Example contd

- \[ Y = 250 + 0.75(Y - 200) + 1000 - 50r + 200 \]
- \[ Y = 250 + 0.75Y - 50r + 1050 \]
- \[ r = \frac{-0.25Y + 1300}{50} \]
- \[ Y = 0, r = 1300/50 \]
- \[ r = 0, Y = \]

Example contd

- Is budget balanced? If so, then replace G w/ T
  - \[ 5000 = 250 + 0.75(5000 - T) + 1000 - 50r + T \]
  - \[ = 5000 - 50r + T \]
  - \[ r = 0.005 T \]
  - Higher T implies higher r; higher r implies lower I; tax cut (and spending cut) reduces r & raises I
  - Cutting both spending and taxes
Tax cut but no spending cut

- \( C = 250 + 0.75(Y - T); \ I = 1000 - 50r \)
- \( 5000 = 250 + 0.75(Y - T) + 1000 - 50r + G \ [= 200] \)
- What effect does tax cut with no spending cut have on \( r \) and \( I \)?
- say \( G \) stays fixed at 200 but \( T \) falls from 200 to 150
  [budget not balanced any more]
- \( r = 0.015Y - 0.015T - 71 \)
- Now raising taxes reduces \( r \) (raises \( I \)); opposite effect of previous example

Yet another example

- \( C = 250 + 0.75(Y - T); \ T = 200 \)
- \( I = 1000 - 50r \)
- \( r \) is fixed at 1.
- What happens to GDP when govt. spending increases but taxes do not?
- \( Y = 250 + 0.75(Y - 200) + 1000 - 50 + G \)
- \( Y = 1050/0.25 + G/0.25 \)
- As \( G \uparrow, \ Y \uparrow \)
- How responsive is changes in \( Y \) to changes in \( G \)?