A2 – ECONOMICS (9708)

MACRO

CHAPTER 1

Economic Growth, Standard of Living & Economic Development

TOPIC 1: ECONOMIC GROWTH

Q1 | **[M/J 2008/Q26]**

The table shows the figures for consumption, capital formation and depreciation in four economies, all measured in US $.

Assuming that the state of technology remains unchanged, which economy is most likely to experience economic growth?

	consumption ($ m)	capital formation ($ m)	depreciation ($ m)
A	100	20	10
B	500	200	200
C	1 000	1 200	1 400
D	20 000	5 000	6 000

Q2 | **[O/N 2008/Q21]**

Real output in an economy grows by 1.5 % but at the same time the level of unemployment increases.

What can be deduced from this information?

A Labour productivity has decreased.

B Actual output has grown more slowly than potential output.

C Population of working age has fallen.

D There has been an increase in the rate of inflation.

Q3 | **[O/N 2008/Q25]**

What would increase an economy's actual output but **not** its potential output?

A an increase in the capital available to the labour force

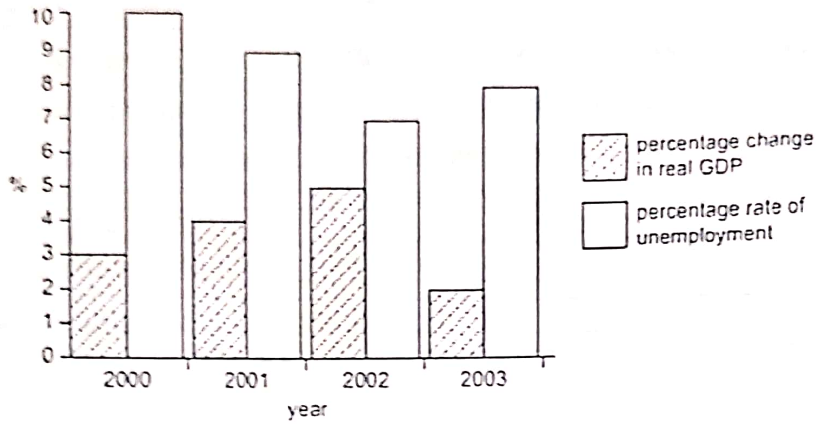
B an increase in the labour force's skill level

C an increase in the number in the labour force

D an increase in the proportion of the labour force employed

Q4 | [O/N 2008/Q26]

The chart shows the rates of economic growth and unemployment in a country for the period 2000 to 2003.



What does the chart show?

A Real GDP was lowest in 2003.

B The total labour force declined between 2000 and 2002.

C The standard of living fell between 2002 and 2003.

D The unemployment rate fell when the growth rate increased.

Q5 | [O/N 2008/Q27]

What is a necessary feature of economic growth?

A the elimination of an economy's output gap

B a continuing increase in the level of employment

C a continuing outward shift in an economy's production possibility frontier

D an increase in an economy's nominal GDP

Q6 | [M/J 2009/Q24]

The table shows the figures for consumption, gross capital formation and depreciation in four economies, all measured in US $.

Assuming that the state of technology remains unchanged, which economy is most likely to experience economic growth?

economy	consumption ($m)	gross capital formation ($m)	depreciation ($m)
A	200	40	50
B	500	200	150
C	1 000	1 200	1 400
D	20 000	6 000	6 000

Q7 **[M/J 2009/Q26]**

Which combination of factors is most likely to result in more rapid economic growth?

- **A** increases in employment and in the balance of payments deficit
- **B** increases in the level of investment and in the size of the working population
- **C** more equal distribution of wealth and a higher level of unemployment benefits
- **D** more rapid inflation and an increase in the national debt

Q8 **[M/J 2011/Q21]**

Which cause of economic growth would involve the least cost for present and future generations of a country's population?

- **A** increased exploitation of a country's mineral resources
- **B** investment financed by borrowing from abroad
- **C** investment financed by high rates of domestic savings
- **D** technological innovations in productive processes

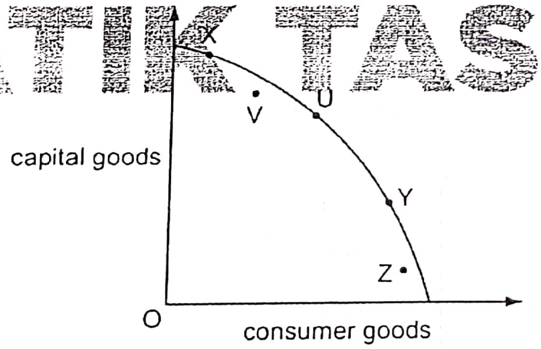
Q9 **[M/J 2012/Q27]**

What will be most likely to decrease a country's national output in the short run but to increase its potential for long-run growth?

- **A** a decrease in the level of import tariffs
- **B** a decrease in the rate of immigration
- **C** an increase in female participation in the labour force
- **D** an increase in the money supply

Q10 **[O/N 2012/Q23]**

The diagram shows a country's production possibility curve and a number of alternative production points.



Which change in the country's output would be most likely to lead to a fall in potential growth?

A U to V **B** U to X **C** Y to X **D** Y to Z

Q11	[O/N 2012/Q26]

What will assist a country's potential growth in national output?

A an increase in cyclical unemployment

B an increase in the rate of inflation

C an increase in the government's budget deficit

D increased participation in the labour force

Q12	[M/J 2013/Q25]

What would be most likely to stimulate long-run growth in an economy?

A employment protection legislation

B government policy to raise aggregate demand

C technical innovations by firms

D the development of trade unions

Q13	[O/N 2013/Q22]

What is most likely to contribute to high long-term growth rates of GNP per head?

A government imposition of maximum prices for particular goods

B high rates of trade union membership amongst the labour force

C high ratios of saving to GNP

D restrictions on inward foreign investment

Q14	[O/N 2013/Q25]

What would increase an economy's actual output but **not** its potential output?

