

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) (20 points) Draw the SRAS/LRAS/AD diagram. Illustrate the effects of a decrease in the price of oil. Explain why the curve(s) moved as drawn. What happens to the price level and real GDP?

2) (20 points) Draw the SRAS/LRAS/AD diagram with the economy in a recessionary gap. State how you know your graph shows a recessionary gap. Illustrate how the economy would get back to equilibrium if the government took no action. Explain why the curve(s) moved as drawn. What happens to the price level and real GDP?

3) (30 points) Is our economy in an inflationary gap or a recessionary gap? Briefly explain your logic. Draw the SRAS/LRAS/AD diagram with the current economic situation. State how you know your graph shows the correct type of gap. What type of fiscal policy is the best policy? Briefly state how you reached that conclusion. Illustrate the effects of the government action. Explain why the curve(s) moved as drawn. What happens to the price level and real GDP?

4) (10 points) Crowding out may render counter-cyclical fiscal policy less effective. Explain how this would occur.

5) (20 points) Ricardian Equivalence may render counter-cyclical fiscal policy completely ineffective. Explain how this would occur. Do you believe that happens most of the time? Explain your logic.