

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 45° diagram, a.k.a., the Keynesian Cross diagram. Illustrate the effects of an increase in government spending. Explain why the curve(s) moved and drawn. Given your diagram, what is the size of the government spending multiplier? Explain how you estimated the number.
- 2) (15 points) For each problem with fiscal policy, explain why that problem may yield fiscal policy ineffective or less effective than originally thought.
 - A) Direct expenditure offset.
 - B) Crowding out.
- 3) (15 points) What are the three automatic stabilizers? Explain how they earn that name.
- 4) (20 points) Draw the LRAS/SRAS/AD diagram for an economy in a recessionary gap. Explain how you know it is in a recessionary gap. What fiscal policy should be done to correct the problem? Illustrate that on the graph and explain why the curve(s) moved as drawn.
- 5) (10 points) Assuming that Ricardian Equivalence holds, how effective do you think the temporary payroll tax cut (which was passed in February and will last until the end of the year) will be for stimulating the economy? Explain your logic.