Q7. In the above question, calculate the effect onoutput 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

$\overline{C} = 20$
$I = 30$

$G = 50$

$TR = 100$

$\Delta TR = 10$

Equilibrium level of income =
$$\frac{1}{1-c}\left[\overline{C}+cTR+I+G+\Delta TR\right]$$

$$=\frac{1}{1-0.80}\left[20+0.80\times100+30+50+0.80\times10\right]$$

$$=\frac{188}{0.20}\times100$$

= Rs 940

Change in income = 940 – 900 = Rs 40

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

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

$$=-10\times\left.\frac{0.80}{0.20}\right|$$

********** END *********