

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) (15 points) Crowding out is a reason why countercyclical fiscal policy may not work. Explain what it is and why that makes countercyclical fiscal policy less effective. (Basically this is asking for a particular reason why the government spending multiplier is not as big as we first said.)
- 2) (25 points) Draw the LRAS/SRAS/AD diagram for a country in a recessionary gap. Explain how you can tell the graph shows a recessionary gap. What type of fiscal policy should be done? Illustrate the effect of that policy on the graph. Explain why the curve(s) moved as drawn.
- 3) (20 points) What are direct expenditure offsets? Explain why they may make countercyclical fiscal policy less effective. What is a problem with that argument for some cases?
- 4) (20 points) What are the three automatic stabilizers? Explain why they are called that.
- 5) (20 points) What is meant by Ricardian Equivalence? Explain why it may make countercyclical less effective. Do you believe it holds? Why or why not?