Department of Economics
Queen's University

Econ320: Macroeconomic Theory II

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Tutorial 3

Long Question 1. Consider the impact of an increase in thriftiness in the Keynesian cross. Suppose the consumption is:

$$C = \overline{C} + c(Y - T),$$

where $\overline{C}$ is a parameter called *autonomous consumption* and c is the marginal propensity to consume.

a. What happens to equilibrium income when the society becomes more thrifty, as represented by a decline in $\overline{C}$

b. What happens to equilibrium saving?

c. Why do you suppose this result is called the *paradox of thrift*?

True or False

1. Consider a household that lives for two periods and chooses its consumption path optimally. An increase in the interest rate will cause him to increase consumption in at least one period.