What is the Multiplier Effect?

Worksheet

The Multiplier Effect is the process where initial injection of spending (like government investment) generates more than its original amount in total economic activity, because spending ripples through the economy.

Questions

1. If MPC = 0.6, what is the multiplier?

A) 0.4
B) 1.67
C) 2.5
D) 6

2. Government spends $10M with multiplier 3. Total impact?

A) $10M
B) $13M
C) $30M
D) $33M

3. What does the multiplier assume?

A) No unemployment
B) Money stays in the economy
C) Prices are fixed
D) Immediate consumer response

4. If MPC increases, the multiplier...

A) Decreases
B) Stays the same
C) Increases
D) Becomes negative

5. Government spends 1 billion on a new highway. Workers earn1 billion, and the marginal propensity to consume (MPC) is 0.8 (80% of income is spent). What is the total economic impact?

6. A firm invests $50 million in new equipment. MPC = 0.75. Calculate the multiplier effect on total spending.

7. If MPC = 0.9, what is the multiplier?

8. Define: Define the Multiplier Effect.

9. Define: What is MPC (Marginal Propensity to Consume)?

10. Define: How does MPC affect the multiplier?

Answer Key

1. C) 2.5 — Multiplier = 1/(1−0.6) = 1/0.4 = 2.5
2. C) $30M — Total = 10M × 3 =30M.
3. B) Money stays in the economy — The multiplier works because spending doesn't leak out—it circulates.
4. C) Increases — Multiplier = 1/(1−MPC). Higher MPC → smaller denominator → larger multiplier.
5. Multiplier = 1 / (1 − MPC) = 1 / (1 − 0.8) = 1 / 0.2 = 5 Total impact = Initial spending × Multiplier Total impact = 1 billion × 5 =5 billion
6. Multiplier = 1 / (1 − 0.75) = 1 / 0.25 = 4 Total economic impact = 50M × 4 =200M Additional spending generated = 200M −50M = $150M
7. Multiplier = 1 / (1 − 0.9) = 1 / 0.1 = 10 Higher MPC → larger multiplier More of each dollar is re-spent in the economy
8. The process where initial spending generates additional income and spending beyond its original amount.
9. The fraction of additional income that a household spends rather than saves.
10. Higher MPC → larger multiplier. If everyone spends more, the chain of spending is stronger.