

Effectiveness of policy options to meet all macroeconomic objectives

A2

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Read first: [Fiscal policy](#), [Monetary policy](#), [Supply-side policy](#), [Policies to correct imbalances in the current account of the balance of payments](#), [Links between macroeconomic problems and their interrelatedness](#)

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What you need to know

The AS notes on fiscal, monetary and supply-side policy explain **how** each policy works, and the previous topic explains how the objectives are linked. This topic asks the A Level question: **how well does each policy meet the objectives, all of them together, and what goes wrong?** You need to be able to:

1. **Judge how effective each type of policy is against each macroeconomic objective** (economic growth, low unemployment, low and stable inflation, a sustainable current account, and often a sound budget and a fair distribution of income):
 - **fiscal policy**, including **Laffer curve** analysis of tax rates and tax revenue;
 - **monetary policy** (interest rates, the money supply, quantitative easing);
 - **supply-side policy**, both **market-based** (tax and benefit incentives, deregulation, privatisation) and **interventionist** (training, infrastructure, support for technology);
 - **exchange rate policy** (devaluation, revaluation, managing the rate);
 - **international trade policy** (tariffs, quotas, export subsidies).
2. **Explain the problems and conflicts that the outcomes of these policies create**: a policy that helps one objective can harm another, policies can work against each other, and they have side effects such as a bigger national debt or a less equal distribution of income.
3. **Explain government failure in macroeconomic policy**: when intervention makes the economy perform worse than it would have done, or creates new problems.

Understand it

The question behind every answer: "effective for what, and at what cost?"

A policy is **effective** when it moves the objective it is aimed at by enough, soon enough, without doing more harm to the other objectives than it does good. So every judgement in this topic weighs four things:

- **Does it work at all?** Does the chain from the policy to the objective hold in this economy, or is it blocked (low confidence, a lack of spare capacity, inelastic demand)?
- **How big and how fast?** A small effect after two years may be useless against a recession now.
- **What does it do to the other objectives?** The side effects are the "conflicts" the syllabus means.
- **Does it fit the cause?** Demand-side policies suit problems caused by demand; supply-side policies suit problems caused by costs and capacity.

What each policy does to each objective

The table sums up the usual short-run effect of each policy on each objective. "Better" means the objective moves towards its target. Use it as a checklist for multiple choice and as the skeleton for every essay.

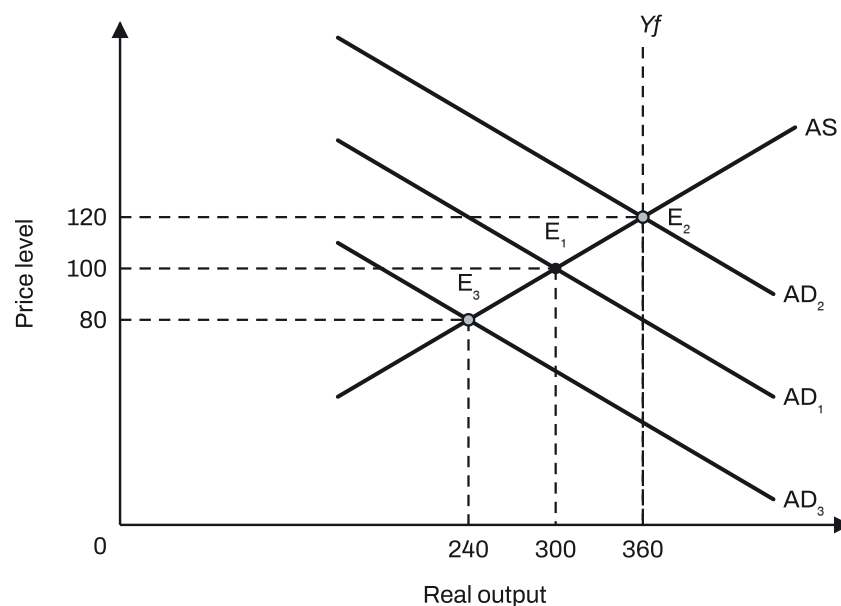
Policy	Growth	Unemployment	Inflation	Current account	Main side effects
Expansionary fiscal (more spending, lower taxes)	better	better	worse, most near capacity	worse (more imports)	bigger deficit and national debt; possible crowding out
Contractionary fiscal (less spending, higher taxes)	worse	worse	better	better (fewer imports)	smaller deficit; cuts to public services; weaker incentives if taxes are already high
Lower interest rates, more money, quantitative easing	better	better	worse	uncertain: more imports, but depreciation helps exports	rising house and share prices; savers lose; little effect if confidence is low
Higher interest rates, less money	worse	worse	better	uncertain: fewer imports, but appreciation hurts exports	less investment, so slower long-run growth; dearer government debt
Supply-side policy	better, in the long run	better (structural)	better (lower costs)	better (more competitive)	slow; costly; tax and benefit cuts can widen inequality
Devaluation or depreciation	better	better	worse (dearer imports)	better if demand is price elastic (worse at first)	debts in foreign currency cost more to repay
Revaluation or appreciation	worse	worse (in exporting firms)	better (cheaper imports)	worse	lost competitiveness

Policy	Growth	Unemployment	Inflation	Current account	Main side effects
Tariffs and quotas	better, short run	better in protected industries	worse (dearer imports)	better at first	retaliation; protected firms stay inefficient; less choice
Export subsidies	better	better	little effect (they cut exporters' costs)	better	cost to the budget; trading partners may retaliate

Two patterns stand out:

- **Every demand-side policy moves output and prices the same way.** If it raises output and jobs it also raises inflation; if it cuts inflation it also cuts output and jobs. That is the core conflict.
- **Only policies that lower costs or raise capacity can improve output and inflation together:** supply-side policy, and measures that cut firms' costs (subsidies to producers or exporters, lower indirect taxes).

