumstances may this not be the case?
   b. Explain how your answer to the previous question affects the saving rate of households.

4. Government officials these days are preaching that consumers had better start spending. Fears of unemployment have decreased _____ and so curtailed _____, therefore dramatically reducing tax revenue.
   a. Fill in the blanks.
   b. Why would an economist urge households to increase consumption in this situation?

5. Fears have been expressed that financing of the federal deficit might squeeze private borrowers out of the market.
   a. By what mechanism are private borrowers squeezed out of the market?
   b. What are the long-run consequences on economic growth of this phenomenon?