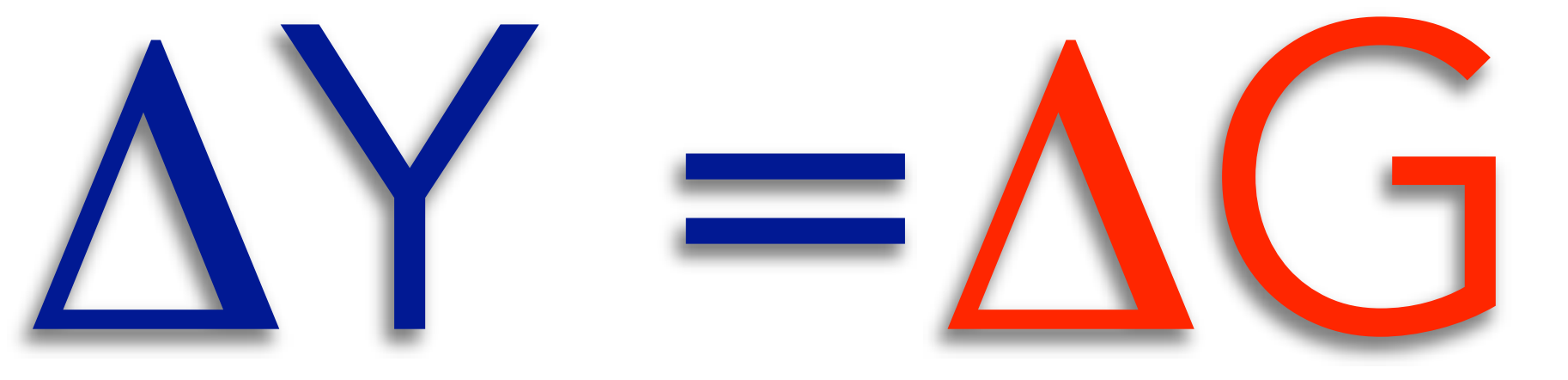

ΔY = ΔG

$\Delta C = \Delta Y$ (MPC)

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

$$\Delta Y = 1{,}000$$

Effect on Consumption:

Effect on the Budget Deficit:

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

The Spending Multiplier


1
1-MPC

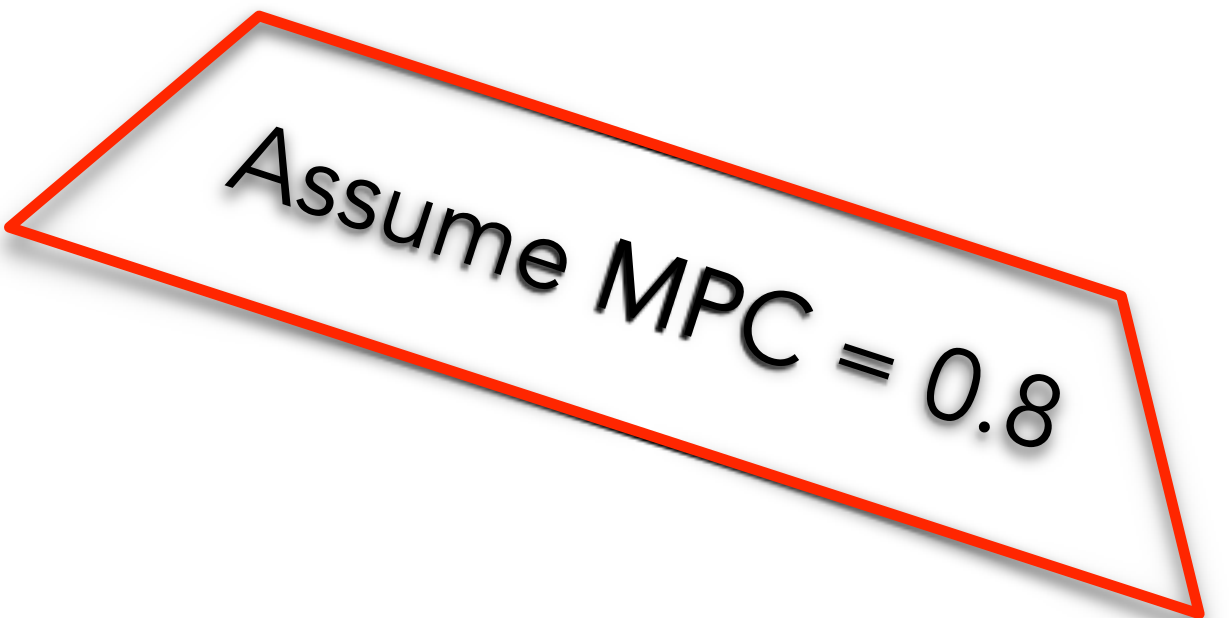

1
1-0.8


1
0.2

(Multiplier)

$$\Delta C = 1{,}000(0.8) = 800$$

$$\Delta \text{ Deficit} = 200 - 0 = 200$$


Assume MPC = 0.8

Recessionary Gap:

