

Building the Keynesian Multiplier

Name: _____

Period: ____

From chapter 9 in the McConnell & Brue text:

1. The fraction, or percentage, of total income that is consumed is called the _____
_____. (p. 163)
2. The fraction of total income that is saved is called _____
_____.
3. $APC = \frac{\text{_____}}{\text{_____}}$.
4. $APS = \frac{\text{_____}}{\text{_____}}$.
5. "The fact that households consumer a certain proportion of a particular total income ... does not guarantee that they will consumer the same _____ of any change in _____ they might receive."
6. The proportion, or fraction, of any change in income consumed is called the _____ to _____.
7. $MPC = \frac{\text{_____ in consumption}}{\text{change in _____}}$.
8. The fraction of any change in income saved is the _____ to _____.
9. $MPS = \frac{\text{change in _____}}{\text{change in _____}}$. (p. 164)
10. "Consuming or saving out of extra income is and _____ - ____ proposition; the fraction of any change in income not consumed is, by definition, _____."
11. $MPC + MPS = \text{_____}$.
12. "The MPC is the numerical value of the _____ of the _____ schedule, and the MPS is the numerical value of the _____ of the _____ schedule."
13. "The investment decision is a _____ - benefit - _____ cost decision: The marginal benefit from investment is the _____ of _____ businesses hope to realize. The marginal _____ is the _____"

_____ that must be paid for borrowing funds. We will see that businesses will invest in projects for which the expected rate of return _____ the interest rate.” (p. 166)

14. “The _____ interest rate is the nominal rate less the rate of _____.” (p. 167)

15. “This law is the disarmingly simple idea that the very act of _____ goods generates _____ equal to the value of the goods produced.” (p. 177)

16. “Keynes disputed _____’s law, pointing out that not all income need be _____ in the same period that it is _____. _____ spending, in particular, is volatile, said Keynes. A substantial decline in _____ will lead to insufficient total spending. Unsold goods will accumulate in producers’ warehouses, and producers will respond by reducing their _____ and discharging _____. A _____ or depression will result, and widespread _____ unemployment will occur. Moreover, said Keynes, recessions or depressions are not likely to _____ themselves.”

Problems:

1. Bill earned \$50,000 in income in 2004 and paid \$10,000 to the government in taxes, resulting in after-tax disposable income of \$40,000. His average tax rate was _____ percent. He managed to save \$4,000. His APS was 0.____ or _____ percent. His APC was 0.____ or _____ percent.
2. Bill’s income increased to \$60,000 in 2005 (a nice raise!). He paid \$13,000 to the government in taxes, resulting in after-tax disposable income of \$_____. His average tax rate was _____ percent and his marginal tax rate was _____ percent. He managed to save \$5,500. His APS was 0.____ or _____ percent. His APC was 0.____ or _____ percent. His MPS was 0.____ or _____ percent. His MPC was 0.____ or _____ percent.

From chapter 10 in the McConnell & Brue text:

1. “You may have noticed that in our example a \$5 billion change in investment _____ led to a \$20 billion change in _____ and _____. That surprising result is called the _____ effect: a change in a _____ of aggregate expenditures leads to a larger change in _____ GDP. The _____ determines how much larger that change will be; it is the ration of a change in equilibrium GDP to the initial change in _____ (in this case, investment).” (p. 183)
2. Multiplier = change in _____ GDP ÷ initial change in _____.
3. Change in GDP = _____ x initial change in spending.

4. "Implicit in the preceding point is that the _____ works in both _____."
5. "The multiplier effect follows from two facts. First, the economy supports _____, continuous flows of expenditures and income through which the dollars _____ by Smith are received as _____ by Chin, then _____ by Chin and received as _____ by Gonzales, and so on. Second, any change in income will cause both _____ and _____ to vary in the same direction as, and by a fraction of, the change in income." (pp. 183-184)
6. "It follows that an initial change in spending will set off a _____ throughout the economy. That chain of spending, although of _____ importance at each successive step, will _____ to a _____ change in GDP."
7. "The fraction of an increase in income saved (the _____) determines the cumulative _____ effects of any initial change in spending and therefore determines the _____. The MPS and the multiplier are _____ related. The smaller the fraction of any change in income _____, the greater the respending at each round and, therefore, the _____ the multiplier. If the MPS is .25, as in our example, the multiplier is _____. If the MPS were .33, the multiplier would be _____." (pp. 184-185)
8. "We can summarize by saying the multiplier is equal to the _____ of the MPS."
9. $\text{Multiplier} = 1 \div \text{_____}$ or $\text{Multiplier} = 1 \div 1 - \text{_____}$.
10. "The multiplier we have just described is called the _____ multiplier, because it is based on a simple model of the economy. When it is computed as $1/\text{MPS}$, the multiplier reflects only the _____ of income into _____. In the real world, successive rounds of income and spending may also be diminished by leakages into _____ and _____." (p. 186)
11. "Generalization: Other things equal, positive net exports increase _____ and GDP beyond what they would be in a closed economy."
12. "Equal increases in _____ spending and in _____ increase the equilibrium GDP. If G and T are each _____ by a particular amount, the _____ level of real output will rise by the same amount." (p. 193)

13. "The rationale for this _____-_____ multiplier is revealed in our example. A change in government spending affects aggregate expenditures more _____ than a tax change of the same size."
14. "Government spending has a _____ and _____ impact on aggregate expenditures. Government spending is a _____ component of aggregate expenditures."
15. "But a change in taxes affects aggregate expenditures _____ by changing disposable _____ and thereby changing consumption."
16. "The _____ gap is the amount by which aggregate expenditures at the full-employment GDP fall short of those required to achieve the full-_____ GDP." (p. 194)
17. "The _____ gap is the amount by which aggregate expenditures at the full-employment GDP exceed those required to achieve the full-_____ GDP."

Problems:

1. If the MPC is .1, MPS is _____ and the multiplier is _____.
2. If the MPC is .2, MPS is _____ and the multiplier is _____.
3. If the MPC is .25, MPS is _____ and the multiplier is _____.
4. If the MPC is .33, MPS is _____ and the multiplier is _____.
5. If the MPC is .5, MPS is _____ and the multiplier is _____.