Solutions

Marking: **M1** a correct method, **A1** the correct answer, **B1** an independent mark.

Each answer shows the steps, then the **result**.

2.1

the difference when real GDP is below potential output; so there is unemployment of resources / cyclical unemployment

2.2

any two: interest rates; business confidence / expected demand; technology; business taxes

2.3

oil is a key input, so firms' costs rise; SRAS shifts left; the price level rises and real GDP falls: stagflation / cost-push inflation and higher unemployment; correctly labelled diagram showing $\text{SRAS}_1 \rightarrow \text{SRAS}_2$, higher P, lower Y

2.4

$k = 1 \div (1 - 0.8) = \mathbf{5}$; change in GDP $= 5 \times 20 =$ \$**100** bn

2.5

$k = 1 \div (0.1 + 0.15 + 0.25) = \mathbf{2}$; more of each extra dollar of income leaks out as saving, taxes and imports; so each round of spending is smaller and the total effect on GDP is smaller

3.1

(a) AS horizontal at low output, upward-sloping, then vertical at full employment output; all three sections and axes labelled

(b) in a deep recession there are many unemployed resources / spare capacity; firms can raise output without bidding up wages or costs; so AD shifts right along the flat section of AS; real GDP rises and the price level stays about the same; as the economy nears full employment, costs rise, and further AD increases cause more inflation; diagram: $\text{AD}_1 \rightarrow \text{AD}_2$ in the flat section, higher Y, same P

3.2

award up to [8]: diagram: vertical LRAS at Y_p; AD falls, short-run equilibrium below Y_p; with high unemployment, wages and other costs fall over time; SRAS shifts right until the economy is back at Y_p at a lower price level; so no government action is needed in the long run; evaluation: wages are sticky downwards (contracts, minimum wages, unions), so this can take years; falling prices (deflation) can delay spending and raise real debt burdens, deepening the recession; Keynesians argue for government action to close the gap faster