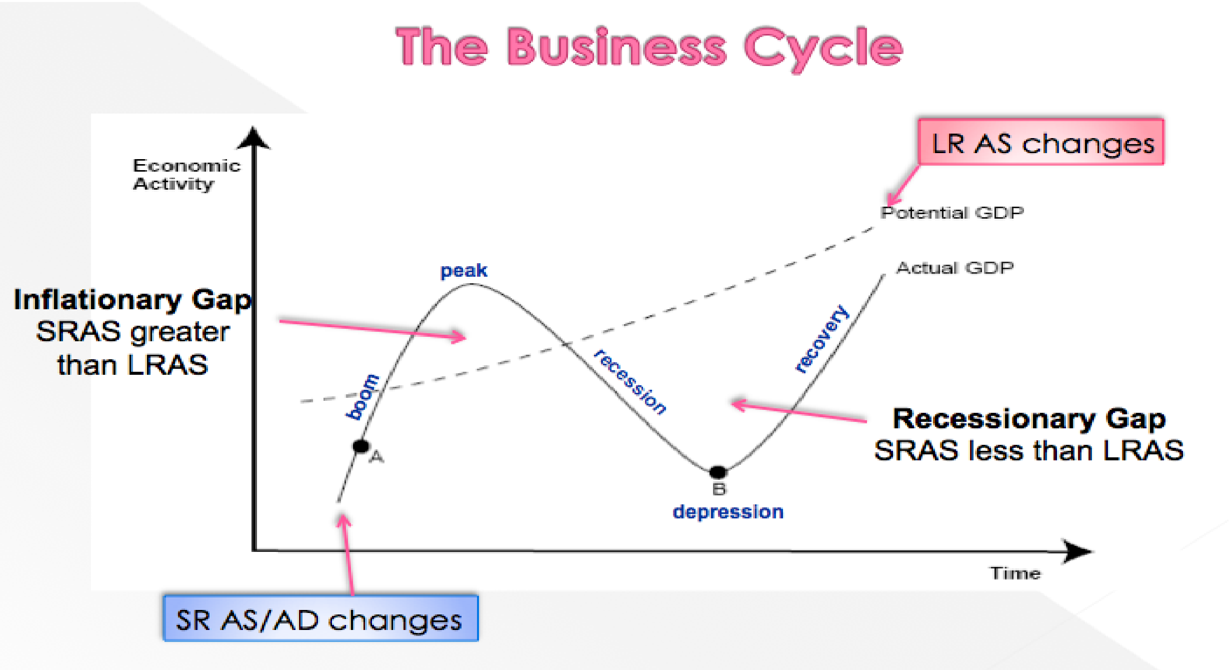
Answer on Question #41644, Economics, Macroeconomics

Unemployment level = 15%
Natural Rate of Unemployment = 6%.
rr = 25%
C = 50 + 0.75Y; I = 600; G = 250, T = 200.
Equilibrium GDP = Y = C + I + G
So, Y = 50 + 0.75Y + 600 + 250
0.25Y = 900
Y = 3,600
The full employment Real GDP = 4,000.
MS = 425
MD = 400 – 500rr + 0.75Y = 400 - 500*0.25 + 0.75*3,600 = 2,975



In our case Real GDP < Potential GDP, so there is a recessionary gap.

Governments use fiscal policy to influence the level of aggregate demand in the economy, in an effort to achieve economic objectives of price stability, full employment, and economic growth. Keynesian economics suggests that increasing government spending and decreasing tax rates are the best ways to stimulate aggregate demand, and decreasing spending & increasing taxes after the economic boom begins. Keynesians argue this method be used in times of recession or low economic activity as an essential tool for building the framework for strong economic growth and working towards full employment. In theory, the resulting deficits would be paid for by an expanded economy during the boom that would follow; this was the reasoning behind the New Deal.

Governments can use a budget surplus to do two things: to slow the pace of strong economic growth, and to stabilize prices when inflation is too high. Keynesian theory posits that removing spending from the economy will reduce levels of aggregate demand and contract the economy, thus stabilizing prices.