IGCSE ECONOMICS · 2.1 GOVERNMENT AND THE ECONOMY · CHAPTER 31 · PAPER 2

# Fiscal Policy

**Topic question sheet L31** | **Total: 31 marks** | **Time: 35 minutes** | **Student Book pp. 250–258**

**Instructions:** answer **all** questions. Write your answers on lined paper. The marks for each question are shown in brackets: use them as a guide to how much to write.

Calculators may be used. Show your working. Draw diagrams in pencil and label them fully. The mark scheme starts on a new page: do not look at it until you have finished.

## Section A: Multiple choice

One mark each. Choose **one** answer: A, B, C or D.

**1** A government spends €654.5m and collects €631.6m in revenue. Its fiscal balance is a: **(1)**

**A** €654.5m deficit
**B** €22.9m surplus
**C** €1286.1m surplus
**D** €22.9m deficit

**2** Which fiscal measure is most likely to increase a fiscal deficit? **(1)**

**A** An increase in spending on education
**B** A rise in VAT
**C** A cut in pension payments
**D** A rise in corporation tax

**3** Which of the following is an indirect tax? **(1)**

**A** Income tax
**B** Corporation tax
**C** VAT
**D** Inheritance tax

**4** To reduce inflation caused by excess demand, a government should: **(1)**

**A** cut taxes
**B** raise government spending
**C** raise taxes
**D** increase benefits

## Section B: Short answers

Define, state, calculate, draw and explain. Show your working for calculations.

**5** Define **fiscal policy**. **(1)**

**6** Calculate Nordova's planned fiscal deficit as a percentage of GDP. You are advised to show your working. **(3)**

**7** State **two** direct taxes. **(2)**

**8** Explain why a growing national debt can be a problem. **(3)**


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## Section C: Data response

Read the extract, then answer the questions. Use evidence from the extract in every answer.

### Extract: Budget in Nordova

The fictional country of Nordova plans to spend US$84 billion next year and expects tax revenue of US$78 billion. Its GDP is US$400 billion and unemployment has risen to 9%.

The finance minister wants to cut income tax by 2% and spend US$5 billion on new railways. Opposition politicians say this will increase the national debt, which already costs US$6 billion a year in interest. Inflation is low at 1%.

Fictional case, written for this sheet.

**9** With reference to the extract, analyse how the minister's plans could reduce unemployment in Nordova. **(6)**

**10** With reference to the extract, evaluate whether Nordova should adopt the minister's plans. **(12)**


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# Mark scheme: Fiscal Policy

**How to mark: Multiple choice, Define, State**: 1 mark. **What is meant by** (2): two separate parts to the definition. **Calculate**: working and answer (with units). **Draw** (3): one mark per correct labelled feature. **Explain** (3): 1 for a point, 2 for developing it in context. **Analyse** (6): knowledge 2, application 2, analysis 2. **Assess** (9) and **Evaluate** (12) are marked by levels: choose the level that best fits the whole answer. Indicative content is a guide: credit other valid points.

## Section A

**1** *A government spends €654.5m and collects €631.6m in revenue. Its fiscal balance is a: (1 mark)*

**Answer: D** (€22.9m deficit). Spending exceeds revenue by €22.9m.

**2** *Which fiscal measure is most likely to increase a fiscal deficit? (1 mark)*

**Answer: A** (An increase in spending on education). More spending, same revenue.

**3** *Which of the following is an indirect tax? (1 mark)*

**Answer: C** (VAT). A tax on spending.

**4** *To reduce inflation caused by excess demand, a government should: (1 mark)*

**Answer: C** (raise taxes). Contractionary fiscal policy.

## Section B

**5** *Define fiscal policy. (1 mark)*

Decisions about government spending, taxation and levels of borrowing that affect aggregate demand (1).

**6** *Calculate Nordova's planned fiscal deficit as a percentage of GDP. You are advised to show your working. (3 marks)*

Deficit = 84 − 78 = US$6bn (1).

6 ÷ 400 × 100 (1).

**Answer:** 1.5% of GDP (1).

**7** *State two direct taxes. (2 marks)*

Any two (1 each): income tax; corporation tax; social insurance tax; capital gains tax; inheritance tax.

**8** *Explain why a growing national debt can be a problem. (3 marks)*

**Point:** more revenue must be spent on interest (1).

**Development:** an opportunity cost, e.g. less for schools or tax cuts (1); burden passed to future generations (1).


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## Section C

**9** *With reference to the extract, analyse how the minister's plans could reduce unemployment in Nordova. (6 marks · K2 · Ap2 · An2)*

**Knowledge (2):** expansionary fiscal policy raises aggregate demand.

**Application (2):** 2% income tax cut; US$5bn railways; unemployment 9%.

**Analysis (2):** more disposable income raises consumption; railway building is labour intensive, creating jobs directly; firms hire more to meet demand.

Knowledge 2 · Application 2 · Analysis 2.

**10** *With reference to the extract, evaluate whether Nordova should adopt the minister's plans. (12 marks · levels)*

**For:** unemployment 9% and inflation only 1%, so little risk of inflation; railways raise productive potential and long-run growth; deficit only 1.5% of GDP.

**Against:** deficit and debt rise; interest already US$6bn (opportunity cost); tax cut may be spent on imports; future burden.

**Judgement:** yes, mainly the capital spending, as low inflation leaves room; depends on borrowing costs and whether growth raises future tax revenue.

Levels: L1 1–3 · L2 4–6 · L3 7–9 · L4 10–12 (balanced, well-developed arguments using the data throughout, and a justified conclusion that answers the question).

Original practice questions written in the style of the Pearson Edexcel International GCSE Economics (4EC1) papers. This is not an official paper. Unless a source is given, the firms, countries and figures are fictional and made up for practice.


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