The Multiplier

In today's lesson we will look at the following :-

- What is meant by the multiplier
- How the multiplier works in practise.
- Calculating the multiplier using the marginal propensity to consume

1) If there is an increase in investment of **$100 million**, what will be the impact on national income?

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2) Why would national income increase by **more** than **$100** million?

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3) Using the circular flow of income diagram below explain what happens when there is an injection into the economy of **$100m**.

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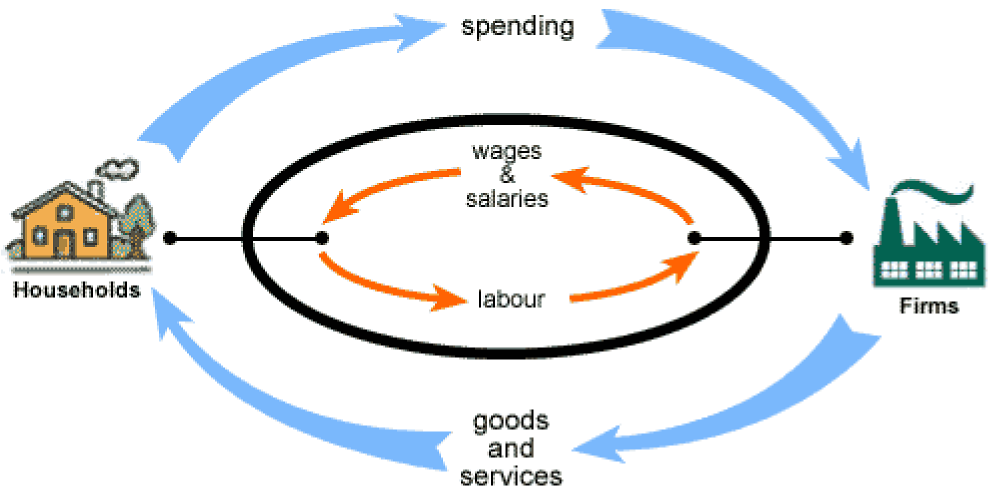
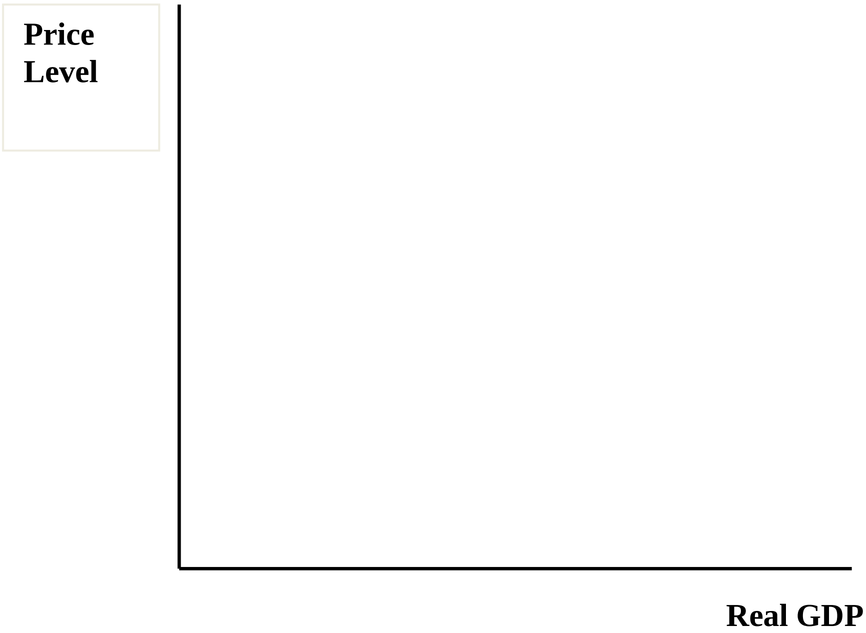


b) Illustrate the ‘multiplier’ using a Keynesian AD/AS diagram.



4) I receive an increase in salary of **$100**. I choose to spend **$50**.

- Using the figures above what do you understand by the term ‘**marginal propensity to consume**’?

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5) Complete the exercise below and calculate the marginal propensity to consume.

- Income increases by $5000 and $1000 is spent.
- I save $80 of an increase in salary of $100.
- National Income increases by $10 billion and there is an increase in consumption of $60 billion.

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6) We use the marginal propensity to consume to **calculate** the multiplier (in a closed economy with no government).

- If there is a high marginal propensity to consume what will be the value of the multiplier and why (**generally**)

- If there is a low marginal propensity to consume what will be the value of the multiplier and why?

7) In a **closed** economy with **no** government activity what equation can be used to show the value of the multiplier?

8) What is the link between the **marginal propensity to save** and the **marginal propensity to consume**?

9) If there is an increase in investment of **$100 million** and the marginal propensity to consumer is 0.8, calculate the overall increase in national income.

10) In an open economy, with a government, calculate the overall increase in national income in response to an increase in government spending of **$100 million** when:-

- ***Marginal propensity to save = 0.2***
- ***Marginal propensity to tax = 0.1***
- ***Marginal propensity to import = 0.2***

11) What will happen to the value of the multiplier in an open economy when there is an increase in taxation and import spending?