

1) What is the marginal propensity to consume?

The marginal propensity to consume is the additional consumption spending which results when consumers experience a one dollar increase in disposable income. It is the slope of the consumption function and, in the simplest Income-Expenditure model, the slope of the aggregate expenditure curve.

2) What is autonomous spending?

Autonomous spending is spending in the Income-Expenditure model which is unrelated to income. It is the level of spending which would occur even if income were zero.

3) Explain the multiplier. That is, what is it and how does it work?

The multiplier measures the scale by which an increase (decrease) in autonomous spending is converted into an increase (decrease) in equilibrium income. It is the ratio of the change in equilibrium income to the change in autonomous spending.

An increase in autonomous spending becomes income to those who receive it. These people spend the marginal propensity to consume times this income increase, which becomes income to the people who receive it. At each step, the new income created is smaller than at the last step, so too is the spending generated. As more steps are completed the additional income created at the step goes to zero. Adding up all the incomes created off the initial autonomous spending increase produces the change in equilibrium income. This change in income is equal to the multiplier times the original autonomous spending increase.