

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 10 points. 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) (10 points) The book says that “creative destruction” will help the economy grow. Explain how it helps the economy.
- 2) (20 points) Draw the 45° diagram, a.k.a. Keynesian Cross. Illustrate the effects of a decrease in the MPC. Explain why the curve(s) moved as drawn. What happens to GDP?
- 3) (20 points) Draw the 45° diagram, a.k.a. Keynesian Cross. Illustrate the effects of an increase in the interest rates. Explain why the curve(s) moved as drawn. What happens to GDP?
- 4) (25 points) Draw the 45° diagram, a.k.a. Keynesian Cross. Illustrate the effects of an increase in government spending. Explain why the curve(s) moved as drawn. What happens to GDP? Given your diagram, what is the size of the government spending multiplier? Explain your logic and/or your calculation.
- 5) (15 points) When we used mathematics to calculate the government spending multiplier, we implicitly made some assumptions. What did we assume about tax revenue? If we relax that assumption (no longer assume that), then what would happen to the size of the government spending multiplier? Explain your logic.
- 6) (10 points) Suppose a person has a consumption function of $C = 1000 + .8(Y-T)$ and \$10,000 in disposable income. What is her MPC and APC? Show all work. If there is no work, explain how you reached your conclusion.