

The Government's Budget Function

HH vs. Govt: Govt is large, affects income by higher spending,

HH cannot.

NOT ALIKE.

Basic Concepts:

Government budget: planned government spending and revenue

Balanced budget: revenues are equal to expenditures

Budget surplus: revenues are greater than expenditures

Budget deficit: revenues are less than expenditures



The Government's Budget Function

Government revenue & spending:

• Net tax revenue: $NT = tY$

• Expenditure on goods & services: G

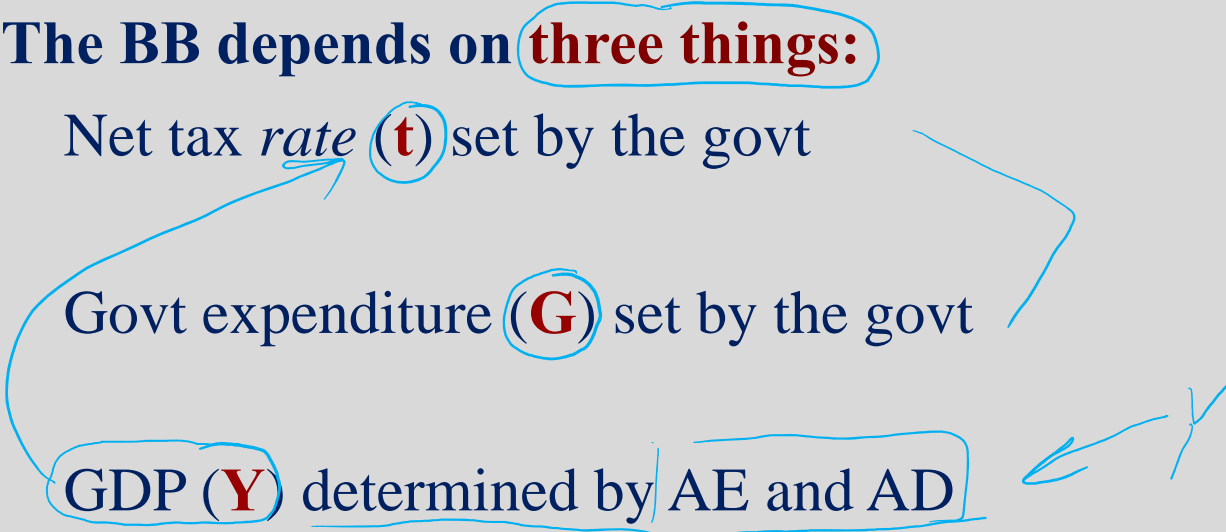
• Govt budget balance: $BB = \text{revenue} - \text{expenditure}$

$$BB = tY - G$$



The Govt Budget and Budget Balance (BB)

The BB depends on **three things:**

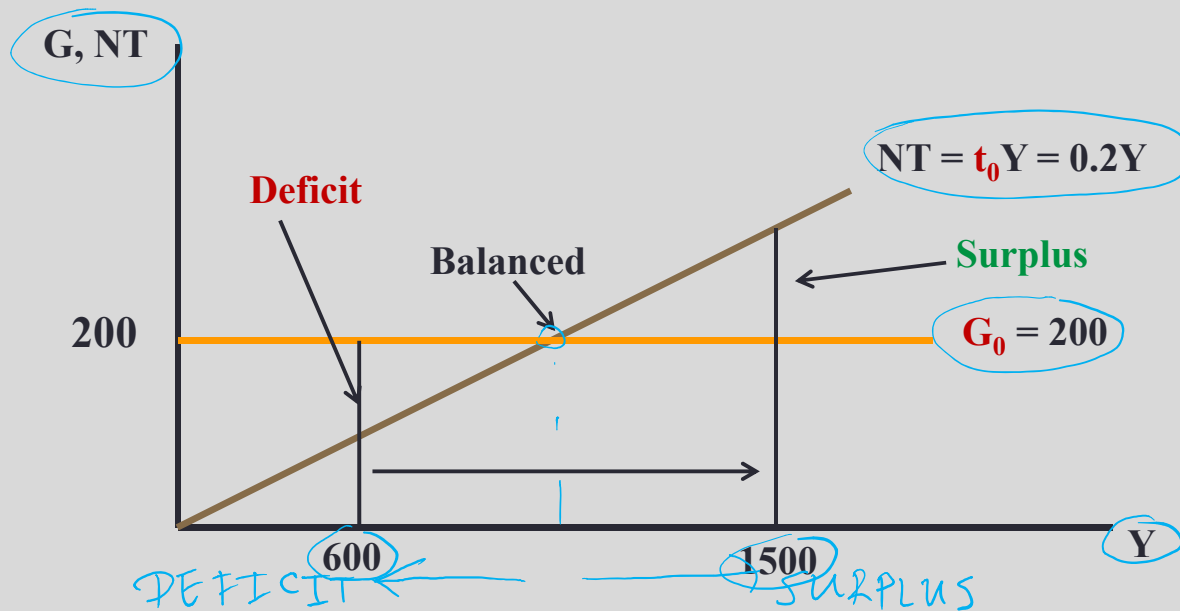
1. Net tax *rate* (**t**) set by the govt
 2. Govt expenditure (**G**) set by the govt
 3. **GDP (Y)** determined by AE and AD
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The Govt Budget and Budget Balance (BB)