Demand-side policy: one objective improves, another worsens

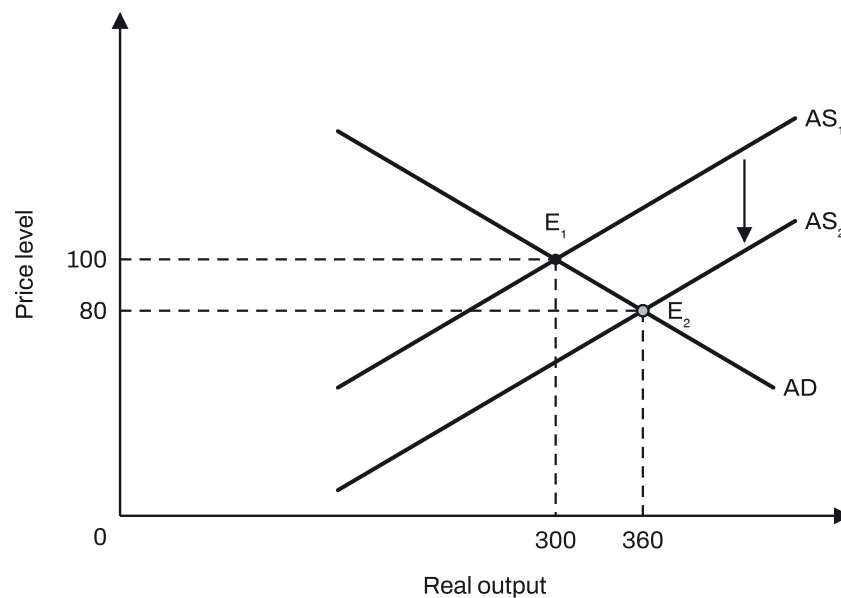


The economy starts at E_1 with output of 300, below full-employment output ($Y_f = 360$), so there is a **negative output gap** and unemployment. Suppose inflation is also too high (as in stagflation after a cost shock).

- **Expand** (AD_1 to AD_2 , through lower interest rates or a bigger budget deficit): output rises to 360 and the gap closes, but the price level rises from 100 to 120, a rise of 20%.
- **Contract** (AD_1 to AD_3 , through higher interest rates or a smaller deficit): the price level falls to 80, but output falls to 240 and the output gap doubles from 60 to 120.

Fiscal and monetary policy can choose **which** objective to favour; they cannot fix both. How much of an AD shift goes into output rather than prices depends on **spare capacity**: with a lot of it, expansion is mostly output; close to Y_f , it is mostly prices.

Supply-side policy: improving both



If supply-side policy lowers firms' costs and raises productive capacity, AS shifts right from AS_1 to AS_2 : output rises from 300 to 360 **and** the price level falls from 100 to 80. More competitive prices also help exports and the current account. That is why examiners treat supply-side policy as the best **long-run** answer to "all the objectives together".

Its limits are what keep it from being the answer to everything:

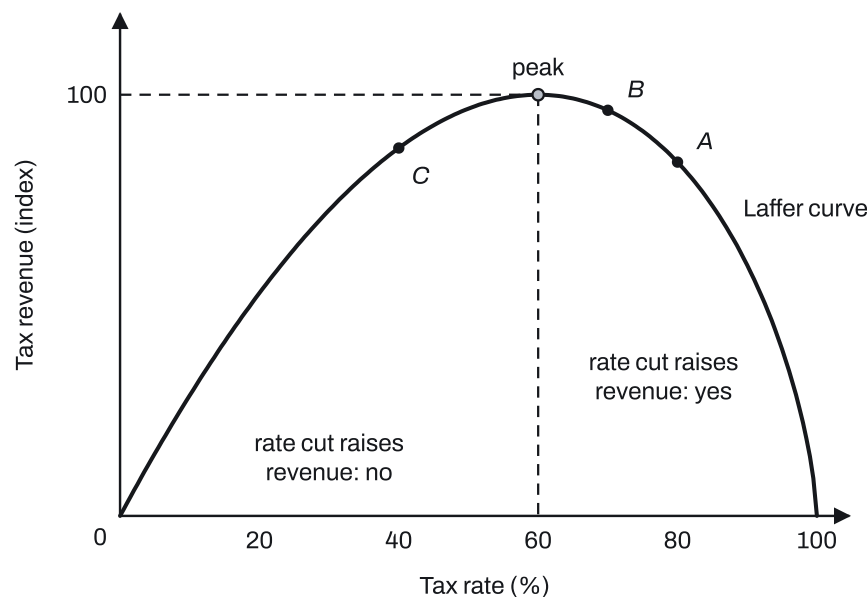
- **Time.** Training, infrastructure and new technology take years; they cannot stop a recession or a burst of inflation now.
- **Short-run demand effects.** Spending on training or roads raises AD before it raises capacity, so prices can rise first.
- **It needs demand.** Extra capacity does not create customers. In a deep recession, firms are short of buyers, not workers, so supply-side policy alone does not cure demand-deficient unemployment.
- **Market-based versus interventionist measures.** Market-based measures (lower income and profit taxes, lower benefits, deregulation, privatisation) are cheap or even save money, but cutting taxes for high earners and benefits for the poor widens inequality, and the incentive effects are uncertain. Interventionist measures (training, infrastructure, research grants) can reduce inequality and fix specific bottlenecks, but cost the government money and depend on the state choosing well.

Fiscal policy: how effective, and the Laffer curve

Why fiscal policy can work well. Government spending is part of AD directly, so it does not rely on anyone choosing to borrow. It can be targeted at regions, industries or low-income households. In a deep recession, when interest rates are already near zero, it may be the only demand policy left.

Why it may not. It depends on the **multiplier**: the more of each extra dollar of income that is spent again, the bigger the final effect. The multiplier is $k = \frac{1}{MPW}$, where the marginal propensity to withdraw is the sum of the marginal propensities to save, to pay tax and to import; with no government or trade, $k = \frac{1}{1-MPC}$. With an MPC of 0.8, \$10bn of extra spending can raise national income by up to $\frac{1}{0.2} \times 10 = 50$, that is \$50bn; with an MPC of 0.5, by only $\frac{1}{0.5} \times 10 = 20$, that is \$20bn. Fiscal policy is also weakened by:

- **Crowding out.** Government borrowing competes with firms for savings, so interest rates rise and private investment falls. If \$4bn of private investment is lost for every \$10bn the government borrows and spends, the net injection is only \$6bn.
- **Confidence and saving.** Households worried about their jobs, or about future tax rises to pay off the debt, save a tax cut instead of spending it.
- **Imports.** In an open economy, part of the extra spending leaks abroad, which also worsens the current account.
- **The national debt.** A high debt means bigger interest payments, possible higher borrowing costs, and pressure to raise taxes later.
- **Time lags and politics.** Budgets take months to agree; tax rises and spending cuts are unpopular, so contractionary policy is often delayed.



