

Do not write your name on the assignment. Write your name only on the back of this sheet of paper and staple your answers on the front of this sheet of paper. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to follow these directions will cost you 1 point on the assignment and failure to type it will cost you 10 points.

1) (30 points) Illustrate on the 45° diagram, a.k.a., the Keynesian Cross diagram, an increase in government spending. Explain why the curve(s) moved as drawn. Given your diagram, what would estimate to be the value of the autonomous expenditure multiplier? Explain your logic. Why isn't your estimate the 10 that we calculated in class?

2) (15 points) When we calculated the autonomous expenditure multiplier, we assumed what about the existence of an income tax? If we relax this assumption (make a more realistic assumption), then what would happen to the size of the multiplier? Explain your logic.

3) (15 points) When we calculated the autonomous expenditure multiplier, we assumed what about the interest rates? If we relax this assumption (make a more realistic assumption), then what would happen to the size of the multiplier? Explain your logic.

4) (15 points) When we calculated the autonomous expenditure multiplier, we assumed what about whether the economy is open or closed? If we relax this assumption (make a more realistic assumption), then what would happen to the size of the multiplier? Explain your logic.

5) (25 points) The article below is from [The Economist](#). It was written last October. It says that Bush's plan to make the tax cuts permanent is the most important problem for the economy's long-run growth. Why is this true? Explain your logic with an appropriate diagram.

The economy and the election

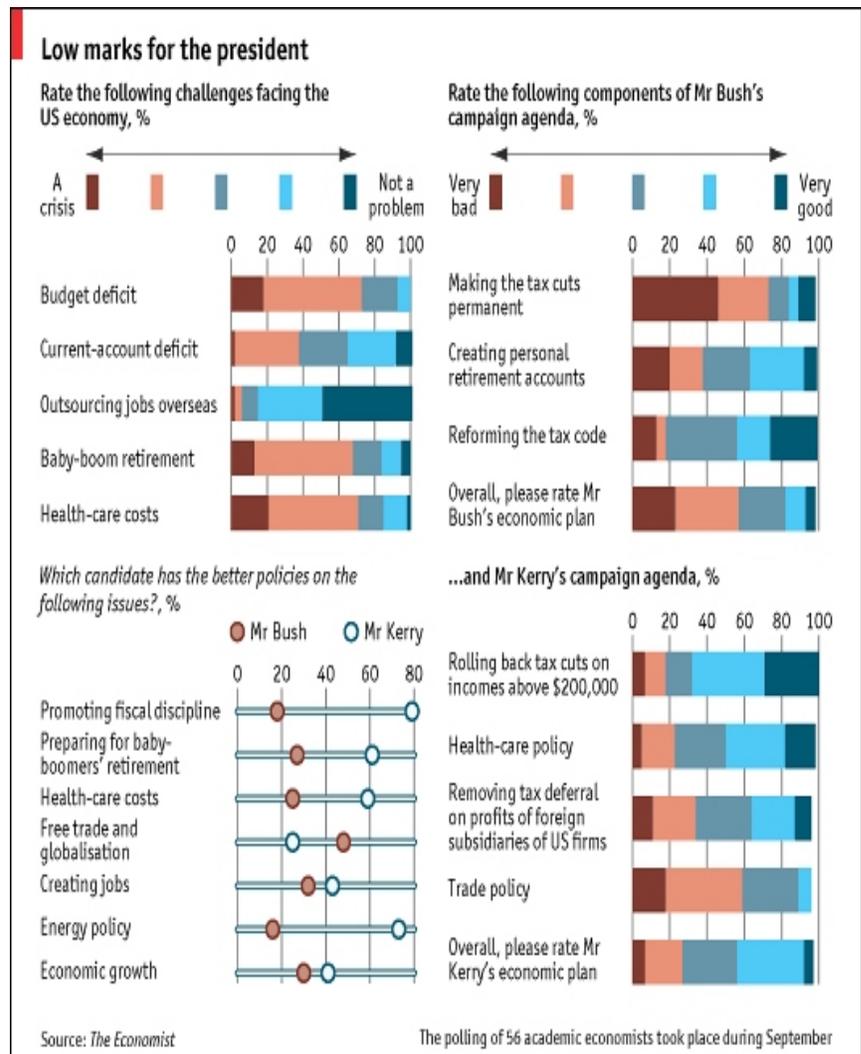
The dismal science bites back

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>From The Economist print edition

George Bush comes out worst in our poll of academic economists

WOULD John Kerry or George Bush do a better job stewarding America's economy? Judging by the polls, voters are not sure. Within the past couple of months both candidates have had narrow leads on the issue. Ask economics professors, however, and you get a clearer answer.

