

SELF-ADJUSTMENT OR INSTABILITY?

The Macro Economy Today, 11th Edition
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Chapter 10

I. The Multiplier Process

A. The most important determinant of consumption spending is:

B. Super Important Policy Question

When a consumer earns or receives additional income, how much of that additional income will he spend on goods and services?

1. The _____ to

_____ will tell us the fraction or percentage of

ADDITIONAL INCOME that consumers choose to spend on goods and services.

2. Formula

3. Example

Suppose the government **LOWERS** your personal income tax rate, and as a result, **YOUR** disposable income increases from:

In response, **YOUR** spending on goods and services increases from:

Compute the MPC

4. In the **REAL WORLD**, will a change in personal income tax rates impact **ONLY ONE** person?

5. In the **REAL WORLD**, what is the MPC for the US economy?

=> Americans (in the aggregate) will **SPEND** approximately _____ of each additional dollar of disposable income.

C. The Multiplier Principle

1.

2.

D. Mathematical Example

1. Assumption

2. The story

Suppose the federal government increases its spending on:

Stage 1: Aggregate Demand (AD) increases by _____ as a direct result of this new government spending.

Stage 2: The government's new spending creates new jobs and income for

_____ .

They will spend _____ of this new income on new goods and services.

Aggregate Demand (AD) has now increased by a total of _____ .

Stage 3: The new spending by _____ creates

new jobs and income for _____ .

They will spend _____ of this new income on new goods and services.

Aggregate Demand (AD) has now increased by a total of _____ .

Stage 4: The new spending by _____ creates

new income for _____ .

They will spend _____ of this new income on new goods and services.

Aggregate Demand (AD) has now increased by a total of _____ .

And this process continues

3. To determine the TOTAL change in Aggregate Demand once ALL spending cycles are complete:

STEP #1:

STEP #2:

E. Facts about the Expenditure Multiplier

1. Small changes in spending can trigger:

2. We've assumed that the new income is spent on:

3. It takes _____ for the Expenditure Multiplier to work!