The Laffer curve shows the **tax revenue the government collects at each tax rate**. Revenue is the tax rate times the **tax base** (the income people declare and earn):

- At a 0% rate, revenue is zero.
- At a 100% rate, there is no point earning taxable income at all, so revenue is also zero.
- In between, raising the rate first raises revenue, because the rate goes up faster than the base shrinks. Past some rate (the **peak**, 60% in the diagram) the base shrinks faster than the rate rises, so revenue **falls**.

Why the tax base shrinks at high rates:

- people **work fewer hours** or stop working, because each extra hour pays little after tax;

- more **tax avoidance** (legal: moving income into lower-taxed forms) and **tax evasion** (illegal: not declaring income);
- **skilled workers and firms move abroad**;
- less incentive to take risks, invest and start firms.

What it implies for policy. If the tax rate is **above** the peak (point A at 80%), cutting it raises revenue as well as incentives: a cut from 80% to 70% (A to B) raises revenue from 84.0 to 96.3. If the rate is **below** the peak (point C at 40%), a cut loses revenue: from 40% to 30% revenue falls from 87.4 to 72.6. This is the argument for cutting high **direct** tax rates as a supply-side policy for growth.

Its limits.

- Nobody knows where the peak is, and it differs between groups of taxpayers and over time.
- A higher tax rate does not always make people work less: some work **more** to keep their income after tax, so "lower taxes always increase the incentive to work" is not always true.
- Lower top rates always cut the **reward from evading** tax, but they also help high earners most, so they **widen** income inequality. Raising top rates puts **equity** ahead of **efficiency**.

Monetary policy: how effective

Strengths. Interest rates can be changed quickly, in small steps, by an independent central bank, and add nothing to the national debt. Against **demand-pull** inflation, higher rates are usually the first tool.

What makes it work better or worse:

- **Interest elasticity.** A rate cut raises spending only if firms' investment and households' borrowing respond to the cost of credit. If investment depends mainly on expected sales, it does not.
- **Confidence and expectations.** In a recession, firms expecting falling sales will not invest even at very low rates; when rates are near zero they cannot be cut much further (the **liquidity trap**, when extra money is simply held).
- **The exchange rate.** With a **floating** rate, higher interest rates attract capital and appreciate the currency, making imports cheaper and so pulling inflation down further. With a fixed rate, the central bank cannot set interest rates freely.
- **Time lags.** It takes time to recognise a problem, to decide and act, and for spending to respond; the full effect of a rate change can take a year or more.
- **Quantitative easing** is least risky in a deep recession with high unemployment, when the extra money meets spare capacity; with full employment or high inflation it fuels inflation and asset prices.
- **Cost-push inflation.** Higher rates do not lower energy or import prices; they only cut output and jobs.
- **Distribution.** Monetary policy is a poor tool for making incomes more equal; fiscal policy (taxes and benefits) does that.

Exchange rate policy: how effective

A government can **devalue** a fixed exchange rate (or let a floating one depreciate, for example by cutting interest rates), or **revalue** it.

- **Devaluation** makes exports cheaper abroad and imports dearer at home, so it can raise net exports, output and jobs and improve the current account. It works only if demand for exports and imports is price elastic enough: the **Marshall–Lerner condition** says the current account improves if the price elasticities of demand for exports and for imports add up to more than 1. In the short run, demand is inelastic, so the current account first gets **worse** before it improves (the **J-curve**). The cost is **inflation**: imported goods and materials cost more, and that can wipe out the price advantage.
- **Revaluation** makes imports cheaper, which helps against **imported cost-push inflation**, but makes exports dearer, so exporting firms lose sales and jobs and the current account worsens.

International trade policy: how effective

- **Tariffs and quotas** switch spending from imports to home-produced goods, so they can protect jobs and improve the current account quickly. But they raise prices (imported goods and imported materials), protect firms from competition so they become **productively inefficient**, and invite **retaliation** that hits exports.
- **Export subsidies** lower exporters' costs, so exports rise (current account better, output and jobs up) without the price rises a devaluation or tariff causes. They cost the government money, may break trade rules and invite retaliation, and at full employment the extra demand adds to inflation.

Problems and conflicts arising from policy outcomes

- **Conflicts between objectives.** A demand-side policy that cuts unemployment raises inflation (the short-run Phillips curve trade-off), and growth driven by demand raises imports. These links are explained in the previous topic; here they are the **costs** of a policy.
- **Policies that work against each other.** A tax cut (expansionary) with an interest-rate rise (contractionary) pull AD in opposite directions; a fixed exchange rate stops the central bank using interest rates for inflation.
- **Side effects outside the four objectives:** a bigger budget deficit and national debt, a less equal distribution of income, rising house prices, damage to the environment from fast growth.
- **Short run against long run.** Many policies help one objective now and another later (spending on infrastructure raises AD now and AS later), or the reverse (higher interest rates cut inflation now but reduce investment and future capacity).
- **One tool cannot hit several targets.** As a rule, a government needs at least as many policy tools as objectives, which is why it uses a **mix**: for example, interest rates for inflation, fiscal policy for demand and distribution, supply-side policy for long-run growth.

Government failure in macroeconomic policy

Government failure in macroeconomic policy happens when intervention leaves the economy worse off than it would otherwise have been, or creates new problems that outweigh the gains. Causes:

- **Imperfect information.** Data on GDP and unemployment arrive late and are revised; nobody can measure the output gap or the natural rate of unemployment exactly, so policy can be set at the wrong strength.
- **Time lags.** By the time a policy takes effect, the economy may have moved on: a stimulus agreed in a recession can arrive during the recovery and add to inflation.
- **Political pressure.** Governments may expand before an election, or put off tax rises and spending cuts, whatever the economy needs.
- **Unintended consequences.** A rise in tax rates that drives skilled workers abroad and reduces revenue; quantitative easing that inflates house prices more than output; tariffs that bring retaliation; subsidies that keep inefficient firms alive.
- **Crowding out:** government borrowing that pushes up interest rates and replaces private investment instead of adding to it.
- **Policies that clash,** so they cancel each other out, or a policy that solves one problem at a big cost to others.

Two views on how effective demand management is

Multiple-choice questions often ask which school of thought holds which view.