7,000 - 6,000 =1,000

$$\Delta Y = 1{,}000$$

1,000 = ΔG


(5)

$$\Delta G = 1{,}000/5$$

$$\Delta G = 200$$

The Government must increase G by 200 in order to close a 1,000 Recessionary Gap

A 200 increase in G will increase the Deficit by 200

Recessionary Gap:

7,000 - 6,000 =1,000

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

$\Delta Y = 1{,}000$

$\Delta G = 1{,}000/5$

$\Delta G = 200$

The Government must increase G by 200 in order to close a 1,000 Recessionary Gap

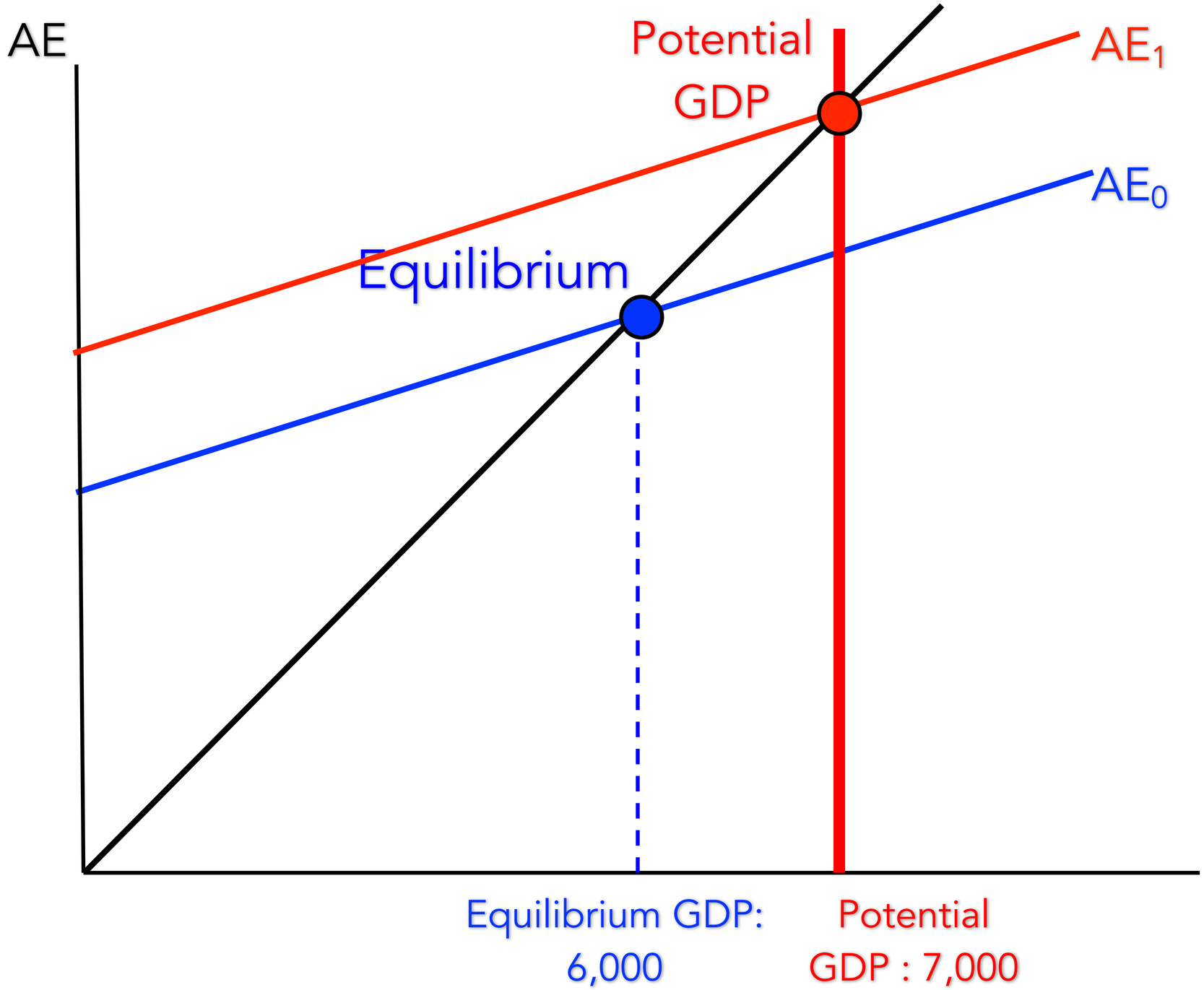
Effect on Consumption:

$\Delta C = 1{,}000(0.8) = 800$

Effect on the Budget Deficit:

Δ Deficit $= 200 - 0 = 200$

A 200 increase in G will increase the Deficit by 200


AE
Potential
GDP
AE_1
AE_0
Equilibrium
Equilibrium GDP:
6,000
Potential
GDP : 7,000