A an increase in the capital available to the labour force

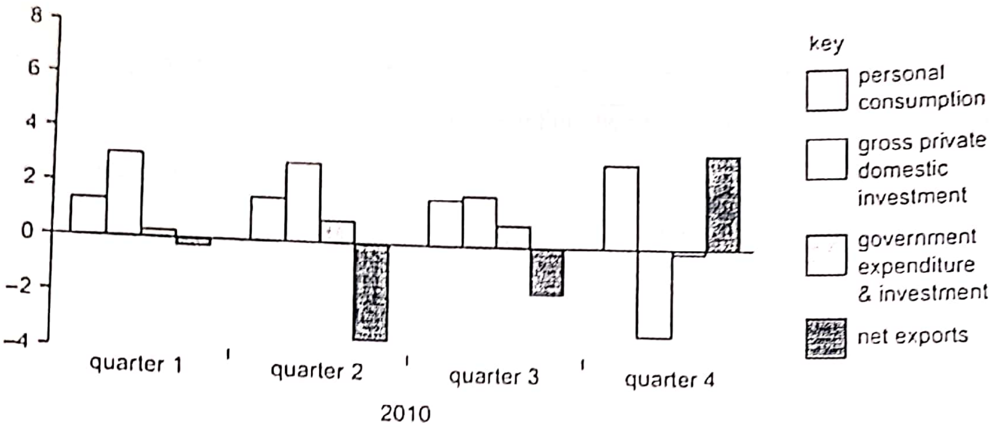
B an increase in the labour force's skill level

C an increase in the number in the labour force

D an increase in the proportion of the labour force employed

Q15 **[M/J 2014/Q22]**

The diagram shows the contribution of four components of aggregate demand to the change in US real GDP in the four quarters of 2010.



Which component made the greatest contribution and which component the least contribution to the positive growth in real GDP in 2010?

	greatest contribution	least contribution
A	gross private domestic investment	government expenditure and investment
B	gross private domestic investment	net exports
C	personal consumption	government expenditure and investment
D	personal consumption	net exports

Q16 **[M/J 2014/Q23]**

An economic recession leads to an increase in unemployment.

Why might this cause a fall in an economy's long-term growth rate?

A It is impossible to regain consumption lost in recession.

B Rising unemployment is likely to raise real wage levels.

C Social attitudes become less accepting of unemployment.

D There will be a harmful effect on human capital.

Q17 **[M/J 2014/Q26]**

It is often argued that the present rate of economic growth will soon lead to the exhaustion of reserves of material resources, such as minerals and oil.

What does this argument fail to take into account?

A the drawbacks of present GDP levels as an indicator of the 'happiness' of the population

B the effect of increasing resource prices on the discovery and exploitation of new reserves

C the right of future generations to enjoy present standards of living

D the role of education in economic development

Q18 | [M/J 2015/Q25]

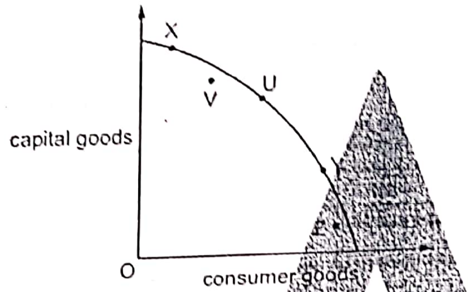
An economy is experiencing economic growth.

What will be the effect on its rate of inflation, level of unemployment and current account surplus?

	rate of inflation	level of unemployment	current account surplus
A	lower	lower	lower
B	raise	lower	raise
C	raise	raise	uncertain
D	uncertain	uncertain	uncertain

Q19 | [M/J 2015/Q26]

The diagram shows a country's production possibility curve and a number of alternative production points.



Which change in the country's output would be **most** likely to lead to a fall in potential growth?

A U to V **B** U to X **C** Y to X **D** Y to Z

Q20 | [M/J 2015/Q27]

A developing country receiving foreign financial aid is **most** likely to experience economic growth in the long-run if it uses the money to

A boost welfare benefits for the poorest households.

B pay for imports of capital goods.

C reduce environmental pollution.

D reduce income tax for all households.

Q21 | [O/N 2015/Q22]

The table shows the figures for consumption, capital formation and depreciation in four economies, all measured in US $.

Assuming that the state of technology remains unchanged, which economy is most likely to experience economic growth?

economy	consumption ($ million)	capital formation ($ million)	capital depreciation ($ million)
A	100	10	20
B	500	200	100
C	1 000	1 200	1 400
D	20 000	5 000	6 000

Q22 | [O/N 2016/Q28]

What has **not** accompanied global economic growth over the last twenty five years?

A a depletion of non-renewable resources

B decreased international trade

C growing urbanisation

D increased atmospheric pollution

Q23 | [M/J 2018/Q21]

Growth rates can be calculated using changes in the value of GDP from year to year.

Why is real GDP per head considered to be a better indicator than nominal GDP per head for this calculation?

A Real GDP adjusts for price changes by using a base year.

