2.26 The National Debt: Fiscal Sustainability and Fiscal Rules: 10-minute Pack

AQA 7136 · Calculators not allowed · about 10 minutes

Total Marks

Name: _____ Date: ____ / ____ / _____

Answer all questions. Full sentences are required for questions worth 4 marks or more. No calculator is allowed. The final question is worth 25 marks; plan your time accordingly.

1 A small country, Northmere, runs a primary surplus of 1% of GDP while its nominal GDP grows at 3% per year and its average effective interest rate on debt is 2% per year. Explain, using these figures, whether Northmere's debt-to-GDP ratio is likely to be falling or rising, and why.

(Total for Question 1 is 4 marks)

2 Explain how a credible fiscal rule combined with an independent fiscal council could improve fiscal sustainability for Albion, and give one limitation of relying on those institutions.

(Total for Question 2 is 4 marks)

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Mark scheme · 2.26 The National Debt: Fiscal Sustainability and Fiscal Rules: 10-minute Pack

Question 1

recognises that effective r < growth g (2% < 3%) and there is a primary surplus	**M1**
explains that with r < g the debt ratio tends to fall even with modest primary balances, and a primary surplus further reduces debt	**A1**
states the direction: debt-to-GDP ratio is likely falling	**M1**
explains that growth increases the denominator faster than interest accrues on the stock, and the surplus reduces the stock itself	**A1**

Answer: The debt-to-GDP ratio is likely falling because r (2%) is below GDP growth (3%), and the primary surplus of 1% further reduces the stock of debt relative to GDP.

Question 2

identifies mechanism: a credible rule signals commitment and the fiscal council provides independent forecasts and monitoring	**M1**
development: independent monitoring reduces information asymmetry, increases transparency and market confidence, lowering risk premia and gilt yields	**A1**
states a limitation, e.g. political risk or limited legal powers of the council	**M1**
development: if politicians ignore advice or change rules under pressure, credibility is lost and the institutions cannot enforce sustainable policy on their own	**A1**

Answer: A credible rule and independent fiscal council can raise transparency and market confidence, lowering yields; limitation: political override or limited enforcement power can erode credibility and effectiveness.

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