

Expenditure Multiplier Problems (Page 1 of 2)

- 1 Suppose the marginal propensity to save is 0.1 and the marginal propensity to import is 0.05. Suppose an increase in consumer confidence leads to a \$80 billion increase in consumer spending. What is the change in real GDP?
- 2 Suppose U.S. consumers become more cautious, and as a precautionary measure, increase their saving and decrease their demand for final goods and services by \$350bn. Suppose the marginal propensity to consume is 0.80 and the marginal propensity to import is 0.05. Compute the immediate change in real GDP in the United States.
- 3 Suppose a decrease in income in Europe causes a decrease in demand for U.S. exports to Europe by \$175bn. Workers and business owners experience a decrease in income. Suppose the marginal propensity to consume is 0.85 and the marginal propensity to import is 0.1. Compute the immediate change in real GDP in the United States.

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- 4 Suppose the marginal propensity to consume is 85% and the marginal propensity to import is 10%. The economy is in a recession. Real GDP is \$20 trillion, and at full employment real GDP would be \$21.5 trillion. Congress and the president decide to increase government spending in an effort to push real GDP to potential GDP. How much should government spending be increased by?
- 5 What happens to the expenditure multiplier if MPS increases from 5% to 10% (assume $MPM=0$). Which MPS gives the government greater power to influence GDP? Which MPS creates a less volatile economy (i.e. which MPS causes smaller fluctuations in real GDP)?