Past-paper walk-through

Fiscal Policy ▪ 3.8

eXercise

Questions in this set

- 2026 Q3
- 2025 Set 1 Q3
- 2025 Set 2 Q1
- 2025 Set 2 Q3
- 2024 Set 1 Q3
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- 2023 Set 1 Q1
- 2021 Set 1 Q2
- 2021 Set 2 Q1
- 2021 Set 2 Q3

Questions in this set

- 2018 Q1
- 2015 Q1

Reading the mark scheme

- **B1** a mark that stands on its own – the point is either made or not.
- **M1** a *method* mark: the right approach, even if the number is wrong.
- **A1** an *answer* mark, and it usually needs its M mark first.
- **C1** a working mark on the way to the answer.
- // separates answers the examiner accepts equally.
- **ecf** = error carried forward: a later part is marked on your own earlier answer.
- **owtte** = "or words to that effect" – the wording need not match.

Question 3

2026 ▪ Q3

Lizland is a small island nation, and its currency is the Lizland crown (LIZ). The economy of Lizland is in short-run macroeconomic equilibrium with a 600 million crown recessionary gap.

(a)(i) Policymakers in Lizland are considering taking action to close the recessionary gap in the short run.

The central bank of Lizland is considering implementing monetary policy. The banking system of Lizland has ample reserves. Identify a specific monetary policy action the central bank of Lizland would implement to close the recessionary gap in the short run.

(a)(ii) The government of Lizland is also considering changing its spending, and the marginal propensity to consume is 0.75. Calculate the minimum change in government spending and identify the direction of the change required to fully close the 600 million crown recessionary gap in the short run. Show your work.

Question 3

2026 ▪ Q3

Lizland is a small island nation, and its currency is the Lizland crown (LIZ). The economy of Lizland is in short-run macroeconomic equilibrium with a 600 million crown recessionary gap.

(b) Assume that the government of Lizland decides to change its spending as calculated in part A (ii). Based solely on this change, will the price level in Lizland increase, decrease, or remain the same in the short run? Explain.

Question 3

2026 ▪ Q3

Lizland is a small island nation, and its currency is the Lizland crown (LIZ). The economy of Lizland is in short-run macroeconomic equilibrium with a 600 million crown recessionary gap.

(c) The nations of Lizland and Andoh are trading partners with flexible exchange rates. The currency of Andoh is the Andoh note (AND). Draw a correctly labeled graph of the foreign exchange market for the Lizland crown (LIZ). Based solely on the change in the price level in part B, show the change in the international value of the Lizland crown on your graph.

Question 3

2025 Set 1 ▪ Q3

3. The table provided shows the quantities and unit prices of shirts, bread, and pants, the only three goods produced in the country of Middleland in 2021 and 2022. Assume that 2021 was the base year.

	Shirts	Bread	Pants
Unit Prices in 2021	$11	$4	$12
Unit Prices in 2022	$10	$5	$15
Quantities Produced in 2021 and 2022	50	70	30

Question 3

A. Was the real GDP in 2021 in Middleland greater than, less than, or equal to the nominal GDP in 2021? Explain.

B. Calculate the real GDP in Middleland in 2022. Show your work.

C. Assume that Middleland was in short-run equilibrium in 2022 and that POTENTIAL real GDP was $1,150 in 2022. Draw a correctly labeled graph of the aggregate demand, short-run aggregate supply, and long-run aggregate supply curves for Middleland in 2022, and show each of the following.

  i. The equilibrium real output and price level, labeled Y_1 and PL_1, respectively

  ii. The full-employment output, labeled Y_F

D. Assume the marginal propensity to consume in Middleland is 0.8. Calculate the minimum change and state the direction of change in government spending required to close the output gap in the short run in Middleland. Show your work.

Question 3

STOP

END OF EXAM

Solution 3

(a)

Mark scheme

- Real GDP in 2021 was EQUAL to nominal GDP in 2021. Because 2021 is the base year, the price level has not changed relative to itself, and real values always equal nominal values in the base year. 1 point.

Solution 3

(b)

Mark scheme

- Real GDP in Middleland in 2022 $=$ $1,190(2021 base - year prices applied to 2022 quantities). Work : Real GDP = (11$ $\times$ 50) $+$ (4×70) $+$ $($12 $\times$ 30) $=$ 550+280 $+$ 360 $=$1,190. 1 point for the calculation with work shown.

Solution 3

(c)

Mark scheme

- This line is only the stem instructing the student to draw the AD/SRAS/LRAS graph for 2022 and 'show each of the following'; it has no independently scorable content beyond what is graded in C(i) and C(ii).

Solution 3

(c)(i)

Mark scheme

- Draw a correctly labeled aggregate demand–aggregate supply graph (Price Level on the vertical axis, Real GDP on the horizontal axis) with a downward-sloping AD curve and an upward-sloping SRAS curve intersecting at the equilibrium point, labeling the equilibrium price level PL_1 and equilibrium real output Y_1. 1 point.

Solution 3

(c)(ii)

Mark scheme

- On the same graph, add a vertical long-run aggregate supply (LRAS) curve positioned to the LEFT of Y_1 (since 2022 short-run output $Y_1 = 1,190 exceedspotentialrealGDPof$1,150), and label the full-employment output on the LRAS curve as Y_F. 1 point.

Solution 3

(d)

Mark scheme

- Minimum change in government spending = a DECREASE of \$8. Work: Output Gap = Potential GDP − Actual 2022 Real GDP = \$1,150 − \$1,190 = −\$40. Spending multiplier = 1/(1−MPC) = 1/(1−0.8) = 5. Minimum ΔG = Output Gap ÷ Multiplier = −\$40 ÷ 5 = −\$8 (government spending must decrease by \$8 to close the inflationary output gap). 1 point for the calculation with work shown.

Question 1

2025 Set 2 ▪ Q1

Assume that the economy of Barrikos is in short-run equilibrium, with its economic data summarized in the table provided. The government budget is balanced, and the capital and financial account (CFA) balance is zero.

Cyclical unemployment rate	6%
Natural unemployment rate	4%
Structural unemployment rate	1%
Actual inflation rate	3%
Expected inflation rate	5%

Question 1

(a) What is the numerical value of the actual unemployment rate in Barrikos?

Question 1

Cyclical unemployment rate	6%
Natural unemployment rate	4%
Structural unemployment rate	1%
Actual inflation rate	3%
Expected inflation rate	5%