CHAPTER 34 : The multiplier

Key terms

1. Marginal propensity to import (MPM) : the increase in import divided by the increase in income that caused them
2. Marginal propensity to save (MPS) : the increase in saving divided by the increase in income that caused it
3. Marginal propensity to tax (MPT) : the increase in tax revenues divided by the increase in income that caused then
4. Marginal propensity to withdraw (MPW) : the increase in withdrawals from the circular flow (S+T+M) divided by the increase in income that caused then ; this the same as the sum of the marginal propensity to save, tax and import (MPS+MPT+MPM)
5. Multiplier : 1/MPW
6. Multiplier effect : an increase in investment or other injection will lead to an even greater increase in income (assuming the injection is not determined by income)

1. **<u>The multiplier effect</u>**

   : shows how much changes of national income caused by an injections or withdraws depends on the multiplier effect

Eg. If government increases budget 5,000 MB , AD= C+I=G+NX

- **Create job** : People have more income to spend on goods and services

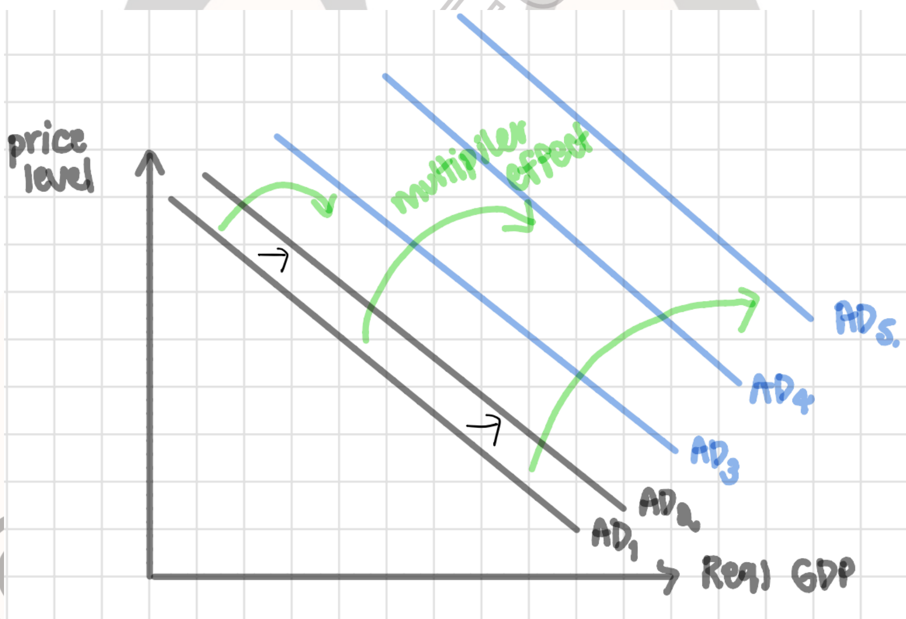
  : Consumption will be higher.

- **Firms receive more revenue** : increase opportunity for business expansion or invest in innovation and technology
- **Better infrastructure** : it can encourage FDI/MNC to invest in the economy

: investment will be higher

Or better infrastructure can bring to better export amount

: NX will be higher



Multiplier effect : Change in income / Change in injection
Or 1 / MPW

For example - Government increases budget by 5,000 MB, total income in the economy increases by 20,000 MB. Find out multiplier effect

= 20,000/5,000

= 4

: Higher MPW, Lower multiplier effect

: Lower MPW, Higher multiplier effect

<u>2. What determines the value of the multiplier effect</u>

- **It depends on propensity of import / Tax/ Saving**

: Lower propensity of tax/saving/import, It can increase more on multiplier effect

- **Amount of spare capacity**

: If there is plenty of spare capacity, AD will increases and hence it can increase in GDP

: However, if aggregate supply has full capacity, aggregate supply will be inelastic and hence it can causes inflation