Question #63212 - Economics – Macroeconomics | Completed

Question

If actual GDP is $18T, full employment or potential GDP is $20T and the marginal propensity to consume is .7 then what kind of fiscal policy is necessary under these conditions?

Answer

From conditions we have government expenditure multiplier is equal to 1/(1-0.7)=3.33. It means that when government increases its expenditures on $1 GDP increases on $3.33.

Actual GDP = $18T, Potential GDP = $20T, difference is equal to $2T – government is to provide expansionary fiscal policy.

$\Delta Y=\Delta G*m_G$, where m_G – expenditure multiplier, ΔG – change in government expenditures, ΔY – change in GDP => $2T=$\Delta G$*3.33 => **$\Delta G$=$0.6T – increase in government expenditures**