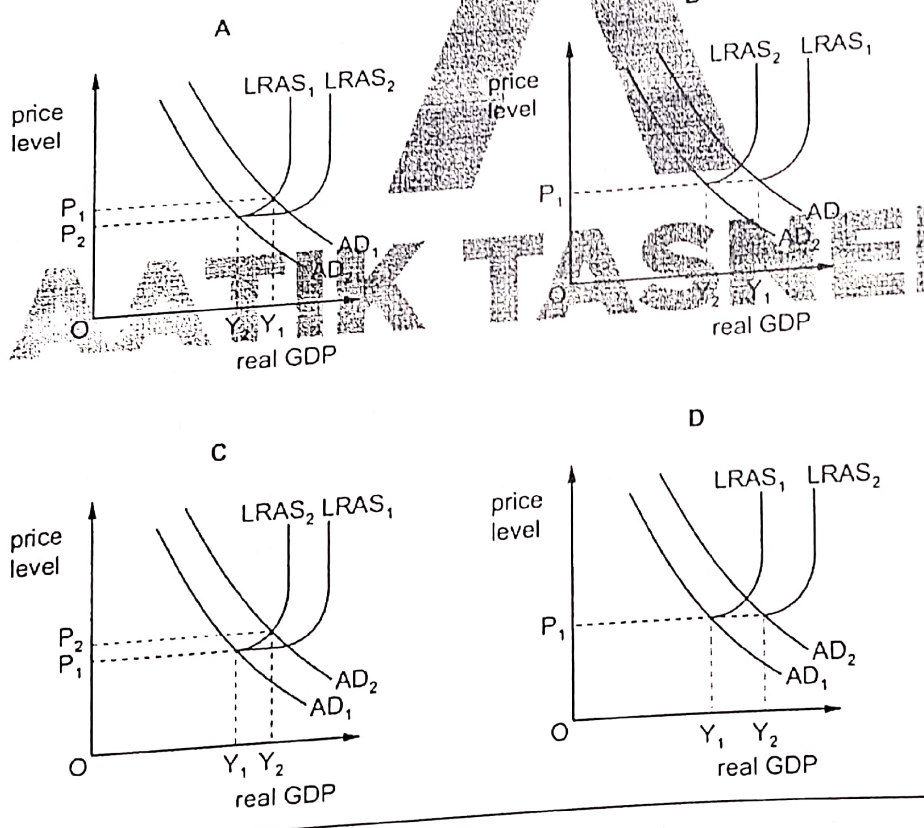
B Real GDP ignores the effects of fluctuations in exchange rates on purchasing power.

C Real GDP includes changes in the size of the population.

D Real GDP measures GDP at factor cost rather than market prices.

Q24 | [M/J 2018/Q27]

Which diagram shows an economy experiencing an increase in actual output but a decline in potential output?



Q25 | [O/N 2018/Q19]

On a diagram showing a production possibility curve, what definitely represents long-run economic growth?

A a change in the slope of the curve

B a movement from a point below the frontier to a point on the curve

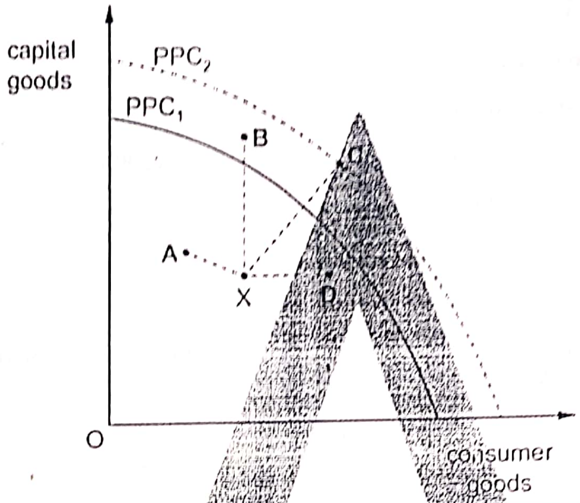
C a movement from one point to another along a given curve

D an outward shift of the curve

Q26 | [O/N 2019/Q25]

The diagram shows a production possibility curve PPC_1. The economy is initially at point X.

If the economy achieves actual economic growth but not potential growth, what would the final position be?



TOPIC 1: ECONOMIC GROWTH

Q1	A

In the economy where the capital formation out ways the depreciation the most will experience the highest economic growth.

Capital Formation	Depreciation	Net Capital Formation
20	10	20 –10 = +10
200	200	200 –200 = 0
1200	1400	1200 –1400 = –200
5000	6000	5000 – 6000 = –1000

Hence only in Option A the net capital was positive.

Key Point: Consumption is never part of this calculation. It is just written to confuse you.

[M/J 2008/Q26]

Q2	B

It is only when the rate of potential growth is higher than the rate of increase in real output that unemployment increases. Option A and B reduce potential output and hence restrict real output and Option C is irrelevant in the given situation.

[O/N 2008/Q21]

Q3	D

Since employment results in a movement from within the PPC to on the PPC this shows an increase in actual output. Options A, B & C all shift the PPC curve and hence potential output increases.

Key Point:
1. Actual Output is movement from within the PPC to on the PPC. [Short-run Economic Growth]
2. Potential Output is the shift of the PPC. [Long-run Economic Growth]

[O/N 2008/Q25]

Q4	D

The data shows that there is an inverse relationship between rate of economic growth which the % change in real GDP and % change in rate of unemployment. When the rate of economic growth increases the unemployment rate declines. Option A , B & C highlight absolute values whereas the table shows % changes.

Key Point:
1. Always remember that we can NEVER calculate absolute values from % change.

[O/N 2008/Q26]

Q5	C

Continuous economic growth is shown by a continuous outward shift the PPC/PPF. Option A is incorrect because it only highlights actual growth. Option B is incorrect because if employment increases it again results actual growth. Option D is incorrect because increase in nominal GDP is the outcome of economic growth and it does not guarantee that the growth will sustain itself.

Common Mistake: Some students ended up choosing option D however the reason it was incorrect was because nominal GDP might just go up for one year whereas if the PPC shifts the potential of the economy is expanding which is necessary to sustain this growth.

[O/N 2008/Q27]

Q6	B

In the economy where the capital formation out ways the depreciation the most will experience the highest economic growth.

Capital Formation	Depreciation	Net Capital Formation
40	50	40 – 50 = –10
200	150	200 – 150 = +50
1200	1400	1200 – 1400 = –200
6000	6000	6000 – 6000 = 0

Hence only in Option B the net capital was positive.

Key Point: Consumption is never part of this calculation. It is just written to confuse you.

[M/J 2009/Q24]

Q7	B

Capital formation as a result of increase in level of investment and increase in labor force result in more rapid economic growth. Option A will lead to recession since deficits will decrease AD. Option C will lead to higher taxes to distribute wealth more equally hence incorrect as it can reduce the potential for growth. Option D is incorrect because increase in debt might lead to economic growth initially however will slow it down when the debt needs to be paid back.

