

*Edexcel A-level Economics exam practice answers*

21: The role of the state in the economy

1 (a) **Correct answer: D** Fall [1]

(b) Vat is an indirect tax; expenditure on food is typically a large proportion of a person's income. Therefore an increase in VAT on food is likely to have a regressive effect i.e. it will make income distribution more uneven. [4]

2 (a) **Correct answer: C** An increase in the skills of the workforce [1]

(b) A depreciation has the effect of reducing the foreign price of a country's exports while raising the price of its imports. However, the higher import prices could result in a higher rate of inflation so reducing competitiveness. Also exporters might use the depreciation as an opportunity to raise prices and so increase their profit margins. [4]

3

(a) **KN: 2 marks; AP: 2 marks; AN: 1 mark**

- Definitions of fiscal deficit and national debt
- Increase in fiscal deficit is likely to cause the country's national debt to increase
- Reference to country, e.g. UK, Greece

(b) **KN: 2 marks; AP: 2 marks; AN: 2 marks Evaluation: 2 marks**

KN & AN:

- Definition of output gap
- Impact of Covid-19 on output gaps in Germany and Spain – larger negative output gap in Spain than in Germany
- Illustration of negative output gap using AD/AS diagrams

AP

- Use of GDP data in Table 1 for Germany and Spain

Evaluation:

- Impact may be short-term only if pandemic was brought under control
- Difficulty of estimating output gap



(c) **KAA** 8 marks; **Evaluation:** 4 marks

KAA:

Costs of unemployment include:

- Opportunity cost: goods and services which could have been produced by the unemployed
- Lower living standards for those out of work and possibility of increased inequality
- Increased pressure on the public finances: increased spending on social benefits; lower tax revenues from income tax, VAT
- Date references from Table 1

Evaluation:

- Costs to economy depend on how long people are unemployed
- Costs to households depend on time out of work and welfare benefits
- Impact on public finances depends on the length of recessions in a country and on government policies.

(d) **KAA** 16 marks; **Evaluation:** 9 marks

KAA: Case for reducing budget deficits quickly

- Rising budget deficits could lead to inflationary pressures – especially if financed by the banking system
- Would lead to an increasing national debt – leading to higher interest payments and an opportunity cost (money could have been used to fund public services)
- In turn higher interest rates might lead to financial crowding out – less private sector investment
- Higher budget deficits might lead to loss of confidence in the economy and to a depreciation in its exchange rate
- Credit rating of the country might fall making it harder and more expensive to borrow money

EV: Case against reducing budget deficits quickly

- Money being spent on the job retention scheme and self-employed income support scheme helps to keep people in jobs and prevents the costs associated with unemployment
- Could make the recession worse and cause a further fall in GDP e.g. if deflationary policies are used
- Reflationary policies would cause a rise in the rate of economic growth so the budget deficit and national debt may fall as a proportion of GDP
- Interest rates are currently very low so servicing the national debt may be falling as a proportion of GDP
- Spending on infrastructure may be justified because it will increase the productive capacity of the country in the future.

