Econ 2020 Homework 4

Instructions:

Homework assignments are optional – there is no penalty for not completing an assignment.

If you like, you can work with other students in the class. Just turn in one assignment per group and include all names (assuming you have the same TA).

Each student can earn up to 2 points per homework. The points will be added to the highest of the first two exam scores.

You can turn in the work at the beginning of class or send the homework to your TA by email.

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The deadline to submit your work is Tuesday, March 14th.

If you have any questions, please ask at the beginning of class.

1) What does crowding out refer to?

   Why does crowding out occur?

2) As discussed in class, the table shows empirical estimates of the fiscal policy multipliers. The absolute value is used for the tax multipliers. For each cell, a, b, c and d, answer the following.

   • What is the fiscal policy that is applied?
   • What is the role of the Federal Reserve?
   • For every dollar change in fiscal policy, what is the additional change in GDP?
   • Does Crowding out occur?
<table>
<thead>
<tr>
<th></th>
<th>No Change in interest rates (r)</th>
<th>Interest rates change</th>
</tr>
</thead>
<tbody>
<tr>
<td>$\Delta Y / \Delta G$</td>
<td>1.93 (a)</td>
<td>0.60 (b)</td>
</tr>
<tr>
<td>$\Delta Y / \Delta T$</td>
<td>1.19 (c)</td>
<td>0.26 (d)</td>
</tr>
</tbody>
</table>

Cell a

Cell b

Cell c

Cell d
3) Holding everything else constant, assume President Trump increases annual defense spending by $50b above the current level.

Given the current state of the US economy, which of the above cells a, b, c, or d reflects the likely macroeconomic outcome?

Explain your answer.