

9 The multiplier – Part 1

Name: _____ Class: _____ Date: _____

Vocabulary

Write each word three times.

English	Write it 3 times (English)		
circular flow of income	_____	_____	_____
injections	_____	_____	_____
leakages	_____	_____	_____
multiplier	_____	_____	_____
marginal propensity to consume	_____	_____	_____

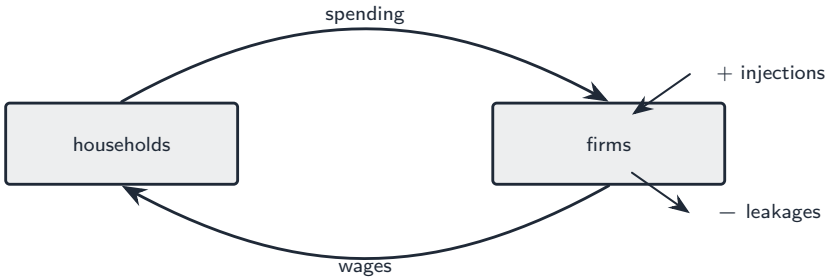
Recall

Money moves round the economy between households and firms. New spending can have a surprisingly large effect.

New ideas

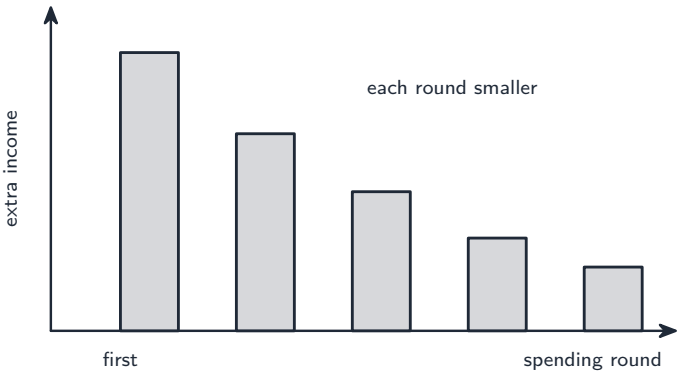
Read these first, then do the Practice.

■ 1 The circular flow



The **circular flow of income** shows money passing between households and firms. **injections** add money (investment, government spending, exports); **leakages** take it out (saving, tax, imports).

■ 2 The multiplier



The **multiplier** means an injection raises income by *more* than the first amount, because it is spent again and again. How much depends on the **marginal propensity to consume** (MPC) – the fraction of extra income people spend.

Worked example. If the MPC is 0.8, the multiplier = $\frac{1}{1 - 0.8} = 5$, so a \$10m injection eventually raises income by \$50m.

Watch out: a bigger MPC (people spend more of extra income) gives a *bigger* multiplier; more leakages (saving, tax, imports) give a *smaller* one. The multiplier = $\frac{1}{1 - \text{MPC}}$.

Practice

Try these in order.

9.1 What does the *circular flow of income* show? [1]

9.2 Give one example of an *injection*. [1]

9.3 Give one example of a *leakage*. [1]

9.4 What does the *multiplier* mean? [1]

9.5 If the *MPC* is large (people spend most extra income), is the multiplier large or small? [1]

9.6 Challenge. A government spends \$20m building a road where people spend three-quarters of any extra income ($MPC = 0.75$). Estimate the final rise in income. [2]