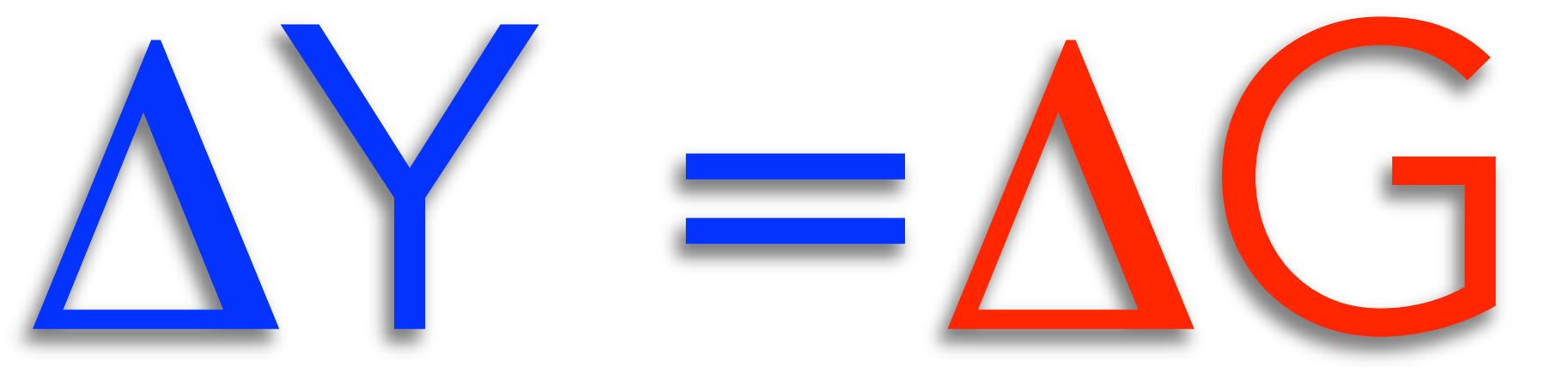

ΔY = ΔG

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

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- 0.75

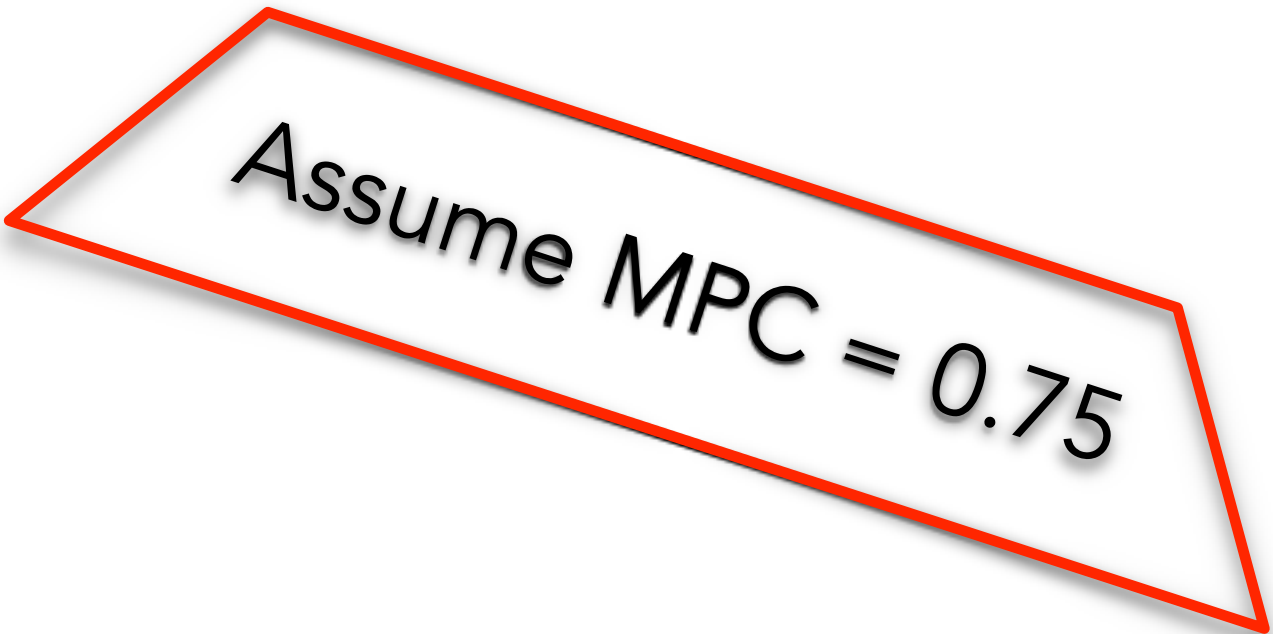

1
0.25


(4)

(Multiplier)

$$\Delta C = -2{,}000(0.75) = -1{,}500$$

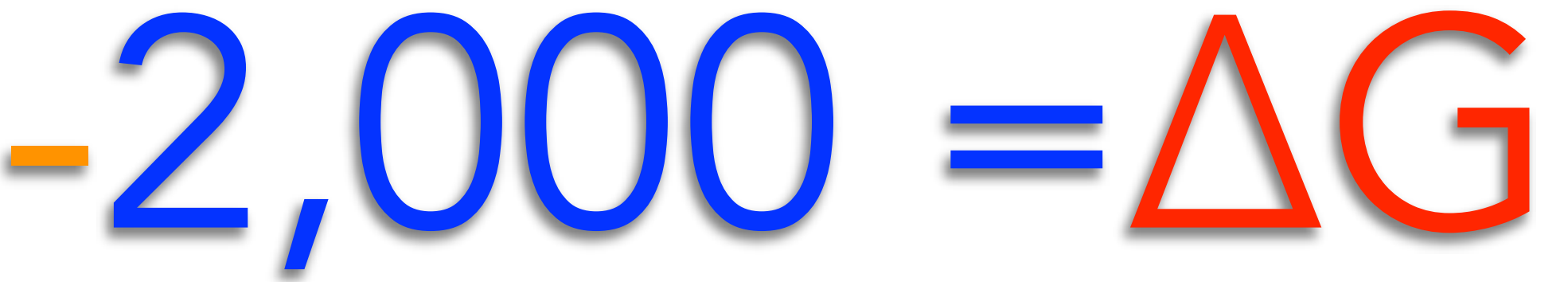
Δ Deficit $= -500 - 0 = -500$


Assume MPC = 0.75

Inflationary Gap:

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

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


-2,000 =ΔG


(4)

$$\Delta G = -2{,}000/4$$

$\Delta G = -500$

The Government must decrease G by 500 in order to close a 2,000 Inflationary Gap

A 500 **decrease** in G will **decrease** the Deficit by 500

Inflationary Gap:

$7{,}000 - 9{,}000 = -2{,}000$

Assume MPC = 0.75

We want Equilibrium GDP to decrease by 2,000: $\Delta Y = -2{,}000$

The Spending Multiplier $\left(\frac{1}{1\text{-MPC}}\right) = (4)$

$\Delta Y = \Delta G(\text{Multiplier})$

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

$-2{,}000 = \Delta G(4)$

$\Delta G = -2{,}000/4$

$\Delta G = -500$

The Government must decrease G by 500 in order to close a 2,000 Inflationary Gap

Effect on Consumption:

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

$\Delta C = -2{,}000(0.75) = -1{,}500$

Effect on the Budget Deficit:

Δ Deficit $= \Delta G - \Delta T$

Δ Deficit $= -500 - 0 = -500$

A 500 **decrease** in G will **decrease** the Deficit by 500

Taxes