

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) (35 points) Draw the SRAS/LRAS/AD diagram with the economy in a recessionary gap. What type of fiscal policy is best for this situation? Why did you make that choice? Illustrate that policy on the diagram. Explain why the curve(s) moved as drawn.
- 2) (15 points) Some people claim that the Reagan administration's expansionary fiscal policy "crowded out investment." Explain what that phrase means and why it would occur. Also, explain the long-run impact of "crowding out investment."
- 3) (20 points) Explain *Ricardian equivalence*. The book says evidence of its validity or invalidity is inconclusive. Do you believe it? Why or why not?
- 4) (30 points) Use the Laffer curve to explain why the Kennedy tax cuts increased tax revenue. (Kennedy cut the top marginal tax bracket from 92% to 75%.) What do you think was the long-term impact of the Kennedy tax cuts? Explain your logic.