

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 an SRAS/LRAS/AD diagram for a country in a recessionary gap. State how you know it is in a recessionary gap. What should the government do if their goal was to bring the economy back to full employment. Illustrate the effects of that action on the diagram. Explain why the curve(s) moved as drawn. What happens to the price level and real GDP?
- 2) (20 points) Crowding out can make expansionary fiscal policy less effective and can hurt the economic growth in the future. Explain why crowding out occurs, how it makes expansionary fiscal policy less effective, and how it can hurt future economic growth.
- 3) (20 points each) For each of the following reasons that counter-cyclical fiscal policy might not work, explain why that could make counter-cyclical fiscal policy less effective. Do you think it is a strong or weak argument in most cases? Explain your logic. Answer each part in separate paragraphs.
 - A) Ricardian Equivalence
 - B) Direct expenditure offset
- 4) (15 points) What are the two automatic stabilizers? Explain why they are called that.