In an informal poll of 100 academics,



conducted by The Economist, Mr Bush's policies win low marks. More than 70% of the 56 professors who responded to our survey rate Mr Bush's first-term economic policies as bad or very bad. Fewer than 20% give positive marks to Mr Bush's second-term economic agenda, and almost six out of ten disapproved. Mr Kerry hardly got rave reviews either, but his economic plan still fared better than the president's did. In all, four out of ten professors rated Mr Kerry's economic plan as good or very good, but 27% gave it negative scores. (The complete numbers are available at www.economist.com/economistpoll.)

Are our economists partisans? We chose their names, at random, from among the referees of the American Economic Review, one of the profession's more prestigious publications. Conservatives often moan that university professors are all left-wingers. Though most of our professors claim they are not interested in working in Washington, 80% of those who would accept a policy job would prefer to work for Mr Kerry. However, even if you allow for some partisanship, the results are fairly striking.

A third of the economists reckon the economy is in good or very good shape; about half give a neutral response, and one in five deems the economy to be weak. They are almost equally split about how much responsibility the Bush administration deserves for the state of today's economy. Just over a third assign some or all credit or blame to the president; another third think he has had little or nothing to do with it.

Despite their diverse assessments of today's economy, the professors are overwhelmingly critical of the central plank of Mr Bush's economic policy—tax cuts. More than seven out of ten respondents say the Bush administration's tax cuts were either a bad or a very bad idea, and a similar proportion disapproves of Mr Bush's plans to make his tax cuts permanent. By contrast, Mr Kerry's plan to roll back the tax cuts for people with incomes over \$200,000 wins the support of seven in ten of them. (This poll was taken before October 4th, when Mr Bush signed into law his fourth tax cut, which extended several popular components of earlier tax cuts that were due to expire at the end of this year, including the child tax credit.)

The broad condemnation of tax cuts seems to be linked to the professors' worries about America's fiscal health and the looming retirement of the baby-boom generation. Although Americans overall seem relatively unconcerned about the budget deficit, a large majority of the economists rate it as a serious problem for the economy, with almost one in five describing it as a crisis. And they back Mr Kerry by a large margin (79% to 18%) to do more to promote fiscal discipline than Mr Bush. In contrast, the boffins seemed much less concerned by the current-account deficit; only one respondent called it a crisis, and close to 20% deemed it either a small problem or no problem at all.

Health care also seems to be an issue that pushed our economists towards Mr Kerry. More than 70% of the academics reckoned health-care costs were a serious problem for the economy—and they preferred Mr Kerry's plans to control those costs by a margin of 59% to 25% (with the rest ducking the question).

There was some good news for Mr Bush on tax reform. More than 40% of the academics hail his plan to simplify the tax code as a good or very good idea—twice as many as think it bad or very bad. Mr Kerry's main tax-reform proposal—ending the ability of foreign subsidiaries of American firms to defer taxes on their profits—was less well received. Around a third of the professors thought that was a good or very good idea, a third were neutral, and a third thought it was a bad idea.

On entitlement reform, the academics' opinions are harder to interpret. They are evenly split on the merits of Mr Bush's proposal to reform Social Security by creating personal retirement accounts: 36% think it is a good or very good idea, 38% a bad or very bad idea. Oddly, most of them think Mr Kerry offers better plans for dealing with the baby-boomers' retirement, even though he has not actually made any concrete proposals for entitlement reform.

One area where the economists clearly favour Mr Bush is trade. Mr Kerry's ranting about outsourcing has irritated economists: a huge majority dismiss outsourcing as either a small or non-existent problem, and almost 60% give Mr Kerry's trade policy a bad or very bad rating. Although they are plainly not wild about Mr Bush's record on trade, they back him by a margin of almost two-to-one to do more to help free trade and globalisation than Mr Kerry would.