[M/J 2009/Q26]

Q8	D

Technological innovation would reduce the amount of inputs used to produce a given level of output, therefore it would result in lower cost both for present and future generations. Option A & B would benefit today however would impose a higher cost on future generations as no resources would be left. Option C would lead to higher cost for the initial generation as they would have to forgo today's consumption.

[M/J 2011/Q21]

Q9	A

A reduction is import tariffs will increase the country's imports in the short-run however but by doing this the country will tend to move towards free trade which will lead to more specialization in the long-run. Option B is incorrect because if less people come into the country the potential for growth will decline. Option C increase both short-run and long-run. Option D will only give a short-run increase.

[M/J 2012/Q27]

Q10	D

A movement from Y to Z will restrict the potential growth since more consumer goods would be produced and less of capital good. This leads to the potential growth to decline.

Key Point:

1. Actual Output is movement from within the PPC to on the PPC. [Short-run Economic Growth]
2. Potential Output is the shift of the PPC. [Long-run Economic Growth]

[O/N 2012/Q23]

Q11	D

More labor force available to work will lead to an outward shift in the PPC. Option A is incorrect because during unemployment the curve stays there is just a movement from on the curve to a point inside the curve. Option B is incorrect because inflation is caused by either excess of AD or less AS. An increase in AD is only going to lead to short-run growth. Option C is incorrect because if the government budget deficit increase that shows that the government is spending more which increases AD however would not cause the PPC to shift outwards.

Key Point:

1. Actual Output is movement from within the PPC to on the PPC. [Short-run Economic Growth]
2. Potential Output is the shift of the PPC. [Long-run Economic Growth]

[O/N 2012/Q26]

Q12	C

Long-run economic growth is achieved by technical innovation leading to an increase in the potential of the economy. Option A will restrict growth since if employment protection legislation increases this will restrict firms from hiring labor which will reduce the potential for growth. Option B is only related to the short-run growth. Option D will restrict growth as trade unions tend to put pressure on the firms hence reducing their ability to hire people. **[M/J 2013/Q25]**

Q13	C

High savings ratio provides funds for investment which a main determinant for long term growth. Option A will reduce growth as firms will tend to supply less at lower prices. Option B will restrict growth because if the trade union memberships increase it would be difficult for the firms to operate in that environment as wages would be high and they would have less control over labor. Option D will lead to less economic growth as investment is the main determinant for long term growth. **[O/N 2013/Q22]**

Q14	D

An increase in employment refers to using existing capacity, as there is a movement from within the PPC to on the PPC. therefore does not affect potential output. Option A, B & C all increase the potential output and tend to shift the PPC outwards.

Common Mistake: Some students misread the answer choices and choose option C thinking that increase in labor force means increase in employment. Students need to know that they are different if the size of the labor force increases, it shifts the curve as resources are going up, however if employment increases there is only a movement from within the PPC to on the PPC.

Key Point:
1. Actual Output is movement from within the PPC to on the PPC. [Short-run Economic Growth]
2. Potential Output is the shift of the PPC. [Long-run Economic Growth]

[O/N 2013/Q25]

Q15	D

Greatest Contribution: Personal Consumption was the highest as it remains positive throughout the four quarters and the percentage keeps on increasing.

Least Contribution: Net Exports were the lowest because most of the quarters they were in negative except for quarter four. **[M/J 2014/Q22]**

Q16	D

Workers who are unemployment for a certain period become de-skilled as their skills become increasingly outdated. Option A is incorrect because consumption lost can be regained through more employment in the future. Option B is incorrect because rising unemployment will likely reduce real wages levels. Option C is irrelevant. **[M/J 2014/Q23]**

Q17	B

This statement fails to take into account that with the consumption the supply would be less and hence the prices will rise which will prevent the exploitation. Option A & C are taken into account. **[M/J 2014/Q26]**

Q18	D

The reason for rate of inflation, level of unemployment and current account surplus are all uncertain because the reason for economic growth will decide the final impact. **[M/J 2015/Q25]**

Q19	D

When the economy moves from Y to Z it is producing more consumer goods, hence in the future the productive capacity of the economy will fall, hence reducing the potential growth (outward shift of the PPC). **[M/J 2015/Q26]**

Q20	B

Always remember increase in capital is always the most likely cause of economic growth in the long-run. Hence option B. Option A will not contribute to economic growth a lot rather would aim to reduce uneven distribution of income. Option C leads to environmental conservation not necessarily economic growth. Option D will increase in consumption but the impact is less than capital goods.
[M/J 2015/Q27]

Q21	B

In the economy where the capital formation out ways the depreciation the most will experience the highest economic growth.

Capital Formation	Depreciation	Net Capital Formation
10	20	10 – 20 = –10
200	100	200 –100 = +100
1200	1400	1200 –1400 = –200
5000	6000	5000 – 6000 = –100

Hence only in Option B the net capital was positive.

Key Point: Consumption is never part of this calculation. It is just written to confuse you.
[O/N 2015/Q22]

Q22	B

A decrease in international trade leads to restricting economic growth. Option A, C & D all lead to economic growth.

Common Mistake: Some students choose answer D. This was incorrect because pollution is harmful for economic development not economic growth. When industries open they cause pollution but that is a sign of economic growth.
[O/N 2016/Q28]

Q23	A

Any value that is real is better than the nominal one because all real values adjust for inflation. Options B & D are incorrect. Option C is incorrect because both real GDP per head and nominal GDP per head take the population into account.
[M/J 2018/Q21]

Q24	C

Actual Output: This is where the AD = LRAC
Potential Output: This is the point where the LRAC becomes perfectly inelastic.

