2.10 Fiscal Policy and the Public Finances: Test Pack

AQA 7136 · Calculators not allowed · about 25 minutes

Total Marks

Name: _____ Date: ____ / ____ / _____

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

1 Define discretionary fiscal policy in the context of the UK government's use of spending and taxation to influence aggregate demand.

(Total for Question 1 is 2 marks)

2 Multiple choice: In the context of fiscal policy, which of the following best describes crowding out? A: Government spending directly increases private consumption by increasing household incomes. B: Government borrowing to finance spending raises interest rates and reduces private investment. C: Automatic stabilisers reduce the volatility of the business cycle. D: A tax cut that is fully offset by an increase in savings. Choose the single best answer for a UK economy.

- [ ] A
- [ ] B
- [ ] C
- [ ] D

(Total for Question 2 is 1 mark)

3 Define automatic stabilisers and give one UK example of such a mechanism.

(Total for Question 3 is 3 marks)

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4 State what is meant by the structural budget deficit and contrast it with the cyclical budget deficit, in the context of an economic downturn.

(Total for Question 4 is 3 marks)

5 Explain two reasons why discretionary fiscal policy might be less effective in practice at influencing aggregate demand than theory suggests.

(Total for Question 5 is 3 marks)

6 Country B has a national debt of £1,800 billion and nominal GDP of £2,400 billion. State the debt-to-GDP ratio as a percentage and briefly explain why policymakers watch this ratio.

(Total for Question 6 is 4 marks)

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Mark scheme · 2.10 Fiscal Policy and the Public Finances: Test Pack

Question 1

a deliberate change in government spending or taxation made by policymakers to influence aggregate demand **B1**

typically used to stabilise the economy, for example by increasing spending or cutting taxes in a recession **B1**

Answer: A deliberate change in government spending or taxes by policymakers to influence aggregate demand, for example cutting tax or raising spending to stimulate a recession.

Question 2

B is correct: crowding out refers to government borrowing pushing up interest rates and reducing private investment **B1**

Answer: B

Question 3

automatic stabilisers are fiscal mechanisms that change government receipts or spending automatically as the economic cycle moves, without new government action **B1**

example: unemployment-related benefit spending rises automatically when unemployment increases **B1**

or example: income tax receipts fall automatically when incomes fall during a downturn **B1**

Answer: Automatic stabilisers are fiscal mechanisms that automatically change tax receipts or benefit spending with the economic cycle, for example unemployment benefits rise when unemployment increases.

Question 4

structural deficit is the part of the deficit that would exist at full employment, reflecting permanent policy choices or structural factors **B1**

cyclical deficit is the part that arises because the economy is below potential, due to the economic cycle **B1**

contrast: cyclical falls as output gap closes, structural remains unless fiscal policy changes **B1**

Answer: The structural deficit is the portion of the budget shortfall that would persist at full employment due to policy or structural factors; the cyclical deficit arises because the economy is below potential and will shrink as output recovers.

Question 5

identifies one reason, e.g. long implementation lags and political delays can mean policy arrives too late to affect the current phase of the cycle **B1**

identifies a second reason, e.g. crowding out: increased government borrowing to finance spending can push up interest rates and reduce private investment **B1**

develops either point with a brief explanation of how it weakens the effect on AD **B1**

Answer: Delays in deciding and implementing discretionary fiscal measures can mean stimulus is mistimed, and borrowing to finance spending can crowd out private investment by raising interest rates, both reducing the policy's impact on aggregate demand.

Question 6

calculation: debt-to-GDP = (1,800 / 2,400) x 100 **M1**

= 75%, awrt 75% **A1**

states that policymakers monitor this ratio as an indicator of the sustainability of public finances and the capacity to borrow **B1**

development: high ratios may raise concerns about higher interest costs, credit ratings, and reduced fiscal space for future shocks **B1**

Answer: Debt-to-GDP = (1,800/2,400)*100 = 75%. Policymakers watch it as a measure of fiscal sustainability; a high ratio can increase interest costs and limit future borrowing ability.

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