

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) (30 points) The government has three options to finance a new expenditure. The options are to collect more taxes, borrow, or print more money. Since the latter is monetary policy, we will ignore it for this question. Why do some economists say that an increase in government spending will not stimulate GDP whether it is financed through borrowing or taxes?

2) (20 points) The book says that there are three lags in fiscal policy. What is meant by "lags in fiscal policy"? Why is it important that we understand how long they are?

3A) (25 points ) Illustrate on the LRAS/SRAS/AD diagram an increase in government spending that causes crowding out. Show both the increase in government spending and the crowding out. Explain why the curve(s) moved as drawn.

3B) (25 points) What are the long-term effects of crowding out? Illustrate that on a new LRAS/SRAS/AD diagram and explain the movement(s) of the curve(s).