Hence from the diagrams we can see that in option C the actual output increased from Y_1 to Y_2 however the LRAC shifted leftward.
[M/J 2018/Q27]

Q25	D

In the long-run economic growth the PPC shifts outwards. Option A is irrelevant. Option B represents short-run economic growth. Option C may or may not lead to economic growth.
[O/N 2018/Q19]

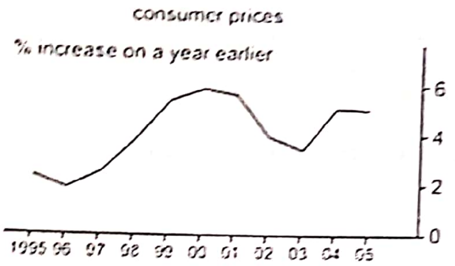
Q26	D

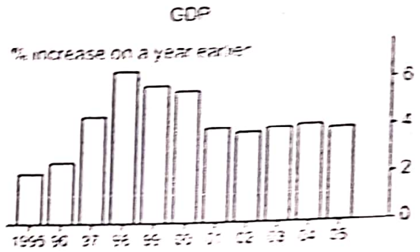
Actual growth is shown by a movement from within the PPC to on the PPC or closer to the PPC. Hence a movement from X to D. A movement from X to C would have been potential economic growth because in potential economic growth the PPC shifts outwards entirely.
[O/N 2019/Q25]

TOPIC 2: STANDARD OF LIVING

Q1 | [M/J 2008/Q16]

The graphs show how consumer prices and real GDP changed in a country between 1995 and 2005





Which conclusion may be drawn from the graphs?

A Living standards remained roughly constant between 1995 and 2005.

B The country experienced continuous economic growth between 1995 and 2005.

C The level of GDP was lower in 2005 than in 2000.

D The price level fell between 2000 and 2003.

Q2 | [M/J 2008/Q17]

During a year, a country's national income in money terms increased by 8%, prices increased by 4% and total population increased by 2%.

What was the approximate change in real income per head?

A a decrease of 2%

B nil

C an increase of 2%

D an increase of 4%

Q3 | [O/N 2008/Q14]

During a year, a country's national income in money terms increased by 6%, prices increased by 4% and total population increased by 2%.

What was the approximate change in real income per head?

A a decrease of 2%

B nil

C an increase of 2%

D an increase of 4%

Q4 | [M/J 2009/Q15]

A country's national income per head increases.

What could explain why this is accompanied by a fall in households' standard of living?

A an increase in personal taxes

B an increase in the trade deficit

C an increase in population

D a rise in the exchange rate

Q5 **[O/N 2009/Q25]**

An economy's GDP per capita grows over a certain period of time, but its development when measured by the Human Development Index remains unchanged.

What could explain the difference?

A longer working hours

B increased pollution

C an increased crime rate

D a decline in life expectancy

Q6 **[M/J 2010/Q13]**

A government requires all its young citizens to undertake community service for a period of 6 months. The wages paid to those on the community service are below what they would otherwise have earned.

What effect will this have on recorded GDP and on national welfare?

	effect on GDP	effect on national welfare
A	reduction	increase
B	reduction	uncertain
C	unchanged	increase
D	unchanged	uncertain

Q7 **[M/J 2012/Q17]**

A government uses real personal disposable income per head as a measure of the standard of living.

What does this measure **not** take into account?

A the distribution of income

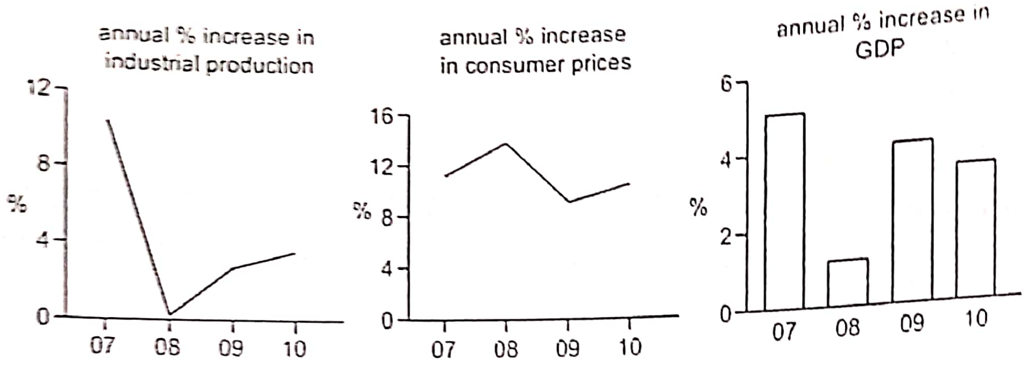
B the level of national income

C the size of the population

D the average price level

Q8 | [M/J 2012/Q18]

The graphs indicate economic performance in a country between 2007 and 2010.



Which conclusion may be drawn from the graphs?

A Between 2007 and 2008 industrial production and GDP fell but prices rose.

B Between 2008 and 2009 the rates of growth of industrial production, GDP and prices all increased.

C GDP and industrial production were at their lowest in 2008.

D At no time did industrial production, GDP or prices fall.

Q9 | [O/N 2012/Q16]

Over a given period, the nominal value of a country's national income increased by 20 % and the rate of inflation was 10 %.

What can be deduced from this information?

A There was an increase in the volume of output.

B There was a reduction in the demand for money.

C There was an increase in the income velocity of circulation.

D The country's money supply increased by 10 %.

Q10 | [M/J 2013/Q17]

National income statistics show that real GDP per head is 25% higher in country X than in country Y.

Why might this difference exaggerate the gap in average living standards between the two countries?

A Country X has a larger population than country Y.

B Country X has a higher rate of inflation than country Y.

C The proportion of services people provide for themselves is higher in country Y.

D The proportion of the country's industry which is owned by foreign firms is higher in country Y.

Q11 | [O/N 2013/Q17]

What might cause the growth of measured GNP to overstate the 'true' rate of economic growth in an economy?

A People move from unpaid housework to paid employment.

B The exchange rate is overvalued according to purchasing power parity.

C There is a reduction in environmental pollution.

D There is a reduction in the rate of investment in physical capital.

Q12 | [M/J 2014/Q24]

The table shows the annual income thresholds per person used by the World Bank to classify countries according to their nominal Gross National Income (GNI) in 2000 and 2010.

	2000	2010
low income	$755 or less	$1005 or less
lower middle	$756 to $2995	$1006 to $3975
upper middle	$2996 to $9625	$3976 to $12 275
high income	$9266 or more	$12 276 or more

What could explain the changes recorded in the table?