	Keynesians	Monetarists
Wages and prices	Sticky, especially downwards	Flexible up and down
Without intervention	The economy can stay below full employment for a long time; unemployment can persist	The economy tends back to full employment (the natural rate of unemployment)
Aggregate demand	Total spending determines real output and employment, at least in the short run	In the long run AD affects only prices: the long-run AS curve is vertical
Investment	Driven by expectations; not very responsive to interest rates	Responsive to interest rates
Cause of inflation	Excess demand or rising costs	Too much growth in the money supply
Velocity of money	Can change	Stable

	Keynesians	Monetarists
Policy	Active fiscal policy to manage demand; government intervention is needed	Rules to control the money supply; supply-side policy for jobs and growth; budget deficits crowd out private spending

Both schools agree that high inflation and high unemployment are bad; they disagree about the cure.

Key facts and formulas

There is no formula list in the 9708 exam, so every row is "Learn it".

Formula	Status
Multiplier $k = \frac{1}{MPW} = \frac{1}{MPS + MPT + MPM}$; with no government or trade, $k = \frac{1}{1 - MPC}$	Learn it
Change in national income = $k \times$ change in injections	Learn it
Net injection after crowding out = extra government spending – private investment crowded out	Learn it
Debt (or deficit) as % of GDP = $\frac{\text{debt (or deficit)}}{\text{GDP}} \times 100$	Learn it
Tax revenue = tax rate $\times$ tax base; Laffer curve: revenue rises with the rate up to a peak, then falls	Learn it
Percentage change = $\frac{\text{new} - \text{old}}{\text{old}} \times 100$	Learn it
Marshall–Lerner condition: a devaluation improves the current account if PED for exports + PED for imports > 1 (ignoring signs)	Learn it
Demand-side policy moves output and the price level in the same direction; supply-side policy raises output and lowers the price level	Learn it

How to do it

We tagged 112 questions for this topic from March 2021 to March 2026 (93 different; 19 are repeats across paper variants): 76 Paper 3 multiple choice and 36 Paper 4 essays and data responses. Five data-response questions have parts of more than one type, so the counts add up to 118.

Question type	Questions
Multiple choice: choose the policy or mix that meets given objectives	19
Multiple choice: predict a policy's effects and side effects on the objectives	18

Question type	Questions
Essay (20 or 25 marks): evaluate one policy against a named objective or problem	17
Multiple choice: Laffer curve and changes in income tax rates	15
Multiple choice: conditions that make a policy more or less effective	12
Essay (20 or 25 marks): compare policies or weigh conflicts between objectives	11
Multiple choice: Keynesian and Monetarist views	9
Data response (6–8 marks): assess a policy's effectiveness or the evidence for it	8
Data response (4–6 marks): explain a policy's effect on output, prices or jobs	4
Multiple choice: classify a measure as macroeconomic, fiscal or reflationary	3
Data response (2 marks): read fiscal figures	2

1. Multiple choice: choose the policy or mix that meets given objectives (19 questions)

- List every problem in the stem** (unemployment, inflation, a trade deficit, a recession, deflation) and any condition ("without causing inflation", "in the long run", "full employment").
- Test each option against every problem**, using the table in "Understand it". Write "better" or "worse" next to each problem for each option. One "worse" rules the option out.
- For a combination**, check every column points the same way: all expansionary for a recession, all contractionary for inflation.

Variations you will meet:

- High unemployment, high inflation and a trade deficit together:** export subsidies ([9708/34/M/J/25 Q20](#)). They lower exporters' costs, so exports, output and jobs rise and the deficit shrinks without pushing up home prices. A devaluation and a tariff raise import prices (inflation worse); lower interest rates add to AD (inflation worse).
- Growth without inflation:** subsidies to producers ([9708/32/F/M/25 Q21](#)), which cut costs and shift AS right. More government spending, lower direct taxes and lower interest rates all add to AD.
- More output without inflation at full employment, in the short term:** only higher productivity works, such as labour-market reforms that raise output per hour ([9708/31/O/N/22 Q30](#)). With no spare capacity, export subsidies, quantitative easing and tax cuts just add to demand.
- Inflation in the long run:** supply-side policy ([9708/33/O/N/25 Q20](#)).
- Inflation caused by dearer imports** (or by imported raw materials): a revaluation or appreciation of the currency ([9708/32/F/M/24 Q20](#), [9708/32/F/M/24 Q26](#)), which makes imports cheaper. Higher interest rates or taxes cut demand, not import prices.
- Energy-price inflation plus a recession:** lower indirect taxes, which cut prices directly and leave people more to spend ([9708/33/M/J/24 Q22](#)). Lower interest rates or more spending would add to inflation; lower direct taxes do nothing for prices.

- **Recession or deflation:** expansionary fiscal and monetary policy (with supply-side policy if offered) ([9708/32/M/J/24 Q22](#), [9708/32/M/J/24 Q24](#)); with falling prices and high unemployment, lower income tax plus a lower interest rate ([9708/33/O/N/21 Q30](#)).
- **Raise output using fiscal and monetary policy only:** a bigger budget deficit with lower interest rates, or with the central bank **buying** government bonds (which adds money) ([9708/33/M/J/23 Q23](#), [9708/33/M/J/21 Q23](#)).
- **Reduce unemployment with all three policies:** lower taxes, lower interest rates and a more flexible labour market ([9708/32/F/M/21 Q22](#)).
- **Biggest fall in national income / lower inflation:** higher direct taxes with higher interest rates ([9708/32/F/M/21 Q23](#)); higher direct taxes, higher interest rates and less government spending on households ([9708/32/M/J/22 Q30](#)).
- **The aim monetary policy is least able to achieve:** a more equal distribution of income ([9708/32/F/M/23 Q22](#)).

2. Multiple choice: predict a policy's effects and side effects (18 questions)

1. **Decide whether the policy works through demand** (AD up or down), **through costs** (AS), or both.
2. **Trace it to each objective in the options:** AD down means lower inflation but more unemployment and slower growth, and fewer imports (current account better); AD up means the reverse.
3. **Look for the named side effect:** crowding out, inefficiency, inflation, government failure.

