Written Assignment Unit 6

Due to the post pandemic changing scenario there is an economic slowdown, and the only solution is to boost the economy by infusion. The federal government decided to infuse $ 400000 into the economy for a period of time and see the rolling effect. Calculate the multiplier effect and find out the real GDP change if the multiple propensities to consume is 0.6?

Solution

Given:

Expenditure = $ 400000

MPC = 0.6 or 60%

Multiplier effect (k) = change in real GDP (y)/ change in injections

Applying the formula for the calculation of multiplier

Multiplier (k) = 1/MPS where MPS is marginal propensity to save

Multiplier (k) = 1/1-MPC where MPC is marginal propensity to consume

When MPS = 1-MPC

The premise behind this formula is: one person spending is equal to another person saving until the saving is equal to the induced money in the market.

Substituting the values

Multiplier (k) = 1/(1-MPC)

= 1/(1-0.60)

=1/0.40

The Value of multiplier effect = 2.5

Change in the GDP = Investment * Multiplier effect

= $ 400,000 * 2.5

= $ 1,000,000

The induced money will help the real GDP to change by $ 1,000,000 with the multiplier effect calculated at 2.5. The consumption percentage is at 60%.