**CONCEPT:** MULTIPLIER EFFECT AND THE MARGINAL PROPENSITY TO SAVE AND CONSUME

- An increase in ***investment spending*** causes a chain reaction of spending in the economy
  - □ When firms increase investment 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**: Investmentland has increased investment spending by $5 billion dollars:

| | | |
|---|---|---|
| Increase in Investment 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… | | |

- The ***multiplier effect*** describes how the total increase in spending is more than just the initial boost in spending
  - □ The actual multiple will depend on the _____________

$$Total\ Increase\ in\ GDP = (1 + MPC + MPC^2 + MPC^3 \ldots) * Initial\ Spending\ Boost$$

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

Note that (1-MPC) = ___________ →

**PRACTICE**: Investmentland has increased investment spending by $5 billion dollars. If MPC = 0.75, what is the multiplier and total increase in GDP?