Variations you will meet:

- **Higher direct taxes:** lower inflation is more likely and unemployment rises ([9708/32/O/N/25 Q21](#)); unemployment and growth worsen while the balance of payments improves ([9708/33/O/N/22 Q29](#)); with government spending unchanged, inflation falls and unemployment rises ([9708/33/O/N/22 Q30](#)).
- **Interest rates:** setting them artificially low raises consumer price inflation ([9708/33/M/J/25 Q19](#)); raising them to cut inflation also slows growth ([9708/32/F/M/24 Q23](#)); lowering them cuts unemployment by making borrowing cheaper for firms ([9708/33/O/N/24 Q20](#)).
- **A tariff** protects home producers from competition, so the protected industry becomes productively inefficient ([9708/33/M/J/25 Q25](#)).
- **Government borrowing and debt:** higher borrowing that raises interest rates and cuts private investment is **crowding out** ([9708/32/M/J/23 Q23](#), [9708/32/M/J/25 Q24](#)); a bigger deficit raises effective demand ([9708/32/O/N/23 Q20](#)); the future burden of the debt grows most with a big deficit, slow GDP growth and falling bond prices (which mean higher interest rates on new debt) ([9708/32/O/N/22 Q27](#)).
- **A deficit financed by printing money** for infrastructure: growth, lower unemployment **and** higher inflation all become more likely ([9708/32/F/M/24 Q22](#)).
- **Pairs of policy and outcome:** a depreciation raises exports, so employment rises ([9708/31/O/N/23 Q23](#)). Higher interest rates do not encourage spending; less government spending does not create jobs.
- **A tax rise that drives skilled workers abroad** is government failure, not market failure or an externality ([9708/31/O/N/22 Q29](#)).

- **Subsidising local firms to export:** incomes and government spending rise, but the effect on the current account is uncertain, because higher incomes also buy more imports (9708/32/M/J/21 Q29).
- **Which budget changes could produce a surplus from balance?** Any change except a tax cut with a spending rise (9708/32/M/J/21 Q30).

3. Essay (20 or 25 marks): evaluate one policy against a named objective or problem (17 questions)

For example: "evaluate the effectiveness of monetary policy to increase the rate of economic growth", "evaluate fiscal policy to solve stagflation", "whether a bigger budget deficit will always lead to growth", "whether monetary policy alone will solve falling exports", "whether quantitative easing is effective in a recession". Since 2023: Table A (knowledge and analysis, 14 marks) and Table B (evaluation, 6 marks).

1. **Define** the policy (its tools) and the objective or problem (economic growth as a rise in real GDP; inflation; a negative output gap; stagflation). (AO1)
2. **Draw an AD/AS diagram** of the policy's effect and refer to it in your text. When the question says "with the help of a diagram", no diagram caps the answer (at Level 3 or 8 marks in recent mark schemes). (AO1/AO2)
3. **Analyse every route the policy works through**, each as a full chain (AO2):
 - **monetary:** more money supply → lower interest rates → more investment and consumption → AD right → real GDP up; and lower rates (or a devaluation) → depreciation → exports up → export-led growth;
 - **fiscal:** more spending or lower taxes → AD right, multiplied by the multiplier → real GDP up; spending on education or infrastructure also shifts AS right in the long run.
4. **Evaluate with what the effect depends on** (AO3):
 - spare capacity: a big effect on output in a recession, mostly inflation near full employment (diagram 2);
 - for monetary policy: the liquidity trap, interest-inelastic investment (when the marginal efficiency of capital curve is steep), low confidence and negative expectations, the Marshall–Lerner condition for a devaluation, inflation from extra money;
 - for fiscal policy: the size of the MPC and so of the multiplier, crowding out, expectations of future taxes, the national debt, time lags;
 - the multiplier is a short-run effect; lasting growth needs investment (the accelerator) and supply-side policy that shifts LRAS right;
 - **stagflation** (high inflation with a negative output gap): cutting AD reduces inflation but widens the gap, and raising AD closes the gap but adds to inflation (diagram 2), so supply-side policy is the better long-run answer (diagram 3).
5. **Conclude:** how effective the policy is in the **short run** and in the **long run**, and which alternative (usually supply-side) is better for lasting results. (AO3)

Older 12- and 13-mark parts (2021–2022) used the same plan in levels: one route explained well with an evaluation and a conclusion for the top level. For quantitative easing: the central bank creates money to buy bonds, raising bank reserves and bond prices and lowering long-term interest rates; it may fail if banks do not lend or firms do not borrow.

4. Multiple choice: Laffer curve and changes in income tax rates (15 questions)

1. **Know what it shows:** tax revenue at each tax rate ([9708/34/O/N/25 Q25](#), [9708/32/F/M/22 Q29](#)); as the rate rises, revenue eventually falls ([9708/33/O/N/22 Q28](#)).
2. **Name it** from a diagram of revenue against a tax rate ([9708/33/M/J/22 Q29](#)), from a prediction that a higher top rate will **lower** revenue ([9708/32/M/J/22 Q29](#)), or from a history of a rate cut that **raised** revenue ([9708/33/M/J/21 Q29](#)). It is not the Lorenz, Phillips or J curve.
3. **Read the diagram:** find the peak. Beyond the peak, the higher the rate, the lower the revenue, and a rate cut raises revenue; below the peak, a cut lowers revenue ([9708/32/F/M/24 Q24](#)).
4. **Explain why revenue falls above the peak:** people choose to work fewer hours ([9708/31/O/N/23 Q24](#)), avoid more tax ([9708/32/O/N/22 Q29](#)), evade it or emigrate. The trap: people working fewer hours **to keep their income** makes no sense (keeping income would mean working more).
5. **Link it to policy:** a growth policy based on the Laffer curve is a cut in direct taxes ([9708/32/O/N/23 Q23](#)).

Variations you will meet:

- **"Which argument for lowering income tax rates is always valid?"** It reduces the incentive to evade tax, because evasion saves less ([9708/32/O/N/24 Q22](#)). It does not always boost activity or the incentive to work (some people work less once they reach their target income), and it does not always cut the deficit.
- **"Which is not a valid reason for cutting the tax rate on higher incomes?"** To reduce income inequality ([9708/34/O/N/25 Q23](#)). Attracting skilled workers, discouraging evasion and work incentives are valid.
- **"Why raise the highest rates of income tax?"** The government puts equity ahead of efficiency ([9708/32/O/N/21 Q13](#)).

5. Multiple choice: conditions that make a policy more or less effective (12 questions)

1. **Write out the policy's chain** (for example: rate cut → cheaper borrowing → more investment → AD → output).
2. **Find the option that strengthens or blocks a link.** A large multiplier, interest-sensitive spending, confidence and spare capacity strengthen expansion; a high marginal propensity to save, low confidence and full capacity weaken it.

