**4.5 The role of the state in the macroeconomy**

**1 Public expenditure**

a) The distinction between capital expenditure, current expenditure and transfer payments.

b) Reasons for the changing size and pattern of public expenditure in an international context:

• changing incomes

• changing age distributions

• changing expectations.

c) The significance of differing levels of public expenditure as a proportion of GDP on:

• productivity and growth

• crowding out

• levels of taxation.

**2 Taxation**

a) The distinction between, and examples of, direct and indirect taxes.

b) The distinction between progressive, proportional and regressive taxes.

c) The economic effects of changes in direct and indirect tax rates on:

• incentives to work

• tax revenues: Laffer curve analysis

• income distribution

• real output and employment

• the price level

• the trade balance

• FDI flows.

**3 Public sector borrowing and public sector debt**

a) The distinction between:

• fiscal deficits and fiscal surpluses

• automatic stabilisers and discretionary fiscal policy

• a fiscal deficit and the national debt

• structural and cyclical fiscal deficits.

b) Factors influencing the size of fiscal deficits and national debts.

c) The significance of the size of fiscal deficits and national debts:

• impact on interest rates

• debt servicing

• intergenerational equity.

**4 Macroeconomic policies**

a) How governments use fiscal policy, monetary policy, exchange rate policy, supply-side policies and direct controls to:

• reduce fiscal deficits and national debts

• control the rate of inflation

• respond to external shocks in the global economy

• reduce poverty and inequality.

b) Use of demand-side policies in response to the global financial crisis of 2008.

c) Measures to control TNCs:

• to reduce tax avoidance

• the regulation of transfer pricing

• limits to government ability to control TNCs.

d) The impact of policy changes on:

• local economies

• national economies

• the global economy.

e) Problems facing policymakers when applying policies:

• inaccurate information

• risks and uncertainties

• inability to control external shocks.