

Extra Credit Problem

Name:

The economy is currently in equilibrium. The aggregate planned expenditure function is:

$$APE = C + I + G + NX$$

where NX are net exports, which are a part of the autonomous expenditure. Consumers pay taxes according to the following formula:

$$T = T_0 + s(Y - T_0)$$

where T_0 is the autonomous tax, Y is income, and s is the tax rate on the income in excess of T_0 . Assume that $Y \geq T_0$.

a) Derive the expression for the expenditure multiplier.

b) If the slope of the consumption function is 0.7, what will the change in the equilibrium GDP be if T_0 increases by 10?