A-LEVEL ECONOMICS • EXERCISE SHEET

10.3 Effectiveness of policy options to meet all macroeconomic objectives

Name: __________ Class: ________ Date: ________ **Total: 24 marks**

Objective

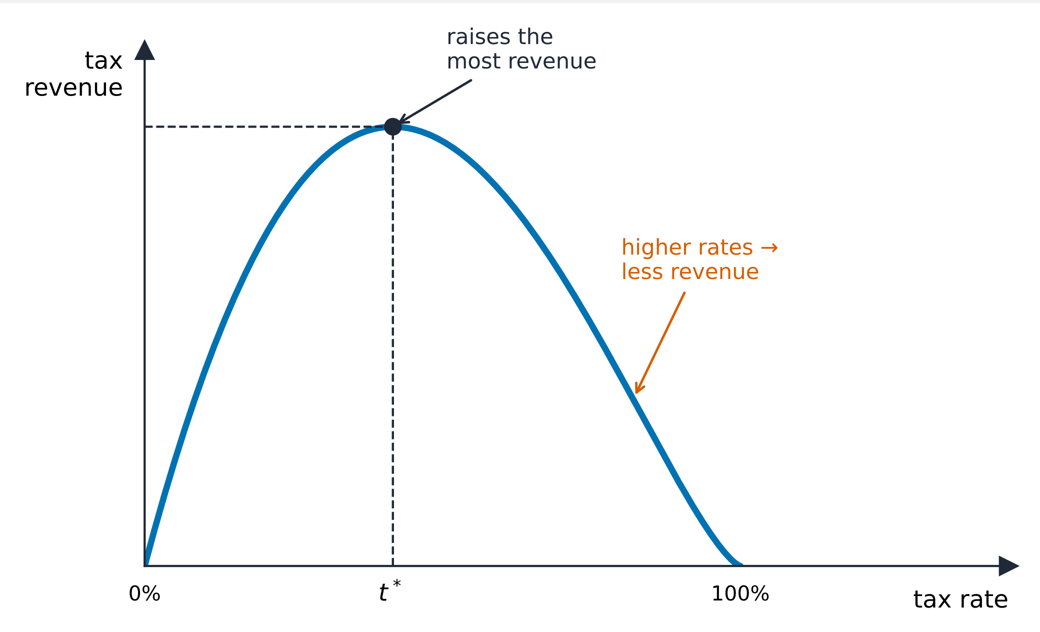
Build the skills to answer exam questions on the **effectiveness of policy options** 政策有效性—the strengths and weaknesses of **fiscal, monetary and supply-side** policy, including **crowding out** 挤出效应 and the **Laffer curve** 拉弗曲线.

You must be able to:

- explain the strengths and weaknesses of each policy
- explain crowding out and the Laffer curve
- evaluate the best policy mix to meet objectives