A Income inequality between countries increased between 2000 and 2010.

B On average, real GNI in low income countries increased by roughly one third between 2000 and 2010.

C On average, world prices increased by roughly one third between 2000 and 2010.

D Some of the countries in the upper middle income category in 2000 were re-classified as high income countries in 2010.

Q13 | [O/N 2014/Q20]

During a year, a country's national income in money terms increased by 8%, total population increased by 2% and real income per head remained constant.

What was the approximate change in the average price level?

A a decrease of 4%

B an increase of 4%

C an increase of 6%

D an increase of 10%

Q14 | [O/N 2014/Q25]

Which change would cause an increase in a country's Human Development Index?

A a decrease in gender inequality

B a decrease in income inequality

C an increase in the mean years of schooling

D an increase in the retirement age

Q15 | [O/N 2015/Q20]

Over one year the money income in an economy increased by 6%. In the same period prices rose by 4%.

What can be concluded from this?

A Real incomes decreased by 2%.

B The velocity of circulation decreased by 2%.

C The money supply increased by 10%.

D The volume of output increased by 2%.

Q16 | [O/N 2015/Q23]

Gross Domestic Product (GDP) per head is an indicator sometimes used to compare living standards of various countries. GDP is converted into a common currency at market exchange rates.

What might cause this indicator to **exaggerate** the relative position of an individual country?

A a high level of female participation in the labour force

B a high level of foreign ownership in domestic industry

C a high level of subsistence farming

D relatively low hours worked by the labour force

Q17 | [M/J 2016/Q19]

What would cause estimates of the money value of the 'Measure of Economic Welfare' for a country to be **greater** than the value of 'Gross National Product'?

A negative externalities such as pollution

B property income received from abroad

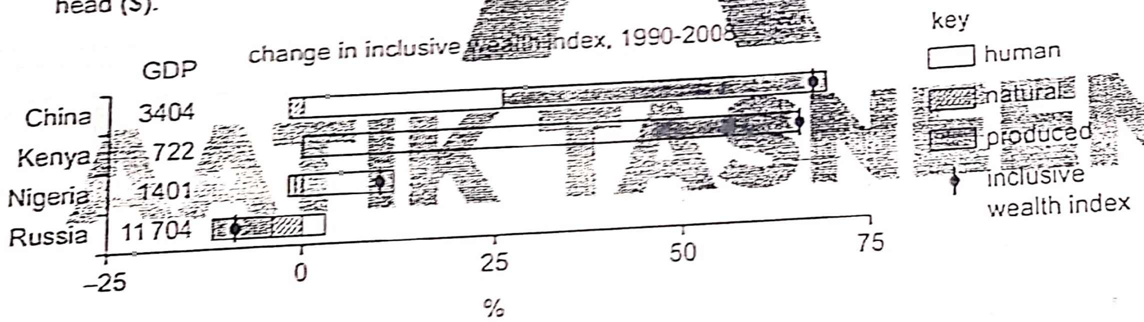
C regrettable necessities

D the value of non-marketed activities and leisure

Q18 | [M/J 2016/Q20]

In 2012 a United Nations report calculated the stock of wealth of 20 countries in terms of human, natural and produced resources. This was measured as the Inclusive Wealth Index (IWI).

The diagram shows the annual percentage (%) change in the IWI between 1990 and 2008 of the economies with the fastest and the slowest growth in IWI. It also shows their 2008 GDP per head ($).



What can be concluded from the diagram?

A A low level of GDP per head meant an inability to build stocks of wealth.

B No country was able to prevent depletion of its natural resources.

C The faster the growth in a country's IWI the higher was its GDP.

D There was an increase in human resources in all four countries.

Q19	[M/J 2017/Q21]

During a certain period, a country with a constant population expands its output per head. It also experiences a significant increase in river and atmospheric pollution.

In the absence of any other changes, which measure would show a decrease in living standards?

A Gross Domestic Product per head

B Gross National Product per head

C Human Development Index

D Measure of Economic Welfare

Q20	[O/N 2017/Q19]

How might real GNP per head be adjusted to make it a more reliable indicator when comparing standards of living in different countries?

A adjustments to allow for differences in population size in different countries

B adjustments to allow for differences in rates of inflation in different countries

C adjustments to allow for differences in the relative size of the hidden economy in different countries

D the use of market exchange rates rather than purchasing power parity exchange rates

Q21	[O/N 2018/Q22]

Country X's living standards were compared with country Y's living standards using real GNP per head converted into US dollars. Country X was ranked above country Y.

Which factor might have caused this ranking to be **incorrect**?

A Actual market exchange rates were used rather than purchasing power parity rates.

B Government spending on transfer payments was higher in country Y than in country X.

C Inflation was higher in country X than in country Y.

D The distribution of income was more unequal in country X than in country Y.

TOPIC 2: STANDARD OF LIVING

Q1	B

The country experienced continuous economic growth since the % increase always remained positive. Option A is incorrect because livings standards cannot be deduced with just he GDP increase. Option C is incorrect because the GDP was highest in 2005. Option D is incorrect because the prices never dropped as the graph continued to stay positive.

Key Point:
1. Always remember if on the axis of the graph the examiner has mentioned % unless that graph goes to negative the value keeps on rising.

[M/J 2008/Q16]

Q2	C

Out of 8% increase in national income 4% is adjusted for inflation and 2% for increase in population. The net effect on real income per head is an increase of 2%.

Net effect on real income per head= Increase in total national income – Increase in Prices – Increase in Population

[M/J 2008/Q17]

Q3	B

Out of 6% increase in national income 4% is adjusted for inflation and 2% for increase in population. The net effect on real income per head is an increase of 0% or nil.

Net effect on real income per head= Increase in total national income – Increase in Prices – Increase in Population

[O/N 2008/Q14]

Q4	A

An increase in personal taxes i.e. more than the increase in income per head reduces disposable income. Option B & D are incorrect because both increase consumption. Option C is incorrect because NY per head is already adjusted for any changes in population so does not effect this calculation.

