

Place your name on the back of this sheet of paper and nowhere else. Staple your answers face up on the front of this sheet of paper. Failure to follow these directions will cost you 10 points. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to type it will cost you 10 points. If you use double-sided printing or print on the back of scrap paper, I will give you one additional point.

1) (15 points) According to The Balance (citing the American Economic Review), when President Bush mailed out checks to some taxpayers, “A 2008 survey found that only 20% of those who received checks spent them. Another 32% put the money into savings. The rest use the checks to pay off debt.” Which theory that we discussed explains this behavior? Explain your logic. (Note that paying down debt is a form of saving.)

<https://www.thebalance.com/bush-economic-stimulus-package-3305782>

2) (20 points) Draw the SRAS/LRAS/AD diagram. Illustrate the effects of the recent increase in the price of oil. Explain why the curve(s) moved as drawn. What happened to GDP, inflation, and the unemployment rate?

3) (25 points) Draw the SRAS/LRAS/AD diagram starting in a recessionary gap. Explain how you know the diagram shows a recessionary gap. If the government takes no action, how will the economy’s self correcting mechanism bring the economy back to full employment? Explain why that occurs and why that moves the curve(s). What happens to GDP, inflation, and the unemployment rate?

4) (25 points) According to the Bureau of Labor Statistics, the unemployment rate in February of 2020 was 3.5%. Draw the LRAS/SRAS/AD diagram which shows that situation. Explain how you know that it shows an unemployment rate of 3.5%. What was the best fiscal policy at that time? Illustrate the effects of that on the graph. Explain why the curve(s) moved as drawn. What happened on your graph to GDP, inflation, and the unemployment rate?

<https://data.bls.gov/timeseries/LNS14000000>

5) (15 points) One reason why counter-cyclical fiscal policy may not work well is direct expenditure offset. Explain that reason. Is that a strong or weak argument? Explain your logic.