



Edexcel A - AS Level Economics

Theme 2 – The UK economy – performance and policies

2.6 Macroeconomic objectives and policies

Worked Examples

Contents

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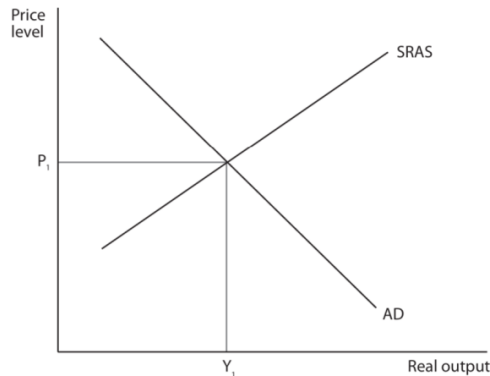
- Macroeconomic objectives and policies

2.6 Macroeconomic objectives and policies

Exam Style Question 1

In August 2018 the Monetary Policy Committee of the Bank of England raised the UK's base interest rate from 0.5% to 0.75%.

- (a) Define the term 'interest rate'. [1]
- (b) Annotate the aggregate demand (AD) and short-run aggregate supply (SRAS) diagram below to show the possible impact of a rise in the base interest rate on the equilibrium level of real output and the price level. [2]



- (a) Which **one** of the following demand-side policies best explains a rise in the base interest rate? [1]

- A Contractionary fiscal policy
- B Contractionary monetary policy
- C Expansionary fiscal policy
- D Expansionary monetary policy

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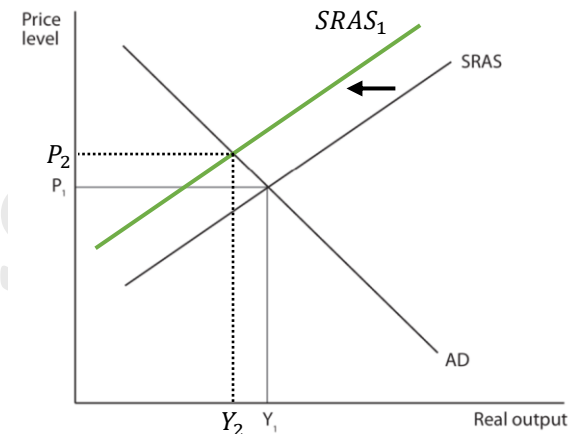
Exam Style Question 1

Answer:

- (a) Define the term 'interest rate'.

The **interest rate** is the cost of borrowing money or the reward for saving money, expressed as a percentage. When you take out a loan, it's the extra amount you pay back to the lender. [1]

- (b) Annotate the diagram to show the impact of a rise in interest rates.



- (c) Which **one** of the following demand-side policies best explains a rise in the base interest rate?

Answer: B – Contractionary monetary policy

Option A and C: Incorrect as fiscal policy involves government spending or changes in tax rates.

Option D: Incorrect because an expansionary monetary policy involves reducing interest rates and increasing asset purchases (quantitative easing).

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Exam Style Question 2

The UK has experienced a budget deficit since 2001. The government aimed to reach a budget surplus by 2019, but in 2016 this target was abandoned.

(Source: adapted from <https://www.gov.uk/government/news/autumn-statement-2016-some-of-the-things-weve-announced>)

- (a) Explain **one** likely reason why the 2019 budget surplus target was abandoned. [2]
- (b) Explain the likely impact of abandoning the budget surplus target on the UK national debt. [2]
- (c) If a government takes decisions to target a budget surplus, this is an example of: [1]
- A Contractionary monetary policy
 - B Discretionary fiscal policy
 - C Expansionary fiscal policy
 - D Expansionary monetary policy

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Exam Style Question 2

Answer:

(a) Explain one likely reason why the 2019 budget surplus target was abandoned.

One key reason why the UK abandoned its budget surplus target in 2016 was the economic uncertainty following the Brexit referendum. The decision to leave the EU created instability in financial markets, lowered business confidence [1], and slowed economic growth. To avoid further economic downturn, the government chose to continue borrowing and spending rather than cutting expenditures or increasing taxes to achieve a surplus. [1]

(b) Explain the likely impact of abandoning the budget surplus target on the UK national debt.

By not achieving a budget surplus, the UK continued to spend more than it collected in revenue, which meant the government had to keep borrowing. [1] This increased the national debt [1] because the country had to finance its spending through loans, leading to higher interest payments in the future.

(c) If a government takes decisions to target a budget surplus, this is an example of:

Answer: B - Discretionary fiscal policy

Option A and D: Incorrect as this is monetary policy and not fiscal policy.

Option C: Incorrect as this would involve a budget deficit.

