

Suppose the UK Government borrows £20 billion more next year than this year.

- a. Does the interest rate rise or fall?
- b. What happens to investment? To private saving? To public saving? To national saving? Compare the size of the changes to the £20 billion of extra Government borrowing.
- c. How does the elasticity of supply of loanable funds affect the size of these changes?
- d. How does the elasticity of demand for loanable funds affect the size of these changes?
- e. Suppose households believe that greater Government borrowing today implies higher taxes to pay off the government debt in the future. What does this belief do to private saving and the supply of loanable funds today? Does it increase or decrease the effects you discussed in parts (a) and (b)?

Notes for students:

This short essay must be typed and should not be longer than 1000 words, **excluding** both graphs and the essay question itself (limits are strict); this is about 2 pages of text in Times New Roman, single spaced in font size 12. The ability to write succinctly is an important skill; and this essay will help you learn how to distil your ideas into a small number of key points. It is also useful preparation for the assessed (coursework) essay, which you will need to complete later in this semester.