

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 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 use double-sided printing or print on the back of scrap paper, I will give you one additional point.

1) (15 points) Suppose the government spending is \$300, transfer payments are \$150, tax revenue is \$400, and the bonds outstanding total \$1200. How much is the government deficit and how much is the government debt? Explain your answer and show all work.

2) (15 points) For each problem with fiscal policy lags, explain why that problem may yield fiscal policy ineffective or less effective than originally thought.

3) (25 points) Draw the SRAS/LRAS/AD diagram starting at equilibrium. Illustrate the effects of an increase in government spending. Then illustrate the effects of crowding out on the graph. Explain both movements of the curve(s). What happens to the effectiveness of fiscal policy to change GDP?

4) (15 points each) When we estimated the size of the government spending multiplier, we assumed many variables were constant. For each of these variables, explain how relaxing that assumption (letting the variable change) will affect the size of the multiplier. In other words, if that variable can change, will the multiplier be bigger or smaller?

A) No income tax.

B) No change in imports.

C) No change in prices.