

HOW THE MULTIPLIER WORKS

1. Suppose there is an increase in investment of \$1000.
2. Also suppose Marginal Propensity to consume is $\frac{4}{5}$ or 80%.

(1) Number of Rounds of Spending*	(2) Increase in Investment	(3) Increase in Consumption	(4) Increase in National Product (National Income)	(5) Increase in Savings
0	\$1000		\$1000	
1		\$800	800	\$200
2		640	640	160
3		512	512	128
4		410	410	102
5		328	328	82
6		262	262	66
7		210	210	52
8		168	168	42
9		134	134	34
•		•	•	•
•		•	•	•
•		•	•	•
Infinite Number of Rounds of Spending*	Total Increase in Investment	Total Increase in Consumption	Total Increase in National Income	Total Increase in Savings
	\$1000	\$4000	\$5000	\$1000

National Income = Consumption + Investment + Government Spending (Product Approach)

National Income = Consumption + Savings + Taxes (Income Approach)

*Rounds of spending refers to the basic circular flow diagram of the economy.