Past-paper walk-through

Effectiveness of policy options to meet all macroeconomic objectives ▪ 10.3

eXercise

Questions in this set

- 9708/31 N25 Q16 ▪ 1 mark
- 9708/32 N25 Q20 ▪ 1 mark
- 9708/33 N25 Q18 ▪ 1 mark
- 9708/33 N25 Q22 ▪ 1 mark
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Question 16

9708/31 N25 ▪ Q16 ▪ 1 mark

16 What describes a Keynesian measure to reduce cyclical unemployment?

A adopting a supply-side policy to retrain unskilled workers

B allowing the private sector to take over the supply of merit goods

C increasing the ratio of capital equipment to manual labour in production

D using fiscal policy to increase effective demand

Solution 16

Answer: **D**

Why

- Cyclical unemployment comes from a deficiency of aggregate demand.
- The Keynesian remedy is therefore to raise aggregate demand directly.
- That means expansionary fiscal policy – government spending or tax cuts, not supply-side retraining.

Question 20

9708/32 N25 ▪ Q20 ▪ 1 mark

20 A government funds an increase in transfer payments to the unemployed by increasing the higher rate of income tax.

What is the most likely impact of this change?

A government borrowing increases

B the incentive to work increases

C the marginal propensity to consume increases

D the quantity of imports increases

Solution 20

Answer: **C**

Why

- Transfer payments to the unemployed go to people with a high propensity to consume.
- Higher-rate taxpayers have a lower propensity to consume, so they cut spending by less.
- So aggregate demand rises overall, and the income distribution becomes more equal.

Question 18

9708/33 N25 ▪ Q18 ▪ 1 mark

18 Which combination of policies is most likely to reduce cyclical unemployment but might increase frictional unemployment?

	direct taxes	unemployment benefits
A	decrease	decrease
B	decrease	increase
C	increase	decrease
D	increase	increase

Solution 18

Answer: **B**

Why

- Cutting direct taxes raises disposable income, so aggregate demand and employment rise – less cyclical unemployment.
- But raising unemployment benefits lengthens job search, so frictional unemployment rises.
- So the combination pulls the two kinds of unemployment in opposite directions.

Question 22

9708/33 N25 ▪ Q22 ▪ 1 mark

22 The central bank of an economy decreases the money supply in an attempt to reduce inflation.

Under which conditions is this policy most likely to be effective?

	exchange rate	responsiveness of aggregate demand to interest rate changes
A	fixed	low
B	fixed	high
C	floating	low
D	floating	high

Solution 22

Answer: **D**

Why

- Reducing the money supply raises interest rates, which reduces borrowing and spending.
- It works best when spending is *responsive* to interest rates.
- If households and firms borrow regardless of the rate, the policy has little effect.

Question 22

9708/34 N25 ▪ Q22 ▪ 1 mark

22 A government is aiming to increase the role of market forces.

Which policy might achieve this?

A deregulation

B nationalisation

C price controls

Question 22

D production quotas

Solution 22

Answer: **A**

Why

- Increasing the role of market forces means reducing state control.
- Deregulation removes the rules that restrict competition.
- Nationalisation, price controls and quotas all *increase* government intervention.

Question 25

9708/34 N25 ▪ Q25 ▪ 1 mark

25 What does the Laffer curve show?

A the amount of tax revenue received at each tax rate

B the impact on the distribution of income after tax rates rise

C the rise in inflation following a fall in unemployment due to a cut in income tax

D the rise in poverty due to a rise in the basic rate of income tax

Solution 25

Answer: **A**

Why

- The Laffer curve plots tax revenue against the tax rate.
- Revenue rises with the rate at first, peaks, then falls as incentives and compliance weaken.
- So it shows the revenue obtained at each possible tax rate.