Solutions

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

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

2.1

current: day-to-day spending on running services, e.g. teachers' wages, medicines; capital: spending on long-lasting assets, e.g. roads, hospitals, schools

2.2

in a recession more people lose jobs and receive benefits, so government spending rises automatically; this supports household income and spending, so AD falls less

2.3

lower income tax raises disposable income; consumption rises, so AD shifts right; real GDP rises towards potential output and unemployment falls; correctly labelled diagram with $AD_1 \to AD_2$, $Y_1 \to Y_p$

2.4

$k = 1 \div (1 - 0.75) = 4$; change in GDP $= 4 \times 12 =$ \$**48** bn

2.5

G enters AD in full in the first round; with a tax cut, households save part: only $0.75 \times 12 =$ \$9 bn is spent in the first round; so the total effect is $4 \times 9 =$ \$36 bn, less than \$48 bn

3.1

(a) any two: construction firms and their workers; steel and other suppliers; passengers and businesses using the railway later; the unemployed who find jobs

(b) G adds directly to AD, with a multiplier effect on income and jobs; it also raises long-run capacity (LRAS) by improving transport; but large projects take time to plan and start, so the effect may come after recovery; borrowing raises debt and may crowd out private investment if interest rates rise; judgement: effective if projects are ready and the recession is deep with idle resources

3.2

award up to [8]: to finance a deficit, the government borrows; higher demand for loanable funds raises interest rates; higher rates reduce private investment and consumption on credit; so the net rise in AD is smaller than the rise in G; in a deep recession, private demand for loans is weak and savings are high; so government borrowing may not raise interest rates much: little crowding out; central banks may also keep rates low; judgement: crowding out matters more near full employment than in a deep recession

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