Variations you will meet:

- **Cutting the money supply against inflation works best** with a **floating** exchange rate and AD that is **highly** responsive to interest rates ([9708/33/O/N/25 Q22](#)): the currency appreciates too, and spending falls a lot.
- **Expansionary fiscal policy is least effective** when there is a lack of confidence ([9708/32/O/N/25 Q15](#)); a bigger deficit against deflation is weakened by a **high marginal propensity to save** ([9708/31/O/N/25 Q22](#)); with an MPC of only 0.2 the multiplier is small, so the rise in output is limited ([9708/32/F/M/25 Q24](#)).
- **Rate cuts in a recession** fail when business confidence is low ([9708/33/O/N/24 Q18](#)) or the MPC is falling ([9708/33/M/J/21 Q18](#)), and work best when firms' spending on capital goods is interest elastic ([9708/33/O/N/24 Q23](#)).

- **Quantitative easing is least likely to destabilise the economy** in a deep recession with high unemployment ([9708/34/O/N/25 Q24](#)).
- **Time lags**: for a government that wants a rapid **domestic** effect, the lag before the exchange rate responds matters least; the lags in recognising the problem, putting the measure in place and the economy responding all delay the domestic effect ([9708/33/O/N/24 Q24](#)).
- **A supply-side stimulus is weakened** by a legal limit on weekly working hours ([9708/33/M/J/23 Q25](#)).

6. Essay (20 or 25 marks): compare policies or weigh conflicts between objectives (11 questions)

For example: "assess the effectiveness of policies to reduce demand-pull (or cost-push) inflation", "evaluate a tax cut together with higher interest rates against supply-shock inflation", "a bigger budget surplus raises unemployment but helps the current account", "Keynesian budget deficits or Monetarist supply-side policies for unemployment", "policies to cut a budget deficit", "policies to reach full employment".

1. **Define** the problem and **diagnose its cause** with a diagram: demand-pull inflation is AD shifting right near full capacity; cost-push is AS shifting left; cyclical unemployment is too little AD. (AO1/AO2)
2. **Analyse at least two policies**, each with its chain and a diagram (AO2):
 - **fiscal** (for demand-pull inflation: higher direct taxes, less spending → AD left);
 - **monetary** (higher interest rates, revaluation of the currency, selling bonds through open market operations → AD left; a revaluation also makes imports cheaper);
 - **supply-side** (lower costs and higher productivity → AS right).
3. **Evaluate each one by its side effects and conditions** (AO3):
 - higher direct taxes and less spending: slower growth, more unemployment, cuts to education and health care that harm welfare and future capacity;
 - higher interest rates: less investment, so slower long-run growth; falling house prices;
 - revaluation: exporters lose sales and jobs; the current account worsens, depending on the Marshall-Lerner condition and the J-curve;
 - supply-side policy: slow and costly, but lowers inflation and raises output together;
 - all of them: the state of the economy when they start, and whether the policy fits the **cause** (demand policies do little for cost-push inflation except cut output).
4. **Conclude** with which policy (or mix) is most effective **in the short run**, which **in the long run**, and why. (AO3)

Variations you will meet:

- **Policies that pull against each other** (a tax cut with higher interest rates): show the two AD shifts, ask which is bigger, and point out that neither tackles supply-side causes.
- **Keynesian against Monetarist** views of unemployment: deficits raise AD and cut **cyclical** unemployment; they cannot lower the **natural rate**, which needs supply-side policy; judge by the type of unemployment.

- **Reducing a budget deficit:** higher taxes and spending cuts (quick, but cut AD and jobs), faster growth (raises revenue without cuts, but slow), and their effect on the other objectives.

7. Multiple choice: Keynesian and Monetarist views (9 questions)

1. **Sort each statement** with the table in "Understand it": sticky wages, persistent unemployment, AD driving output and jobs, intervention, interest-inelastic investment → **Keynesian**; money-supply rules, inflation from money growth, a vertical LRAS, flexible wages, stable velocity, a return to full employment → **Monetarist**.
2. **Check both halves** of a paired option.

Variations you will meet:

- Keynesians: raising AD brings the economy out of recession; Monetarists: the economy always tends to full employment in the long run ([9708/33/O/N/22 Q25](#)).
- Monetarists: policy makers should follow set rules for the money supply ([9708/32/O/N/22 Q25](#)); they do **not** believe velocity is highly unstable ([9708/31/O/N/22 Q25](#)).
- Keynesians: unemployment can persist in the long run ([9708/32/M/J/22 Q26](#)); total spending affects real output and employment in the short run ([9708/32/F/M/22 Q26](#)); wages are not flexible and investment is interest-inelastic ([9708/31/O/N/21 Q26](#)); government intervention is needed to manage the economy ([9708/32/F/M/21 Q26](#)).
- Both accept that high inflation and high unemployment are undesirable ([9708/33/M/J/21 Q28](#)).

8. Data response (6–8 marks): assess a policy's effectiveness or the evidence for it (8 questions)

For example: the advantages and disadvantages of two policies used in the article; whether the article shows government intervention has little effect; one supply-side and one fiscal policy for more equal incomes; whether tax measures will cut a deficit; whether low interest rates worked.

1. **Name the policies from the article** (often 1 mark for identifying two).
2. **Advantages, each a developed point tied to the text** (up to 2 marks each, usually 3 at most for this side).
3. **Disadvantages or counter-evidence**, the same way (usually 3 at most).
4. **A justified conclusion** (a mark is often kept for it): which side is stronger, in this country's case.

For "does the evidence prove it?" questions, take each piece of evidence in the article and say whether it supports or contradicts the claim, and why; finish with a conclusion.

9. Data response (4–6 marks): explain a policy's effect on output, prices or jobs (4 questions)

1. **Draw an AD/AS diagram:** price level and real output axes, AD and AS labelled (1); the shift with the old and new equilibrium marked (1).

2. **Explain:** more government spending or income support raises AD (government spending is part of AD; transfers raise disposable income and consumption) (1) → real output rises (1) → the price level rises, by how much depending on where the economy starts (1).
3. **For unemployment:** more output needs more workers, so cyclical unemployment falls.
4. **Crowding out:** government borrowing raises the demand for loanable funds, so interest rates rise and private investment falls, most of all when the economy is near capacity.
5. **Why governments borrow in a recession:** tax revenue falls and benefit spending rises automatically, and extra spending supports AD.

