Exercise walk-through

Fiscal policy ▪ 4.2

eXercise

You must be able to

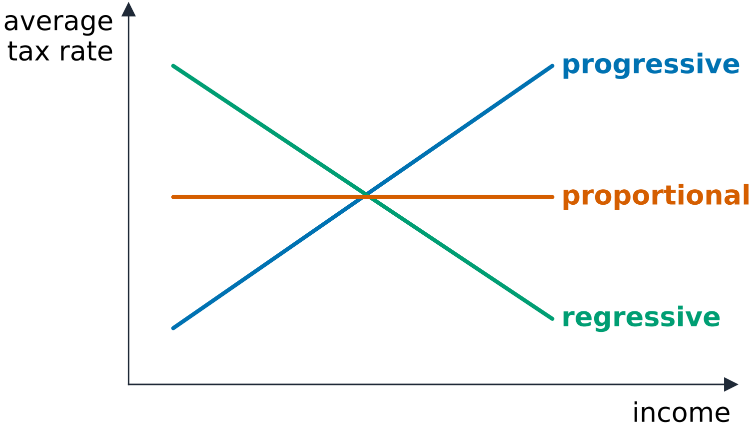
- explain fiscal policy, budget deficit and surplus
- classify taxes (direct/indirect, progressive/regressive)
- analyse how fiscal policy affects the economy

Method — Spending, tax and the budget

- **Budget deficit 预算赤字**: spending > tax (must borrow). **Surplus 盈余**: tax > spending.
- **Direct tax 直接税**: on income/profit. **Indirect tax 间接税**: on spending.
- **Progressive tax 累进税**: rate rises with income (redistributes). **Regressive tax 累退税**: rate falls with income.
- **Boost the economy:** more spending or lower taxes (raises demand) — but may cause inflation.

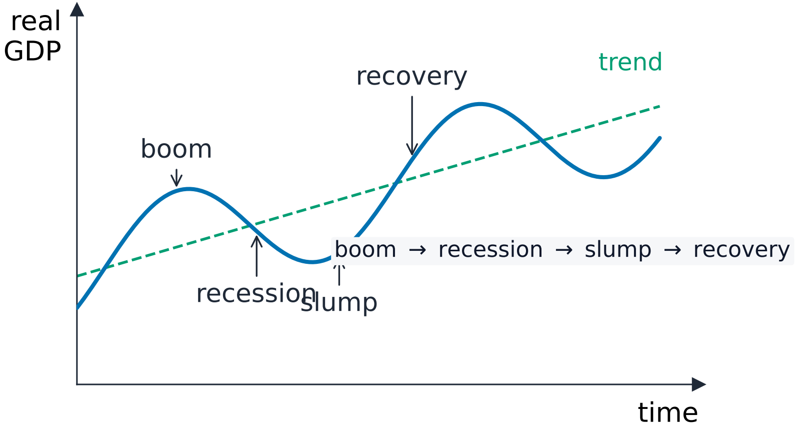
Answer shapes: K + App + An + Ev (a justified judgement, for discuss questions).

Method — Spending, tax and the budget



Average tax rate against income for the three tax types

Method — Spending, tax and the budget



Real GDP moves through boom, recession, slump and recovery

Practice 2.1 ▪ 2 marks

Define the term *fiscal policy*.

Solution 2.1

Method: Spending, tax and the budget

Worked steps

the government changing its spending and taxation to manage the economy (2 for a clear definition; 1 for a partial idea).

Practice 2.2 ▪ 2 marks

State the difference between a *direct* and an *indirect* tax.

Solution 2.2

Method: Spending, tax and the budget

Worked steps

a direct tax is paid straight to the government from income or profit; an indirect tax is added to the price of goods and paid when spending (2 for a clear difference; 1 for a partial idea).

Practice 2.3 ▪ 2 marks

Define the term *budget deficit*.

Solution 2.3

Method: Spending, tax and the budget

Worked steps

when government spending is greater than the tax raised, so the government must borrow (2 for a clear definition; 1 for a partial idea).

Exam-style 3.1 ▪ 1 mark

A **progressive** tax takes:

- **A** a bigger percentage from higher incomes
- **B** a smaller percentage from higher incomes
- **C** the same percentage from everyone
- **D** no tax from the rich

Solution 3.1

- **A** a bigger percentage from higher incomes ✓
- **B** a smaller percentage from higher incomes
- **C** the same percentage from everyone
- **D** no tax from the rich

Worked steps

A. A progressive tax takes a bigger percentage from higher incomes.

Exam-style 3.2 ▪ 4 marks

Explain how a government could use fiscal policy to increase economic growth.

Solution 3.2

Method: Spending, tax and the budget

Worked steps

[4] K 1 + An up to 3 — the government can raise its own spending (e.g. on roads, schools) or cut taxes → this leaves people and firms with more to spend → total demand rises → firms produce more and hire more workers → economic growth rises.

Exam-style 3.3 ▪ 8 marks

Discuss whether raising taxes is a good way for a government to reduce inflation.

Solution 3.3

Method: Spending, tax and the budget

Worked steps

[8] K/App/An up to 5 + Ev up to 3. **For raising taxes:** higher taxes leave people with less to spend → total demand falls → demand-pull inflation eases. **Against:** it lowers demand, which can raise unemployment and slow growth; it is unpopular; and it does not help *cost-push* inflation. **Judgement (Ev):** raising taxes can curb demand-pull inflation, but it risks higher unemployment and does not fix cost-push inflation — so it depends on the cause of inflation and the state of the economy.