

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. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to follow these directions will cost you 1 point on the assignment.

Because of the Economics Club trip, I will not be in class on Friday. Therefore, this assignment will be due on Monday of next week. The class will be made up by handing back the exam with an answer key on Monday of next week.

- 1) (25 points) Illustrate an increase in government spending on the 45° diagram, a.k.a. Keynesian Cross diagram. Using your graph, estimate the size of the autonomous expenditure multiplier. Explain how you came to your estimate and explain why the curve(s) moved as drawn.
- 2) (20 points) When we calculated the autonomous expenditure multiplier, we made an assumption about prices. What was that assumption? What would happen to the size of the multiplier if that assumption was relaxed? Why would that occur?
- 3) (20 points) When we calculated the autonomous expenditure multiplier, we made an assumption about taxes. What was that assumption? What would happen to the size of the multiplier if that assumption was relaxed? Why would that occur?
- 4) (10 points) Suppose the MPC is 0.8. Ignoring the effects mentioned in questions #2 and #3, how much would the government have to change its spending if it wanted to increase GDP by \$10 Billion? Show all work and briefly explain your answer.
- 5) (25 points) What is crowding out? Explain why it occurs and the problem with it.