[M/J 2009/Q15]

Q5	D

The Human Development Index (HDI) is a statistic composite index of THREE elements:
(i) Life expectancy
(ii) Education
(iii) GDP per capita income indicators

Hence even if GDP increase if any of the other two factors declined the value of the HDI will decline. Therefore a decline in left expectancy will lead to a fall in HDI. Option A, B & C are not part of HDI calculation.

[O/N 2009/Q25]

Q6	B

Effect on GDP: Lower wages will contribute towards less GDP.

National Welfare: The reasons it is uncertain is because welfare comprises of GDP and several other qualitative variables. Hence since GDP is decreasing and other qualitative variables are increasing there is no way to calculate the net effect.

[M/J 2010/Q13]

Q7	A

Real: This takes the inflation/average price level into consideration
Disposable Income: Takes into account the national income
Per head: This takes population into account

The only thing that is not taken into account is the distribution of income.

[M/J 2012/Q17]

Q8	D

Since the % change remained positive throughout that means all of the variables continuously increased. Therefore at no time did the production, GDP or prices fall.

Key Point:
1. Always remember if on the axis of the graph the examiner has mentioned % unless that graph goes to negative the value keeps on rising.

[M/J 2012/Q18]

Q9	A

MV = PY, in the equation PY represents national income and if it increased by 20% and P alone rose by 10% then Y must have increased by 10%. Option B is irrelevant. Option C & D cannot be calculated and can't be deduced with the given information.

[O/N 2012/Q16]

Q10	C

Services people provide for themselves is not part of the GDP. Since the question states that Real GDP per head is 25% higher that means Option A, B & D are all incorrect because of this since inflation and population are already taken into account.

[M/J 2013/Q17]

Q11	A

Output not counted previously now becomes part of GNP therefore GNP rises without any real increase in output.

[O/N 2013/Q17]

Q12	C

If we multiple every figure by 1.33 we can see that approximately prices did increase by roughly 1 third. Option A cannot be calculated. Option B is incorrect as these are nominal figures. Option D is incorrect because there is no evidence to support this information.

[M/J 2014/Q24]

Q13	C

Out of 3% increase in national income, 2% for increase in population. The net effect on real income per head is an increase of 0%. Hence the increase inflation was 6%.

Net effect on real income per head= Increase in total national income – Increase in Prices – Increase in Population

[O/N 2014/Q20]

Q14	C

The Human Development Index (HDI) is a statistic composite index of THREE elements:
(i) Life expectancy
(ii) Education
(iii) GDP per capita income indicators

Hence if mean years of school increases the education will increase and so would the HDI. Option A, B & D are not part of the HDI calculation.

[O/N 2014/Q25]

Q15	D

MV = PY, so if PY(money income) increase by 6%and out that 4% was P then Y must be 2% which is volume of output.

[O/N 2015/Q20]

Q16 | B

Foreign ownership of country's resources will cause part of its GDP to be transferred abroad therefore the country's GDP will not indicate the actual level of income available to the people of this country.

[O/N 2015/Q23]

Q17 | D

Net Economic Welfare (NEW) or Measure of Economic Welfare (MEW) is an adjusted measure of GDP that includes not only consumption and investment items but also all monetary and non-monetary factors that contribute directly to economic well-being.

Additions (+)	**Subtractions (-)**
1. Value of Leisure Time: Working fewer hours to get satisfaction from leisure 2. Unpaid Jobs: These include cooking meals 3. Income Inequality 4. Illegal Goods: These include selling of drugs 5. Legal Goods: These include carpenter doing work without reporting to the government.	1. Congestion 2. Pollution 3. Depletion of natural resources 4. Crime 5. Traffic accidents

If we add the value of non-marketed activities and leisure the value of the MEW will exceed the GNP.

[M/J 2016/Q19]

Q18 | D

Human resources increased in all four countries because this was the only variable that was positive in the diagram.

[M/J 2016/Q20]

Q19 | D

Out of the methods mentioned only Measure of Economic Welfare takes pollution into account. Option A & B are incorrect because they only national output and population into account. Option C takes national output along with health care and education.

[M/J 2017/Q21]

Q20 | C

Options A and B are incorrect because Real GNP per head already adjusts for inflation and population. Option D is incorrect because purchasing power parity exchange rates are more beneficial when comparing different countries. Hence by adjusting the relative size of the hidden economy the results can be more beneficial.

[O/N 2017/Q19]

Q21 | A

Whenever GNP is compared in order to get the right results the purchasing power parity rates should be used and not the market exchange rates. Hence Option A is correct. Option B is incorrect because if transfer payments are not included in GNP. Option C is incorrect because real GNP removes the impact of inflation. Option D is incorrect because distribution of income is not taken into account.

[O/N 2018/Q22]

TOPIC 3: ECONOMIC DEVELOPMENT

Q1 | [M/J 2008/Q24]

What is likely to result in an increase in GDP per worker in a developing economy?

A an increase in the employment rate

B an increase in the population of working age

C a shift from working in subsistence agriculture to working in manufacturing

D a shift from working in manufacturing to working in subsistence agriculture

Q2 | [O/N 2008/Q24]

A developing economy experiences a rapid growth in labour productivity.

What is most likely to result from this?

A an increase in the country's balance of trade deficit

B an increase in the country's relative labour costs

C a depreciation of the country's currency

D an increase in real income per head

Q3 | [M/J 2009/Q23]

Which change would best indicate that a country has experienced economic development?

A an improvement in the average citizen's quality of life

B an increase in the country's real GDP

C an improvement in the country's trade balance

D an appreciation in the country's currency

Q4 | [M/J 2009/Q25]

Which change would best indicate that a country has experienced economic development?

A an improvement in the average citizen's quality of life

B an increase in the country's real GDP

C an improvement in the country's trade balance

D an appreciation in the country's currency

Q5 | [M/J 2009/Q27]

How might a developing economy gain from a multilateral reduction in import tariffs and the removal by developed economies of subsidies on food exports?

