

# Discussion 07

Instructor: Yushang Wei  
Introduction to Macroeconomics

June 28, 2023

**Reading list: Chapter 27, 28**

1. Multiplier Effect
2. Automatic Stabilizers
3. Fiscal policy

## part 1

1. If a recessionary gap exists, it can be offset by \_\_\_ [contractionary/expansionary] fiscal policy. Such a policy entails \_\_\_ [decreasing/increasing] government expenditures or \_\_\_ [decreasing/increasing] taxes, which will cause the aggregate demand curve to shift \_\_\_ [leftward/rightward]. Real GDP should \_\_\_ [fall/rise], and the price level should \_\_\_ [fall/rise].
2. If government spending increases by 200 billion then AD would initially increase by \_\_\_\_\_. This is called the \_\_\_ [expenditure effect/multiplier effect]. If taxes were cut by 200 billion then AD would initially increase by \_\_\_\_\_. This is because people \_\_\_ some of this increase in income.
3. Once AD initially increases, this results in higher \_\_\_\_\_. As a result of this, consumption will increase by  $\text{___} \times$  the change in income. This increase in spending results in \_\_\_ increases in spending. This effect is called the \_\_\_ [expenditure effect/multiplier effect].
4. Let's say that we are experiencing a recession and the government decreases taxes by \$25 billion. Let's also assume that the MPC equals 0.75. By how much will GDP increase?

## Part 2

The Canadian Economy in 2023: A Snapshot In January 2023, Canada's monetary aggregates were as follows:

Currency in circulation: \$307.3 billion

Demand deposits: \$1,222.5 billion

Savings and other less liquid deposits: \$890.1 billion

Canada's inflation rate is 5.2% (compared to a target of 2%), its real GDP growth rate is 2.1%, its unemployment rate is 5.0% (compared to a natural rate of unemployment of 6.2%). The Bank of Canada is targeting an interest rate of 4.5%. Canada's budget deficit for the past year was \$5.5 billion (down from \$70.1 billion in 2021).

- 1. What are automatic stabilizers? Give two examples. What are discretionary fiscal policy tools? How do automatic stabilizers differ from discretionary fiscal policy?**
- 2. How do automatic stabilizers work to counteract business cycles?**
- 3. How do discretionary fiscal policy tools work to counteract business cycles? What discretionary fiscal policy tools could Canada use to return their economy to long-run macroeconomic equilibrium and why?**
- 4. What are the benefits and drawbacks of automatic stabilizers, and discretionary fiscal policy?**