CONCEPT: TAXES AND THE MULTIPLIER EFFECT ON AGGREGATE DEMAND

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

□ A decrease in taxes is essentially an increase to household _____________

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

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

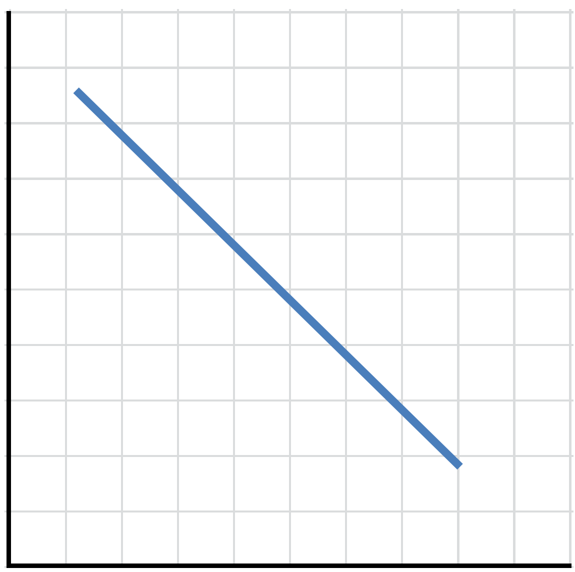
□ The chain reaction continues…

□ Note: The tax multiplier tends to be _____________ in magnitude than the purchases multiplier

> The tax multiplier is ______________ → A decrease in taxes leads to an ____________ in consumption

> Some of the extra disposable income goes to ____________ leading to smaller chain reactions

Aggregate Demand



Tax Multiplier

$$Tax\ Multiplier = \frac{\Delta\ Equilibrium\ GDP}{\Delta\ Taxes}$$

● Taxes are said to be an ***automatic stabilizer*** in the economy:

> Government purchases will stay stable regardless of business cycle without discretionary policy

> The amount of taxes depends on the amount of income being earned

- Economy is booming → GDP, inflation, income _______ → Taxes ______ → Consumption ______
- Economy in recession → GDP, inflation, income _______ → Taxes ______ → Consumption ______