Answer on Question #60990-Economics-Macroeconomics

Given a hypothetical consumption function of the form:

Y = C + I0 + G0 ,C = α + β Yd Where: Yd = Y – T, Y = Income, T = Taxes

Government spending and investment are exogenously determined at G and I respectively. Assuming this model represent a three sectors economy, determine Investment multiplier, Government spending multiplier and Tax multiplier. If there is an increase in marginal propensity to consumer, how will this affect the national income?

Answer:

Investment multiplier = $\frac{\Delta Y}{\Delta I} = \frac{1}{1-\beta}$;

Government spending multiplier = $\frac{\Delta Y}{\Delta G} = \frac{1}{1-\beta}$;

Tax multiplier = $\frac{\Delta Y}{\Delta T} = \frac{-\beta}{1-\beta}$.

If marginal propensity to consume increase national income will increase on $\Delta\beta(Y-T)$.