A Tax Cut

The Y and M Curves

The Y Curve

The Y Curve

The Y Curve

The M Curve

Suppose \( D_Y > S_Y \). To get back on the Y curve, the Auctioneer would have to raise \( r \) or \( P \). Thus Y curve shifts up and to the right.

Does the event (e.g. people become more confident) about the future mean \( D_Y > S_Y \) or \( D_Y < S_Y \)?

Pick any point on the Y curve.

Pick any point on the M curve.
Some Problems

- The government gives everyone a $300 tax rebate this year, adding to the national debt.

Or is it? If people have a bequest motive, then no impact. We come back to that case.

Suppose \( D_M > S_M \). To get back on the M curve, the Auctioneer would have to raise \( r \) or lower \( P \). Thus M curve shifts down and to the right.

Does the event (e.g. people become more confident) about the future mean \( D_M > S_M \) or \( D_M < S_M \)?
The Tax Cut

- Pick a point on the Y curve.
- \( D_Y > S_Y \)
- The Auctioneer must lower \( D_Y \)

Memo to the auctioneer:
To cut \( D_Y \), raise \( r \)
To raise \( D_Y \), lower \( r \)

The Tax Cut

- Pick a point on the Y curve.
- \( D_Y > S_Y \)
- The Auctioneer must lower \( D_Y \)
- The Y curve shifts up and to the right

The Tax Cut

- Pick a point on the M curve.
- \( D_M > S_M \)
The Tax Cut

• Pick a point on the M curve.
• $D_M > S_M$
  – Wealth Up
  – Consumption Up
  – Money Demand Up

Well, maybe. Remember the issue of the bequest motive.

Memo to the auctioneer:
To cut $D_M$, raise $r$
To raise $D_M$, lower $r$

The Tax Cut

• Pick a point on the M curve.
• $D_M > S_M$
  – Wealth Up
  – Consumption Up
  – Money Demand Up

The Auctioneer must lower $D_M$

The M curve shifts down and to the right.
The Tax Cut

- The Y curve shifts up and to the right.
- The M curve shifts down and to the right.

The Tax Cut II

- Pick a point on the Y curve.
- $D_Y = S_Y$
- The Y curve is unchanged!

Tax Cut II assumes a bequest motive

- Pick a point on the M curve.
- $D_Y + S_Y$
- No change in $Z$
• Pick a point on the M curve.
  • $D_M = S_M$
    – No change in $Z$

The Y curve doesn’t change.
• The M curve doesn’t change

• Pick a point on the M curve.
  • $D_M = S_M$
  • The M curve is unaffected!

The Y curve doesn’t change.
• The M curve doesn’t change
  • $P$ and $r$ are unaffected.
  • The tax cut is a non-event.

End