

# Chapter 18

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## Put into practice questions

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**Which of the following statements are true and which are false? Explain your answer.**

- a. Injections are determined by the level of national income. FALSE
- b. An increase in injections increases aggregate demand in the economy. TRUE
- c. Lower interest rates might encourage spending and boost aggregate demand. TRUE
- d. Higher exports increase injections into the economy. TRUE
- e. Higher savings increase withdrawals from the economy. TRUE
- f. Higher imports reduce withdrawals from the economy. TRUE

**Which of the following is seen as an example of an injection into the circular flow of income?**

- Consumption No
- Saving No
- Taxation revenue No
- Export spending Yes
- Import spending No

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**Which of the following statements are true and which are false?**

- a. An increase in withdrawals decreases aggregate demand. TRUE
- b. An increase in savings increases withdrawals. TRUE
- c. An increase in exports increases withdrawals. TRUE
- d. A decrease in taxation reduces withdrawals. TRUE
- e. An increase in investment increases injections. TRUE

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**If planned injections are £300 million and planned withdrawals are £400 million, is the economy in equilibrium or not?**

Aggregate demand will be lower than output as withdrawals exceed injections. This means income and output will fall until injections equal withdrawals.

**Which of the following statements are true and which are false? Explain your answer:**

- a. For equilibrium in a four-sector economy, savings must equal investment. FALSE
- b. An increase in exports boosts aggregate demand. TRUE
- c. An increase in taxation rates reduces aggregate demand. TRUE
- d. If planned injections are greater than planned withdrawals, national income will fall. FALSE
- e. If planned injections equal planned withdrawals, the economy is in equilibrium. False
- f. If aggregate demand increases, national income will. TRUE

**Suppose that  $Y_1$  is the equilibrium output.**

- Below  $Y_1$ , are the planned injections more or less than the planned withdrawals, or equal to them? Planned injections are above withdrawals
- Above  $Y_1$ , are the planned injections more or less than the planned withdrawals, or equal to them? Planned injections are below withdrawals
- At  $Y_1$ , are the planned injections more or less than the planned withdrawals. Planned injections equal withdrawals

**Do the following increase or decrease aggregate demand? Explain your answer.**

- Higher taxes Decrease
- Lower interest rates Increase
- More government spending Increase
- More savings Decrease
- More imports Decrease
- Fewer exports. Decrease

**If the proportion of each pound spent in the UK were 0.6, what would the size of the multiplier be?**

$$\text{Multiplier} = 1/(1-0.6) = 1/0.4 = 2.5$$

**What if only 0.5 were spent in the UK out of each pound?**

$$\text{Multiplier} = 1/(1-0.5) = 1/0.5 = 2$$

**What is the impact on the size of the multiplier of each of the following?**

- More spending out of each pound on imports. Reduces
- More saving out of each pound. Reduces
- A higher rate of income tax. Reduces

## End of chapter put into practice questions

**What is the difference between planned and actual injections?**

Planned is intended; actual is what happens (includes unintended changes in stock, for example)

**Using a diagram, show the effect on national income of a fall in planned injections.**

A fall in injections will reduce aggregate demand. This will reduce national income. (It is the opposite of what happens in Figure 18.8)

**Using a diagram show the effect on national income of a fall in planned withdrawals.**

A fall in planned withdrawals increases aggregate demand and increases national income.

**If an increase in injections of £20 billion increases national income by £80 billion what is the size of the multiplier?**

Answer is: 4, MPC = 0.75.

**National income is £600 billion. The marginal propensity to consume is 0.8 and investment increases by £12 billion. What is the new level of national income?**

Multiplier =  $1/(1-0.8) = 5$ . Investment increases £12 billion; National income increase  $5 \times 12 = £60$  billion. New national income is £660 billion

**Savings \$20 billion, Exports \$40 billion, Taxation revenue \$45 billion, Government spending \$20bn, Investment \$15 billion. Given that the economy is in equilibrium what is the value of import spending?**

Injections =  $20 + 15 + 40 = \$75$  billion.

Withdrawals =  $20 + 45 + M$ . Import spending must be \$10 billion

**Planned withdrawals = £500 billion. Planned injections = £600 billion. Explain what will happen to national income compared to its present level.**

Income will increase as injections are greater than withdrawals.