

Name: _____

Date: _____

Activity 3. Answer Key

Spending Multiplier

Instructions: For each of the following, compute the spending multiplier using the information provided. For this example, you should assume that consumption spending is the only type of spending related to income. Then, calculate the economic effect on the overall economy.

1. Increase in spending of \$5 million. MPC of .6
 - a. What is the spending multiplier? [2.5]
 - b. What is the total effect on the economy? [\$12.5 million]
2. Increase in spending of \$20 million. MPS of .2
 - a. What is the spending multiplier? [5]
 - b. What is the total effect on the economy? [\$100 million]
3. Increase in spending of \$17 billion. MPC of .75
 - a. What is the spending multiplier? [4]
 - b. What is the total effect on the economy? [\$68 billion]
4. Decrease in spending of \$7 million. MPS of .4
 - a. What is the spending multiplier? [-2.5]
 - b. What is the total effect on the economy? [-\$17.5 million]
5. Decrease in spending of \$12 billion. MPC of .25
 - a. What is the spending multiplier? [-1.25]
 - b. What is the total effect on the economy? [-\$15 billion]
6. Overall, what do you notice about the spending multiplier when the marginal propensity to consume is closer to one? [As the marginal propensity to consume approaches one, the spending multiplier approaches infinity.]