1 Worked examples

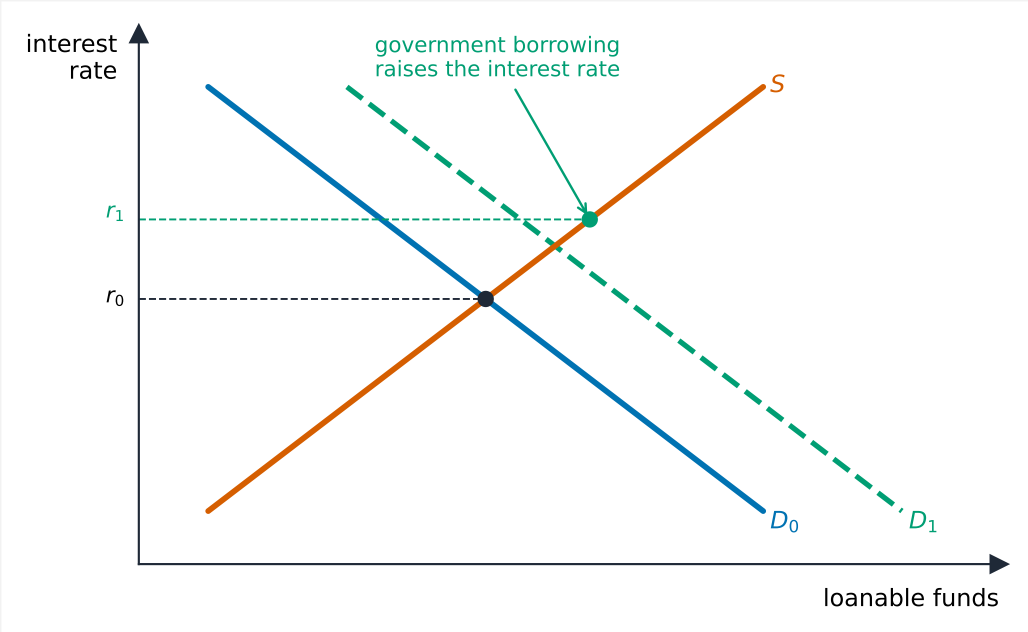
■ The Laffer curve



Revenue is zero at 0% and 100%; going above t lowers revenue*

- **Fiscal policy:** powerful and targeted, but has **time lags** 时滞, raises **national debt** 国债, and risks **crowding out** 挤出效应.

- **Monetary policy:** flexible, but works with a lag and is weak in a deep slump.



A key limit on fiscal policy: crowding out private investment

- **Supply-side policy:** raises growth *and* lowers inflation, but is slow and costly.
- **Laffer curve** 拉弗曲线: above the revenue-maximising rate t^*, higher tax rates *cut* revenue.

Answer shapes: an **Explain** [**up to 8**] answer may use a diagram (AO3); **Discuss** [**12**] adds a judgement (AO4).

2 Practice

2.1 Define the term *crowding out*. [2]

2.2 State what the **Laffer curve** shows. [2]

2.3 State one weakness of monetary policy. [1]

3 Exam-style questions

3.1 According to the Laffer curve, raising the tax rate **above** the revenue-maximising rate will: [1]

- **A** always raise tax revenue
- **B** lower tax revenue
- **C** leave tax revenue unchanged
- **D** raise the money supply

3.2 Explain how heavy government borrowing can crowd out private investment. [6]

3.3 Discuss which policy a government should rely on most to achieve long-term economic growth. [12]

4 Go further

You are now ready for the real exam questions on this subtopic. Open the **10.3 Effectiveness of policy options to meet all macroeconomic objectives** past-paper sheet in the Library, or try these in **Practice mode**:

- 9708/31 N25 —Q16 (policy effectiveness)
- 9708/32 N25 —Q20 (crowding out / fiscal policy)
- 9708/33 N25 —Q18 (policy options)

Solutions

Economics answers are marked by **level of response** against the assessment objectives: award **AO1** knowledge, **AO2** application, **AO3** analysis and **AO4** evaluation.

2.1 when heavy government borrowing raises interest rates and so reduces private-sector investment (2 for a clear definition; 1 for a partial idea).

2.2 that as the tax rate rises, tax revenue first rises but then falls, because very high rates discourage work and encourage avoidance (2 for a clear statement; 1 for a partial idea).

2.3 any one of: it works with a long time lag; it is weak in a deep slump (a liquidity trap); it cannot fix structural problems (1).

3.1 B. Above the revenue-maximising rate, higher tax rates lower revenue.

3.2 *[6]* AO1 1 + AO3 up to 5 —to fund a deficit the government borrows heavily → this raises the demand for loanable funds → the interest rate rises → dearer borrowing means firms invest less → public spending "crowds out" private investment, reducing the net effect on AD.

3.3 *[12]* AO1/AO2/AO3 up to 8 + AO4 up to 4. **Supply-side:** the only tool that raises capacity and productivity, giving growth *with* low inflation —but slow and costly. **Demand-side (fiscal/monetary):** quick to raise output but mainly short-run and inflation-prone. Judgement: for *long-term* growth supply-side policy should lead, supported by stable demand-side policy —the best mix depends on the time horizon and the economy's starting point.