10. Multiple choice: classify a measure (3 questions)

1. **Macroeconomic policy** aims at the whole economy (income tax, infrastructure spending); a tax on one product to cut its consumption is microeconomic (**9708/33/M/J/21 Q13**).
2. **Reflationary fiscal** means more government spending or lower taxes (**9708/32/F/M/21 Q30**); more money or lower interest rates are monetary.

11. Data response (2 marks): read fiscal figures (2 questions)

1. **Compare with figures:** quote each value with its unit (1 each), and a ratio or difference if it helps ("about 20 times as much").
2. **Give one developed reason** when asked: a high-income country can borrow more easily and cheaply, so it can spend more; a low-income country has less access to credit and more debt already.
3. **Evidence of heavy borrowing:** a rising national debt as a percentage of GDP.

Worked examples

Example 1

A government in a recession raises its spending by \$20bn, financed by borrowing. Ignore taxes and imports.

In which situation is real national income most likely to rise by the largest amount?

	marginal propensity to consume	response of private investment to interest rates
A	0.8	very responsive
B	0.8	unresponsive
C	0.5	very responsive
D	0.5	unresponsive

[1]

With an MPC of 0.8 the multiplier is $\frac{1}{1-0.8} = 5$, so the \$20bn could raise income by up to \$100bn; with 0.5 it is $\frac{1}{1-0.5} = 2$, only \$40bn. Government borrowing pushes up interest rates; if investment barely responds, little is crowded out. The answer is **B** (1).

Example 2

The table shows a government's estimates of the revenue from its top rate of income tax (index, highest revenue = 100).

tax rate (%)	20	40	60	70	80	90
revenue (index)	52.9	87.4	100.0	96.3	84.0	59.5

(a) State the tax rate that raises the most revenue. **[1]**

(b) The top rate is 80%. Calculate the percentage change in revenue if it is cut to 70%. **[1]**

(c) Explain why cutting the rate could raise revenue. **[2]**

(a) 60% (1).

(b) $\frac{96.3-84.0}{84.0} \times 100 = 14.6\%$, a rise (1).

(c) At 80% the rate is above the peak of the Laffer curve, where high tax rates discourage work and encourage avoidance, evasion and emigration (1). A lower rate makes declared income grow by more than enough to make up for the lower rate, so revenue (rate $\times$ tax base) rises (1).

Example 3

Extract. Country V has unemployment of 8.5% and inflation of 1.2%, below its 2% target. The central bank rate is 0.5%. GDP is \$400bn, the national debt is 92% of GDP and the current account deficit is 3% of GDP. The government plans to spend an extra \$10bn a year on roads and railways, financed by borrowing. It estimates the multiplier at 1.6.

Assess whether the extra spending on roads and railways is likely to be an effective way to meet the government's macroeconomic objectives. **[7]**

Model answer.

- **Advantage 1.** The \$10bn is an injection worth $\frac{10}{400} \times 100 = 2.5\%$ of GDP; with a multiplier of 1.6 it could raise real GDP by up to $1.6 \times 10 = 16$, that is \$16bn or 4% (1). With unemployment at 8.5% and inflation below target there is spare capacity, so most of the rise is in output and jobs rather than prices (1).
- **Advantage 2.** Better roads and railways cut firms' transport costs, so long-run aggregate supply shifts right later: growth without inflation and more competitive exports (1).
- **Disadvantage 1.** The debt of $0.92 \times 400 = 368$, that is \$368bn, rises to \$378bn, adding to interest payments (1), and with debt already 92% of GDP, lenders may demand higher interest rates, crowding out private investment (1).

- **Disadvantage 2.** Higher incomes will raise spending on imports, widening a current account deficit that is already 3% of GDP (1).
- **Conclusion.** It is likely to be effective for growth and jobs, because there is spare capacity and the 0.5% interest rate leaves little room for monetary policy; if GDP does rise to \$416bn, the debt ratio even falls to $\frac{378}{416} \times 100 = 90.9\%$, but the current account will worsen unless the projects also help exporters (1).

(Advantages 3, disadvantages 3, conclusion 1: **7/7**.)

Example 4

A country has inflation of 6% against a target of 2%, unemployment of 7% and a current account deficit of 5% of GDP. Evaluate which policy, or combination of policies, would be most effective in meeting all three objectives. [20]

Model answer (paragraph plan):

1. **Definitions:** inflation as a sustained rise in the general price level; unemployment; a current account deficit (the country pays out more for imports of goods and services and in income and transfers abroad than it receives); fiscal, monetary, supply-side, exchange rate and trade policy. (AO1)
2. **Diagnosis:** high inflation **and** high unemployment at once suggests rising costs (AS shifting left) rather than too much demand; the deficit suggests uncompetitive prices. (AO2)
3. **Contractionary demand policy** (higher interest rates or taxes), diagram 2, AD_1 to AD_3 : inflation falls and the current account improves as imports fall, but output falls and unemployment rises further. Higher interest rates also appreciate the currency, which cuts import prices but makes exports dearer. (AO2)
4. **Expansionary demand policy**, diagram 2, AD_1 to AD_2 : unemployment falls but inflation and imports rise, so two objectives get worse. (AO2)
5. **Exchange rate and trade policy:** a devaluation raises exports and jobs but adds to inflation through dearer imports; tariffs do the same and invite retaliation; export subsidies raise exports and jobs with little effect on prices but cost the budget. (AO2)
6. **Supply-side policy**, diagram 3: training, infrastructure and lower business costs shift AS right, so inflation and unemployment fall together and exports become more competitive. (AO2)
7. **Evaluation 1, time:** supply-side policy takes years and its short-run spending adds to AD; in the meantime one demand-side objective must give way. (AO3)
8. **Evaluation 2, the cause and the conditions:** if the inflation is imported (energy prices), higher interest rates mostly cost jobs; the Marshall–Lerner condition and the J-curve decide whether a devaluation helps the current account; the national debt limits fiscal options. (AO3)
9. **Evaluation 3, government failure:** time lags, uncertain data and political pressure can make a policy arrive late or too strong. (AO3)
10. **Conclusion:** no single policy meets all three objectives in the short run; the most effective package is a moderate rise in interest rates to keep inflation expectations in check, targeted export support, and supply-side policy for the long run. (AO3)

Table A top level (14): accurate definitions, relevant AD/AS diagrams used in the analysis, several policies analysed against all three objectives. Table B top level (6): developed judgements on what each outcome depends on, short run against long run, and a conclusion that names the best combination. **20/20**

