

Question 9 Answer the following questions.

Country A is a closed economy with no government. The marginal propensity to save in the country is 0.25.

9.1 Calculate the value of the (investment) multiplier.

$$\frac{1}{1-MPC} = \frac{1}{1-0.75} = \frac{1}{0.25} = 4$$

9.2 Due to the initial investment made by firms and the multiplier effect, the (equilibrium) output in the economy has increased by \$200m. Calculate the value of the initial investment.

$$\frac{\Delta Y}{\Delta I} = 4 \quad \begin{array}{l} y \text{ increase by } 1 \text{ unit} = I \text{ increase by } 4 \text{ unit} \\ y \text{ increase by } 200 \text{ unit} = I \text{ increase } 4 \times 200 \text{ unit} = 800 \text{ \#} \end{array}$$

Country B is an open economy with government.

9.3 Do you think the multiplier effect in Country B will be larger than that of Country A? Why or why not?

I think the multiplier effect in country A will larger because there is no export and import. The money will not leakage.