

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 1 point. 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) (25 points) Draw the Keynesian Cross, a.k.a.  $45^\circ$  diagram. Illustrate the effects of an increase in government spending. Explain why the curve(s) moved as drawn. Given your diagram, what is the size of the government spending multiplier? Show all work and explain your logic.
- 2) (15 points) When we calculated the government spending multiplier, we assumed what about the income tax? If we relaxed that assumption, then what will happen to the size of the multiplier? Explain your logic.
- 3) (25 points) What is meant by *crowding out*? Explain how it occurs and why that is so bad for the economy. Do you think it is occurring now? Explain your logic.
- 4) (15 points) Explain *Ricardian Equivalence*. Do you believe it? Why or why not?
- 5) (10 points) What are the automatic stabilizers? Explain why they got that name?
- 6) (10 points) What are the lags in fiscal policy? Explain how they may mean that counter-cyclical fiscal policy may worsen the economy.