

1. Suppose the marginal propensity to save is 0.1 and the marginal propensity to import is 0.05. Suppose an increase in consumer confidence leads to a \$80 billion increase in consumer spending. What is the change in real GDP?

2. Suppose U.S. consumers become more cautious, and as a precautionary measure, increase their saving and decrease their demand for final goods and services by \$350bn. Suppose the marginal propensity to consume is 0.80 and the marginal propensity to import is 0.05. Compute the immediate change in real GDP in the United States.
3. Suppose a decrease in income in Europe causes a decrease in demand for U.S. exports to Europe by \$175bn. Workers and business owners experience a decrease in income. Suppose the marginal propensity to consume is 0.85 and the marginal propensity to import is 0.1. Compute the immediate change in real GDP in the United States.

4. Suppose the marginal propensity to consume is 85% and the marginal propensity to import is 10%. The economy is in a recession. Real GDP is \$20 trillion, and at full employment real GDP would be \$21.5 trillion. Congress and the president decide to increase government spending in an effort to push real GDP to potential GDP. How much should government spending be increased by?
5. What happens to the expenditure multiplier if MPS increases from 5% to 10% (assume MPM=0). Which MPS gives the government greater power to influence GDP? Which MPS creates a less volatile economy (i.e. which MPS causes smaller fluctuations in real GDP)?