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Exam Style Question 3

Which **one** of the following is an example of a market-based supply-side policy? [1]

- A A reduction in unemployment benefits
- B Construction of new transportation links
- C Government-funded apprenticeship schemes
- D Increased government spending on healthcare

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Exam Style Question 3

Answer:

Answer: A – A reduction in unemployment benefits

Option B, C and D: Incorrect as they are all interventionist supply-side policy.

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Exam Style Question 4

The UK Government is planning to cut the rate of corporation tax on all pre-tax profits of companies to 17% by 2020. [1]

(Source: adapted from <https://www.ft.com/content/7579f124-5742-11e7-9fed-c19e2700005f>)

(a) This would be an example of:

- A A contractionary monetary policy
- B An exchange rate policy
- C An expansionary monetary policy
- D A supply-side policy

(b) If a company makes £500,000 pre-tax profit in 2020, calculate how much corporation tax it will pay. Assume that the government cuts the rate of corporation tax as planned. [2]



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Exam Style Question 4

Answer:

(a) This would be an example of:

Answer: D – A supply-side policy. [1]

Option A and C: Incorrect as that would involve interest rates/QE.

Option B: Incorrect as that would involve changing the value of the pound.

(b) If a company makes £500,000 pre-tax profit in 2020, calculate how much corporation tax it will pay.

The new corporation tax rate is 17%. To calculate the tax:

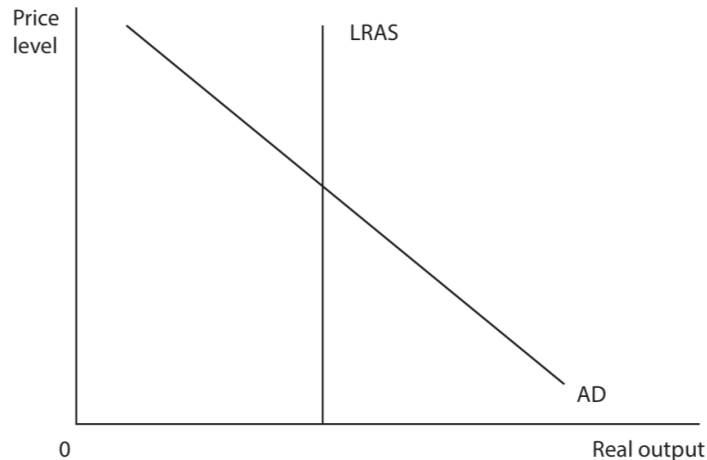
$$\begin{aligned} \text{Tax} &= \text{Profit} \times \text{Tax rate} \\ \text{Tax} &= 500,000 \times 0.17 \\ \text{Tax} &= 85,000 \end{aligned}$$

The company will pay £85,000 in corporation tax.

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Exam Style Question 5

The diagram below shows the AD and a possible long-run LRAS for the UK.



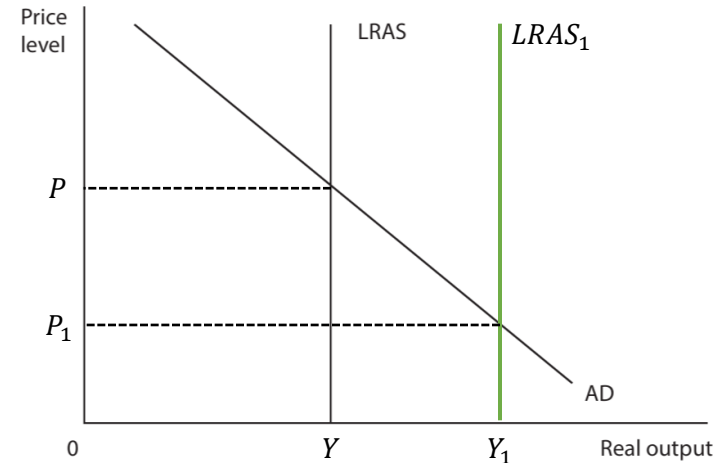
- (a) Annotate the diagram above to show the likely impact of government policy to promote business competition on the equilibrium level of real output and price level. [2]
- (b) Which **one** of the following is an interventionist supply-side policy? [1]
- A An improvement in infrastructure
 - B An increase in indirect taxation
 - C An increase in interest rates
 - D An increase in the regulation of markets

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Exam Style Question 5

Answer:

(a) Annotate the diagram... [2]



(b) Which **one** of the following is an interventionist supply-side policy?

Answer: A – An improvement in infrastructure. [1]

Option B: Incorrect as an increase in indirect taxation is an example of contractionary fiscal policy.

Option C: Incorrect as an increase in interest rate is an example of contractionary monetary policy.

Option D: Incorrect as an increase in the regulation of markets is example of market-based supply side policy.

Please see the '2.6 Macroeconomic Objectives and Policies Revision Notes' pack for detailed notes.

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