$$\Delta Y = \Delta T$$

$$\Delta C = \Delta Y$$

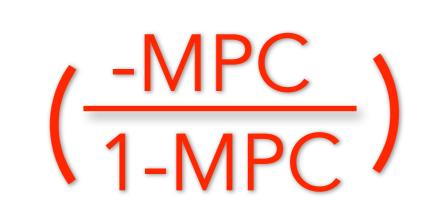We know we want Equilibrium GDP to decrease by 2,000:

$$\Delta Y = -2,000$$

Effect on Consumption:

Effect on the Budget Deficit:

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

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)

ΔC = -2,000

$$\Delta \text{ Deficit} = 0 - (500) = -500$$

Assume: MPC = 0.8

Recessionary Gap:
7,000 - 9,000 = - 2,000

$$\Delta Y = -2,000$$

-2,000 = ΔT

(-4)

$$\Delta T = -2,000/-4$$

$$\Delta T = +500$$

The Government must increase Taxes by 500 in order to close a 2,000 Inflationary Gap

A 500 increase in Taxes will decrease the Deficit by 500

Recessionary Gap:
7,000 - 9,000 = - 2,000

We know we want Equilibrium GDP to decrease by 2,000:
ΔY = - 2,000

Effect on Consumption:

ΔC = -2,000

Effect on the Budget Deficit:

ΔT = - 2,000/-4

Δ Deficit = 0 - (500) = - 500

ΔT = + 500

The Government must increase Taxes by 500 in order to close a 2,000 Inflationary Gap

A 500 increase in Taxes will decrease the Deficit by 500