**CONCEPT:** GOVERNMENT PURCHASES AND THE MULTIPLIER EFFECT ON AGGREGATE DEMAND

● The ***multiplier effect*** describes how an initial boost in spending leads to a much higher increase in __________

☐ When government increases spending, this, in turn, increases ___________ of households

☐ The increase in household ____________, leads to an increase in household _______________

> Refer to our calculations of the Marginal Propensity to Consume

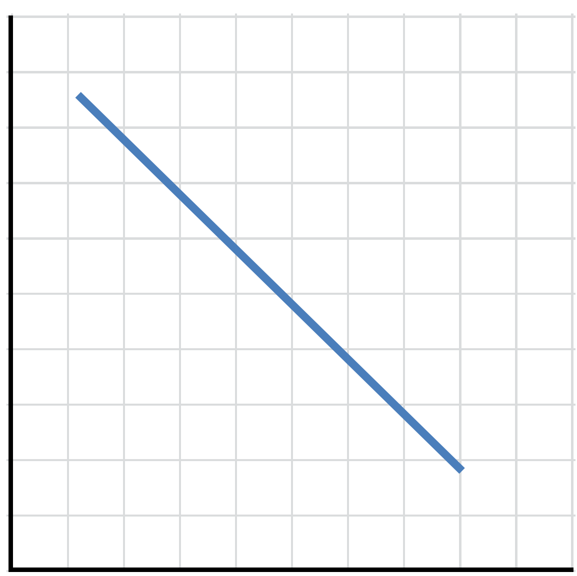
☐ A second round of spending occurs based on the additional consumption, leading to MORE consumption

☐ The chain reaction continues…

**EXAMPLE**: Governmentland has increased government spending by $5 billion dollars:

| | | |
|---|---|---|
| Increase in Government Spending | | $5 billion |
| Increase in Consumer Spending | = MPC * $5 billion | |
| Increase in Consumer Spending | = MPC * (MPC * $5 billion)<br>= | |
| Increase in Consumer Spending | = MPC * (MPC * (MPC * $ 5 billion)<br>= | |
| The chain reaction continues… | | |

Aggregate Demand



**Multiplier Effect**

$$Total\ Increase\ in\ GDP = \frac{1}{1 - MPC} * Initial\ Spending\ Boost$$