

NY

=

AT

NC

=

NY

We know we want Equilibrium GDP to increase by 1,000:

$$\Delta Y = 1,000$$

Effect on Consumption:

Effect on the Budget Deficit:

$$\Delta \text{Deficit} \equiv \Delta G - \Delta T$$

The Tax Multiplier

$$\left(\frac{-MPC}{1-MPC} \right)$$

$$\left(\frac{-0.8}{1-0.8} \right)$$

$$\left(\frac{-0.8}{0.2} \right)$$

(-4)

(Tax Multiplier)

$$\Delta C = 1,000$$

$$\Delta \text{Deficit} = 0 - (-250) = +250$$

Assume: $MPC = 0.8$

Recessionary Gap:

$$7,000 - 6,000 = 1,000$$

NY = 1,000

1,000 = ∇T

(-4)

$\Delta T = 1,000/-4$

NT = 250

The Government must decrease Taxes by 250
in order to close a 1,000 Recessionary Gap

A 250 decrease in Taxes will
increase the Deficit by 250

Recessionary Gap:
 $7,000 - 6,000 = 1,000$

We know we want Equilibrium GDP to increase by 1,000:
 $\Delta Y = 1,000$

Effect on Consumption:

$$\Delta C = 1,000$$

Effect on the Budget Deficit:

$$\Delta \text{Deficit} = 0 - (-250) = +250$$

$$\Delta T = 1,000 / -4$$

$$\Delta T = -250$$

The Government must decrease Taxes by 250
in order to close a 1,000 Recessionary Gap

A 250 decrease in Taxes will
increase the Deficit by 250

