



Q7. In the above question, calculate the effect on output of a 10 per cent increase in transfers, and a 10 per cent increase in lump-sum taxes. Compare the effects of the two.

Ans: MPC = 0.80

$$\bar{C} = 20$$

$$I = 30$$

$$G = 50$$

$$TR = 100$$

$$\Delta TR = 10$$

Equilibrium level of income =

$$\frac{1}{1-c} [\bar{C} + cTR + I + G + \Delta TR]$$

$$= \frac{1}{1-0.80} [20 + 0.80 \times 100 + 30 + 50 + 0.80 \times 10]$$

$$= \frac{188}{0.20} \times 100$$

$$= \text{Rs } 940$$

$$\text{Change in income} = 940 - 900 = \text{Rs } 40$$

Increase in lump-sum tax $\Delta T = 10$

$$\text{Change in Income} = \Delta T = \frac{-c}{1-c}$$

$$= -10 \times \frac{0.80}{0.20}$$

***** END *****