Problem Set 5 with Solutions

Lecture 5: Aggregate Expenditure Model in the Short Run, Consumption Function, Planned Investment, Government Purchases, Net Exports, Macroeconomic Equilibrium, the Multiplier Effect, and the AD Curve

1. In each case, calculate the slope of the PAE function as well as the expenditure multiplier. For parts (b) and (c), explain the intuition why the expenditure multiplier changes in the direction suggested by the math.

(a) There are no taxes, and all imports are autonomous. The marginal propensity to consume out of disposable income is 9/10.