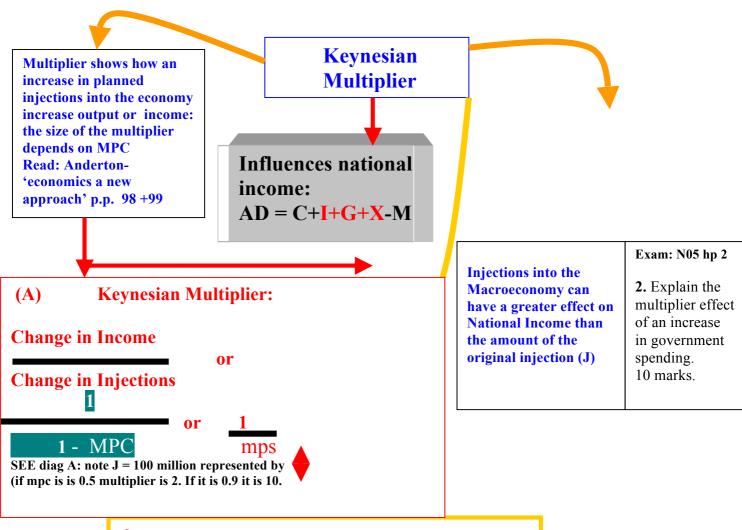
SYLLABUS REFERENCE 2.2: Multiplier – see also webnote 225



3 Determinants of size of the multiplier: (B)

- 1. if economy is open rather than closed consumers will buy imports. M is a leakage and therefore reduces the multiplier
- 2. interest rates- higher rates of interest might encourage more saving and less spending and therefore the multiplier is reduced
- 3. tax rates higher tax rates will also result in a reduction in spending and therefore a smaller multiplier

Or Alternative Keynesian multiplier:

(C)

(D)

mps + mpm + mrt

Note: mrt = marginal rate of tax

Note: in diagram B the extent of the shift of AD1 to AD2 represents the size of the injection. The change in Income (Y) is determined by the size of the multiplier Note: assumption is that income must be consumed, saved, imported or taxed

Marginal Propensity to Import (M) depends upon:

- 1. relative prices between domestic and foreign goods
- 2. quality of goods and services
- 3. income
- 4. interest rates if foreign rates are high this may lead to a capital outflow
- speculation if people think the domestic currency will fall in value they would be inclined to sell domestic and buy foreign currency

Page 1 of 1