

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) (20 points) When we used the Keynesian cross, a.k.a. 45° diagram, to develop the autonomous expenditure multiplier, we made some assumptions. What did we assume about the income tax? If we relax that assumption, then what would happen to the size of the multiplier? Explain the logic.
- 2) (25 points) What is meant by *Ricardian Equivalence*? Explain why it might hold. Do you believe it? Explain your logic.
- 3) (20 points) What are the automatic stabilizers? How do they work and why are they called that?
- 4) (15 points) What is wrong with this argument? “The government debt and deficit will have to be paid by our children and grand-children. That is why it is bad.”
- 5) (20 points) What is meant by “lags in policy”? Why might they mean that fiscal policy should not be done?

Note the table on page 319 and the accompanying graph are misleading in my opinion. The reason is that basically, it subtracts out the money from the social security fund that is used to finance other government spending. It is misleading because they say it is the government owing the government so is unimportant. In reality, it is owed to the social security recipients, so it should not be subtracted out. If you do not subtract it out, according to the US Treasury, on March 29th it was \$8,367,661,575,867.99 or nearly twice the deficit in the book. See <http://www.publicdebt.treas.gov/opd/opdpenny.htm> and according to http://www.brillig.com/debt_clock/ that is \$28,005.74 per citizen. According to NASA's web page, http://map.gsfc.nasa.gov/m_uni/uni_101age.html the universe is 13.7 billion years old. If you believe that number, then if you were to receive 6.96 cents every hour from the beginning of the universe until now and earned no interest, you would still not have enough to pay off the debt.