Assume:

- G_0 & t_0 set by gov't's Budget Plan
- Then **BB** is determined by Y and $\Delta Y \rightarrow \Delta BB$



The Govt Budget and Budget Balance

A numerical example:

The Govt's **Fiscal Plan** sets t_0 & G_0 :

$$NT = t_0 Y,$$

$$G = G_0$$

Budget Function: $BB_0 = t_0 Y - G_0$

E.g. if $BB_0 = 0.2Y - 200$

Y	NT	- G	BB
200	40	200	-160
600	120	200	-80
1000	200	200	0
1600	320	200	120

For this fiscal plan the budget balance depends on Y.

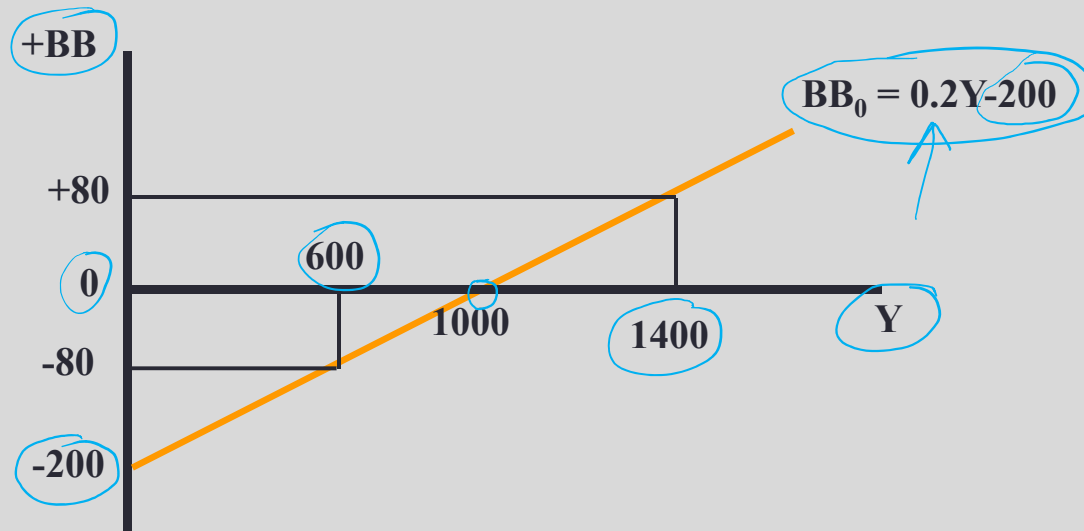
If Y rises from 200 to 1600 the budget balance increases from a deficit of 160 to a surplus of 120

A fall in Y would reduce The budget balance



The Govt Budget and Budget Balance

A Govt Budget Function: $BB_0 = 0.2Y - 200$



- This fiscal program with $t = 0.2$ & $G = 200$
- The BB depends on Y
- $\Delta BB / \Delta Y > 0$