Common mistakes

- **Analysing one policy or one aim when the question says "alone" or "simultaneously".** In June 2022 (Paper 42 Q7(b)), on whether monetary policy alone can achieve the aims at the same time, many answers kept to monetary policy, or to one or two aims, instead of also considering alternatives and the balance of payments. "Alone" needs an alternative; "aims" needs several aims.
- **Ignoring the context of the problem.** In June 2024 (Paper 42 Q4), on a tax cut and higher interest rates when inflation came from supply disruption, answers that did not see this as cost-push inflation were limited. Good answers said fiscal and monetary policy suit demand-pull inflation, and considered supply-side effects.
- **Writing about the opposite policy.** In June 2023 (Paper 42 Q5), on using monetary policy to reduce inflation, weaker answers wrote about expansionary monetary policy, and many barely mentioned the government's other aims. Read the direction of the policy and cover its effects on the other aims too.
- **The wrong diagram, or none.** In March 2025 (Paper 42 Q4), on policies to reduce demand-pull inflation, weaker answers drew microeconomic diagrams instead of AD/AS, which blocks Level 3; a question that asks for a diagram needs a correct one.
- **One-sentence evaluation.** In the same March 2025 question, evaluation of fiscal (Keynesian) policies was often a single statement, which kept many answers at Level 1 for evaluation. Develop each point: say what the outcome depends on and **why**.
- **Explaining the policies without judging their effectiveness.** In June 2022 (Papers 41 and 43 Q7), on Keynesian deficits against Monetarist supply-side policies for unemployment, most answers described the two approaches and few assessed which works better, so they reached Level 3 at best.
- **Not defining the terms in the question.** In November 2022 (Paper 41 Q7), on budget deficits and output gaps, some answers never explained a budget deficit, and some drew correct diagrams without marking the positive and negative output gaps. The top level went to answers that judged the effect by the cause of the gap (cyclical or structural unemployment) and the risks of rising interest rates, inflation and a worse balance of payments.
- **Mixing up the schools of thought.** In November 2021 (Paper 31 Q26) only 13% knew that Keynesians assume wages are not flexible and investment does not respond much to interest rates; 38% chose flexible wages with interest-elastic investment, a Monetarist pair.
- **Assuming tax cuts always raise revenue or work incentives.** They raise revenue only above the peak of the Laffer curve, and some people work less after a tax cut.

How to get the marks

- **Multiple choice:** write "better" or "worse" for each objective beside each option, and check every column of a combination. For a "conditions" question, write the policy's chain and find the link the option strengthens or blocks.
- **Define first:** the policy and its tools, the objective, and terms such as output gap, budget deficit, crowding out, Laffer curve, government failure. Knowledge (AO1) marks depend on precise definitions.
- **"Analyse"** means full chains with every step: "higher interest rates → dearer borrowing and more reward for saving → less consumption and investment → AD shifts left → lower inflation but less output and more unemployment". Say what happens to **each** objective the question names.
- **Diagrams:** AD/AS with price level and real output, curves labelled and both equilibria marked, and referred to in the text. A question that asks for a diagram is capped without one (Level 2 in March 2025, Level 3 or 8 marks in 2025 essays).
- **"Evaluate", "assess", "to what extent", "consider":** weigh each policy's strengths against its side effects, say what the outcome **depends on** (the cause, spare capacity, elasticities, the size of the multiplier, confidence, time lags, the national debt) and explain why. Stated but unexplained "it depends" points stay at the lower evaluation level.
- **"Alone", "always", "most effective":** these need at least one alternative policy and a direct answer to the word.
- **20-mark essays:** Table A (AO1 + AO2, 14 marks) rewards definitions, diagrams and developed analysis of the policies; Table B (AO3, 6 marks) rewards developed evaluation and a conclusion that compares the policies in the **short run** and the **long run**.
- **Data response:** use the article's policies and figures; keep advantages and disadvantages separate (usually up to 3 marks each); end with a conclusion when the mark scheme keeps a mark for it.

Quick check

1. A government raises spending by \$12bn. The MPC is 0.75 (ignore taxes and imports). What is the largest possible rise in national income? If the extra borrowing crowds out \$4bn of private investment, what is the rise then?
2. For each policy, name one objective likely to improve and one likely to get worse: (a) a revaluation of a fixed exchange rate; (b) a tariff on imported cars; (c) a rise in income tax rates.
3. Use the table in Example 2. Calculate the percentage change in revenue if the rate is cut from 40% to 30%, where the revenue index is 72.6. What does the result show?
4. Just before an election, a government at full employment raises its spending to cut unemployment further. Inflation rises and unemployment soon returns to its old level. This is best described as **A** crowding out **B** government failure **C** a liquidity trap **D** a Laffer curve effect
5. Explain why a cut in interest rates may not raise output in a recession. [2]

Answers

1. Multiplier = $\frac{1}{1-0.75} = 4$, so income can rise by up to $4 \times 12 = 48$, that is \$48bn. With \$4bn crowded out the net injection is $12 - 4 = 8$ (\$8bn), so income rises by $4 \times 8 = 32$, that is \$32bn.
2. (a) Inflation improves (cheaper imports); unemployment in exporting firms and the current account get worse. (b) Jobs in the home car industry and, at first, the current account improve; inflation gets worse (dearer cars), and retaliation can hurt exports. (c) Inflation improves (less spending) and the current account improves (fewer imports); growth and unemployment get worse (and, above the Laffer peak, revenue too).
3. $\frac{72.6-87.4}{87.4} \times 100 = -16.9\%$. Below the peak of the Laffer curve, a cut in the rate loses revenue: the tax base does not grow enough to make up for the lower rate.
4. **B.** The policy was badly timed and driven by politics; with no spare capacity it raised inflation and only lowered unemployment for a while, so it left the economy worse off.
5. In a recession firms expect falling sales and households fear for their jobs, so they do not borrow and spend more even when credit is cheaper (1). If rates are already close to zero, they cannot be cut far, and banks may not pass the cut on, so AD and output barely rise (1).

Past questions to try

- **9708/33/O/N/25 Q22:** the conditions under which a cut in the money supply best reduces inflation.
- **9708/32/F/M/24 Q22:** a deficit financed by printing money and the three objectives.
- **9708/32/F/M/24 Q24:** reading a Laffer curve diagram.
- **9708/42/M/J/24 Q4:** a tax cut with higher interest rates against supply-driven inflation.