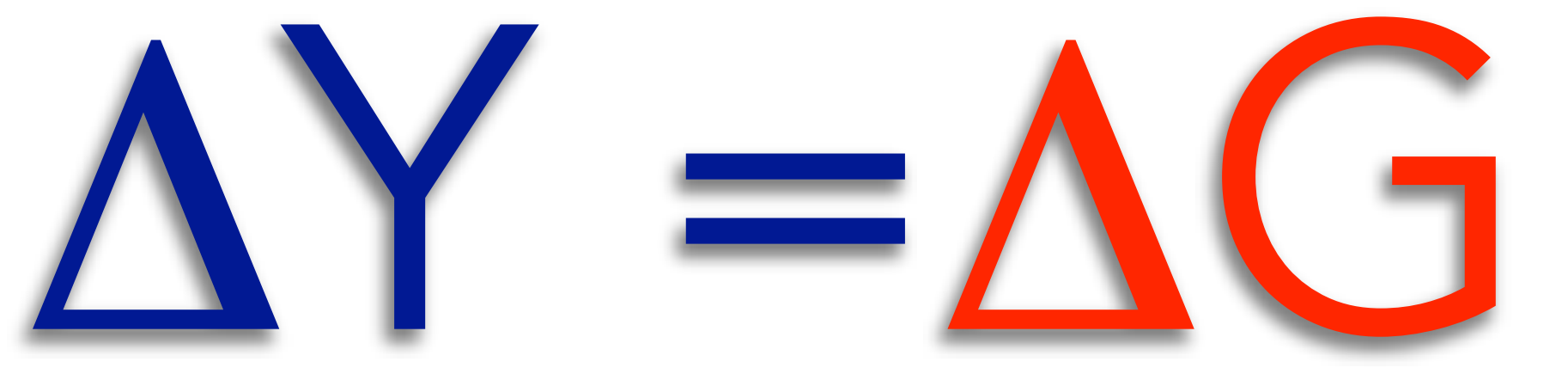

ΔY = ΔG

$$\Delta C = \Delta Y \text{ (MPC)}$$

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 Spending Multiplier


1
1-MPC

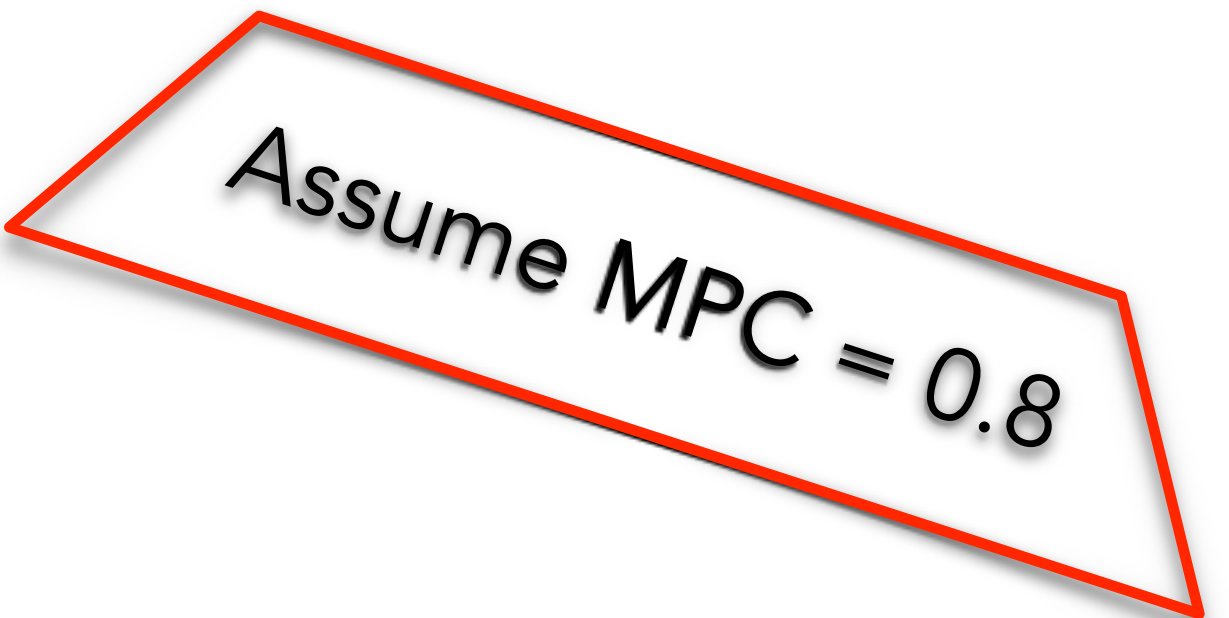

1
1-0.8


1
0.2

(Multiplier)

$$\Delta C = -2{,}000(0.8) = -1{,}600$$

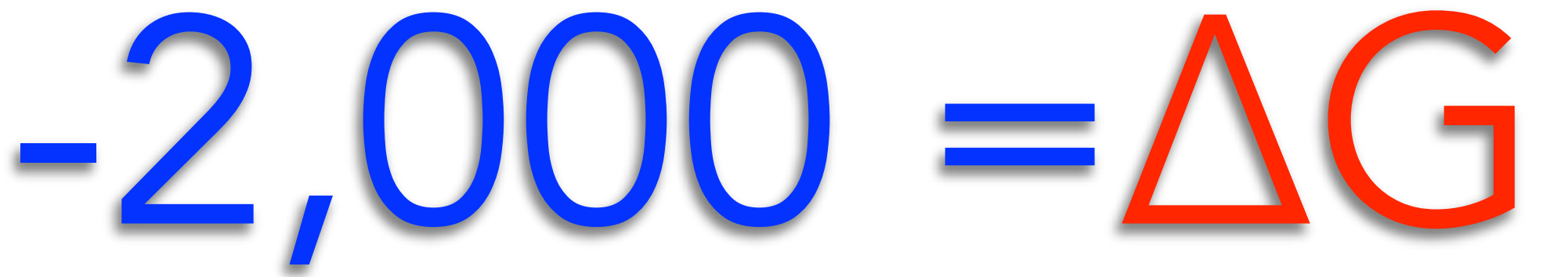
Δ Deficit $= -400 - 0 = -400$


Assume MPC = 0.8

Inflationary Gap:

7,000 - 9,000 = - 2,000

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


-2,000 =ΔG


5

$$\Delta G = -2{,}000/5$$

$\Delta G = -400$

The Government must decrease G by 400 in order to close a 2,000 Inflationary Gap

A 400 decrease in G will decrease the Deficit by400

Inflationary Gap:

7,000 - 9,000 = - 2,000

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

$\Delta Y = -2,000$

$\Delta G = -2,000/5$

$\Delta G = -400$

The Government must decrease G by 400 in order to close a 2,000 Inflationary Gap

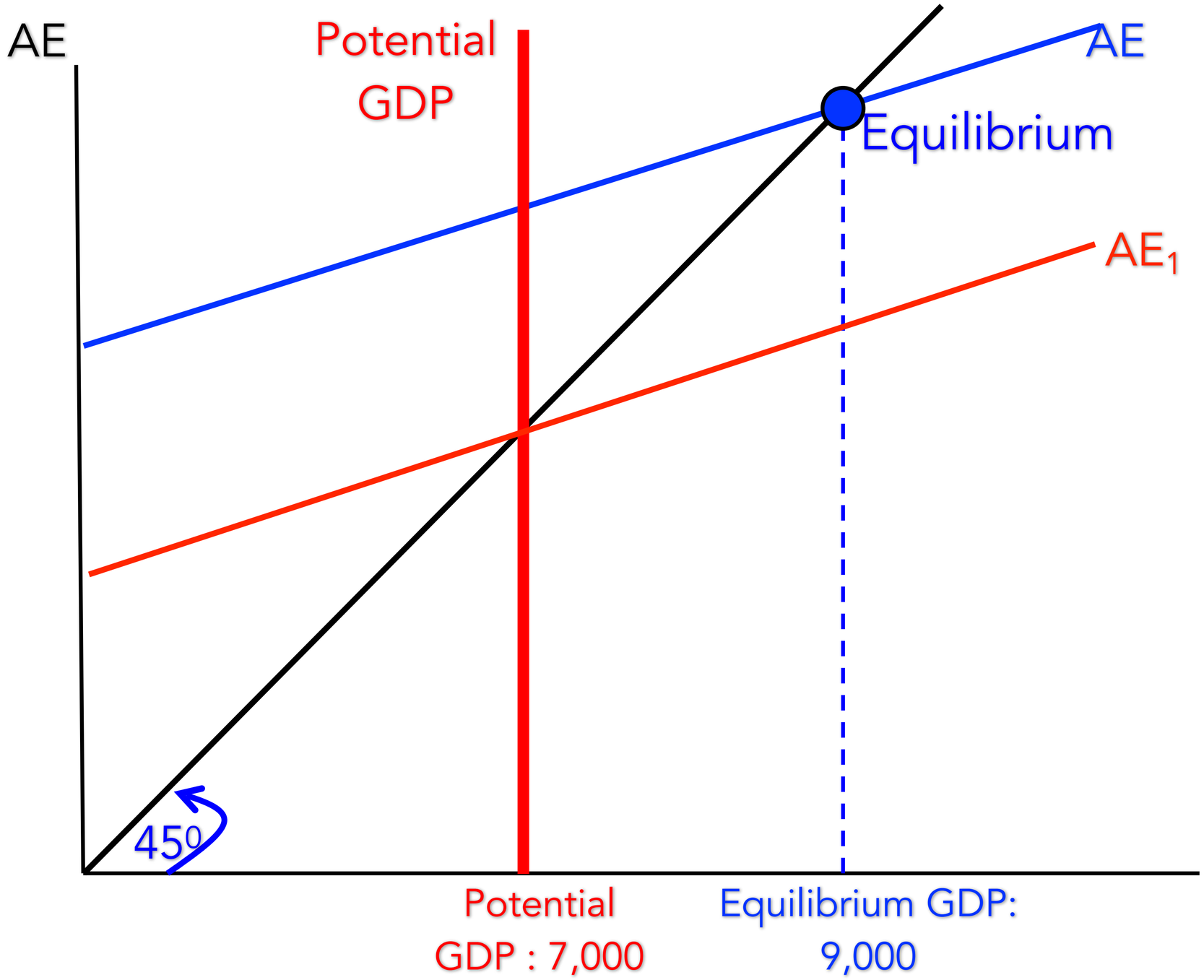
Effect on Consumption:

$\Delta C = -2,000(0.8) = -1,600$

Effect on the Budget Deficit:

Δ Deficit $= -400 - 0 = -400$

A 400 decrease in G will decrease the Deficit by400


AE
Potential
GDP
AE
Equilibrium
AE1
45⁰
Potential
GDP : 7,000
Equilibrium GDP:
9,000