

Do not put your name anywhere on the assignment, other than on the back of this sheet of paper. Staple your answers 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 do double-sided printing or print on the back of scrap paper, I will give you one additional point.

- 1) (25 points) Currently, the USA is in an inflationary gap. Illustrate that on the SRAS/LRAS/AD diagram. Show the inflationary gap on the graph. What type of discretionary fiscal policy should be done? Explain your logic. Show that on the graph and explain why the curve(s) moved as drawn.
- 2) (25 points) Draw the Keynesian Cross diagram, a.k.a. 45° diagram. Illustrate an increase in government spending without the crowding out effect. Explain why the curve(s) moved as drawn. Suppose there is crowding out. Explain what that is and show it on the graph. Explain why the curve(s) moved as drawn.
- 3) (15 points) What is Ricardian Equivalence? Do you believe it? Explain your logic.
- 4) (20 points) What are the “lags with fiscal policy”? Why might they cause a government to not do fiscal policy?
- 5) (15 points) What are the automatic stabilizers? Why are they called that?