2.10 Fiscal Policy and the Public Finances: 30-minute Pack

Total Marks

AQA 7136 · Calculators not allowed · about 30 minutes

Name: _____ Date: ____ / ____ / _____

Answer all questions. Full sentences are required for questions worth 4 marks or more. Calculators are not allowed.

1 Define the budget deficit and explain how it differs from the national debt in the UK public finances context.

(Total for Question 1 is 3 marks)

2 Define the Laffer curve concept and state the implied policy implication for tax rates and tax revenue.

(Total for Question 2 is 3 marks)

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3 Data Table for Country A public finances, 2017 to 2021. The table shows Government Spending (G) and Tax Revenue (T) in GBP billion, and the annual budget deficit (Deficit = G - T) computed in the final column.

Year	Government Spending G (GBP billion)	Tax Revenue T (GBP billion)	Deficit (G - T) (GBP billion)
2017	780	800	-20
2018	795	805	-10
2019	820	810	10
2020	920	770	150
2021	900	790	110

Using the data in the table for Country A, explain how the data show a) the effect of a large economic shock on the public finances in 2020 and b) whether the deficit in 2021 is more likely to be structural or cyclical. Use the data to support your answer.

(Total for Question 3 is 9 marks)

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Mark scheme · 2.10 Fiscal Policy and the Public Finances: 30-minute Pack

Question 1

budget deficit = the amount by which government spending exceeds tax revenue in a given year **B1**

national debt = the total stock of past government borrowing outstanding, accumulated over many years **B1**

difference explained: deficit is a flow in one year, debt is the accumulated stock resulting from past deficits **B1**

Answer: The budget deficit is the annual amount by which government spending exceeds tax revenue; the national debt is the accumulated stock of past government borrowing built up from previous deficits.

Question 2

Laffer curve is the idea that there is a non-linear relationship between tax rates and tax revenue, such that very high tax rates can reduce incentives to work or invest, lowering revenue **B1**

it implies there is some tax rate between 0% and 100% that maximises tax revenue **B1**

policy implication: cutting tax from a rate above the revenue-maximising point may increase revenue, whereas cutting tax below that point reduces revenue **B1**

Answer: The Laffer curve describes a non-linear relationship where tax revenue rises then falls as tax rates increase, implying a revenue-maximising tax rate exists and that cutting taxes above that rate could raise revenue while cuts below it would lower revenue.

Question 3

Level 1 Limited use of the data, simple statements about the 2020 change or 2021 deficit, little or no economic explanation. **1-3**

Level 2 Clear use of the data to describe the large rise in the deficit in 2020 and some explanation, and a plausible judgement about 2021 being largely cyclical or structural with limited development. **4-6**

Level 3 Detailed use of the data quantifying the 2020 shock and its impact on spending and revenue, and a well-developed, balanced evaluation of whether the 2021 deficit is cyclical or structural with evidence from the table and economic reasoning. **7-9**

Indicative content:

- Data: deficit jumps from 10 in 2019 to 150 in 2020, an increase of £140 billion, driven by a rise in G from 820 to 920 (+100) and a fall in T from 810 to 770 (-40).
- This pattern is consistent with a large economic shock in 2020 that both increased government spending and reduced tax receipts, for example an economic downturn or emergency spending.
- Quantification strengthens answers: government spending rose by 12.2% (100/820) between 2019 and 2020, while tax revenue fell by 4.9% (40/810) over the same period.
- By 2021 the deficit falls to 110 from 150, with G falling to 900 and T rising to 790, suggesting partial recovery: spending reduced by 20 and revenues recovered by 20 compared with 2020.
- Interpretation of structural vs cyclical: because deficit increased sharply in 2020 and then partly reversed in 2021, this suggests much of the 2020 deficit was cyclical, arising from the shock. However, the remaining 110 deficit in 2021, higher than 2019 levels, could include a structural component or continued policy choices.
- Balanced judgement might note that without further information on potential output or pre-shock trends it is not possible to be certain, but the large swing points to a dominant cyclical element with a possible residual structural deficit in 2021.

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