# Tax and Transfer Multiplier

Answer the following questions to demonstrate your understanding of the spending multiplier.

1. A recessionary gap of $40 billion is present in the economy and MPC is 0.75. How could Congress close the tax using a change in taxes?

The government wants to use a change in taxes to close the gap in the economy. MPC is 0.8.

* How large is the gap?
* What is the amount and direction
* (increase/decrease) of the change in taxes

needed to close the gap?

2.

3.

The government wants to use a change in transfer payments to close the gap in the economy. MPC is 0.9.

* How large is the gap?
* What is the amount and direction (increase/decrease) of the change in transfer needed to close the gap?

4. Create a table showing the tax and transfer multiplier for each of the MPCs listed.

|  |  |
| --- | --- |
| **MPC** | **Tax/Transfer Multiplier** |
| 0.5 |  |
| 0.75 |  |
| 0.8 |  |
| 0.9 |  |

# Tax and Transfer Multiplier Answer Key

Answer the following questions to demonstrate your understanding of the spending multiplier.

1. A recessionary gap of $40 billion is present in the economy and MPC is 0.75. How could Congress close the tax using a change in taxes?

𝑀𝑃𝐶 *=* .75 *= 3;* $40 *= $13.3 billion decrease in taxes.*

𝑀𝑃𝑆 .25 3

The government wants to use a change in taxes to close the gap in the economy. MPC is 0.8.

* How large is the gap?
* What is the amount and direction (increase/decrease) of the change in taxes needed to close the gap?

2.

•

*The gap is $250b - $150b = $100 billion*

𝑀𝑃𝐶 *=* .8 *= 4;* $100 *= $25 billion decrease in taxes.*

𝑀𝑃𝑆 .2 4

3.

The government wants to use a change in transfer payments to close the gap in the economy. MPC is 0.9.

* How large is the gap?
* What is the amount and direction (increase/decrease) of the change in transfer needed to close the gap?

*The gap is $160b - $79b = $81 billion*

𝑀𝑃𝐶 *=* .9 *= 4;* $81 *= $9 billion increase in transfer payments.*

𝑀𝑃𝑆 .1 9

4. Create a table showing the tax and transfer multiplier for each of the MPCs listed.

|  |  |
| --- | --- |
| **MPC** | **Tax/Transfer Multiplier** |
| 0.5 | *1* |
| 0.75 | *3* |
| 0.8 | *4* |
| 0.9 | *9* |