A through increased specialisation leading to higher productivity

B through increased ability to protect infant industries

C through a reduction in the cost to the economy of imported food

D through increased tariff revenues

Q6 [O/N 2009/Q26]

What is most likely to be the impact on economic growth and on the rate of inflation in developed economies of an inflow of migrant labour from developing economies?

	impact on economic growth	impact on rate of inflation
A	increase	increase
B	increase	decrease
C	decrease	increase
D	decrease	decrease

Q7 [O/N 2010/Q24]

Which feature of the Indian economy could explain why the purchasing power parity exchange rate of the Rupee is much higher than its market exchange rate?

A high levels of duty on imported goods

B high levels of rural unemployment

C the relatively low price of goods not traded internationally

D the relatively low rate of inflation

Q8 [M/J 2011/Q20]

Which characteristics are usually found in developing countries?

	saving ratio	capital output ratio
A	low	low
B	high	low
C	low	high
D	high	high

Q9 [O/N 2011/Q24]

A developing country experiences a rapid growth in labour productivity.

What is likely to result from this?

A an appreciation of the country's nominal exchange rate

B an increase in the country's balance of trade deficit

C an increase in the country's inflation rate

D an increase in the country's relative labour costs

Q10 | [O/N 2011/Q28]

What is **not** a valid economic argument for developing economies to pursue a policy of import substitution?

A to embark on industrialisation as a basis for export-led growth

B to exploit their relative abundance of labour in order to produce labour intensive manufacturing goods

C to increase the opportunities for exporting goods in which they already have a comparative advantage

D to reduce their dependence on a narrow range of primary products

Q11 | [M/J 2012/Q25]

Which change is most likely to increase both economic growth and economic development in the long-run?

A a decrease in the savings ratio

B an increase in investment in human capital

C the depletion of non-renewable resources

D the greater use of compulsory overtime working of labour

Q12 | [M/J 2012/Q26]

What is likely to result from the discovery of oil reserves in a developing economy?

A a more equal distribution of income and wealth

B an increase in the real exchange rate

C an increase in the competitiveness of commercial agriculture

D a reduction in the volume of imports of manufactured goods

Q13 | [O/N 2012/Q27]

How might a developing economy gain from a multilateral reduction in import tariffs and the removal by developed economies of subsidies on food exports?

A through increased specialisation leading to higher productivity

B through increased ability to protect infant industries

C through a reduction in the cost to the economy of imported food

D through increased tariff revenues

Q14 | [M/J 2013/Q23]

The table gives the percentage of employment in the primary, secondary and tertiary sectors in four countries.

Which country is most likely to be a developing country?

	primary sector %	secondary sector %	tertiary sector %
A	15	40	45
B	30	40	30
C	35	45	20
D	45	35	20

Q15 | [M/J 2014/Q25]

What is likely to result in an increase in GDP per worker in a developing economy?

A an increase in the employment rate

B an increase in the population of working age

C a shift from working in subsistence agriculture to working in manufacturing

D a shift from working in manufacturing to working in subsistence agriculture

Q16 | [M/J 2014/Q30]

A fair trade scheme encourages consumers in developed countries to buy food produced by farming cooperatives in developing countries at a higher price than that charged by commercial firms.

Why might this be harmful to economic development?

A It will cause a worsening in the terms of trade of developing economies.

B It will reduce the amount of government aid provided to developing economies.

C It will reduce the prices subsistence farmers receive for their produce.

D It will slow the process of economic diversification in developing economies.

Q17 | [O/N 2014/Q24]

A developing economy experiences a rapid growth in labour productivity.

What is most likely to result from this?

A an increase in the country's balance of trade deficit

B an increase in the country's relative labour costs

C a depreciation of the country's currency

D an increase in real income per head

Q18 | [O/N 2014/Q26]

Real output in an economy grows by 2.5% but at the same time the level of employment decreases.

What can be deduced from this information?

A Actual output has grown more quickly than potential output.

B Labour productivity has increased.

C Population of working age has fallen.

D There has been an increase in the rate of inflation.

Q19 | [M/J 2015/Q29]

The data below relate to a particular country for the four years shown:

Year	1	2	3	4
real GNP/head (Year 1 = 100)	100	110	121	121
life expectancy at birth (years)	65	64	65	67
% of age group enrolled in secondary education	40	38	42	42

What can definitely be concluded from these data?

A Economic growth between Year 2 and Year 3 was 11%.

B The level of economic development was better in Year 2 than in Year 1.

C There was both economic growth and an improvement in economic development between Year 2 and Year 3.

D No conclusions can be drawn as to whether the level of economic development was better in Year 4 than Year 3.

Q20 | [O/N 2015/Q29]

What is likely to be the effect on developing economies of an increase in inward foreign direct investment?

A an acceleration of technology transfer

B an increase in the burden of debt

C an increase in visible trade deficits

D a slowdown of rural-urban migration

Q21 | [O/N 2015/Q30]

Economists have proposed that the best policy to promote development is 'trade not aid'.

What is implied by this proposal?

A Developing countries should become self-sufficient.

B Developing countries should be given greater access to markets in developed countries.

C Developing countries should use foreign aid to invest in their export industries.

D Developing countries should use trade barriers to promote import substitution.

Q22 | [M/J 2016/Q21]

Which combination is usually found in less developed economies?

	low	high
A	capital : output ratio	saving ratio
B	external debt	capital : output ratio
C	population growth	external debt
D	saving ratio	population growth

Q23 | [M/J 2016/Q22]

Which change is most likely to increase both economic growth and economic development in the long run?

A a decrease in the saving ratio

B an increase in investment in human capital

C the depletion of non-renewable resources

D the greater use of compulsory overtime working of labour

Q24 | [M/J 2016/Q29]

What is most likely to result from foreign direct investment in developing economies?

A a deterioration in the trade balances of developing economies

B a reduction in migration to urban areas in developing economies

C a reduction in the transfer of technology to developing economies

D a rise in per capita levels of consumption in developing economies

Q25 | [O/N 2016/Q21]

What is a common characteristic of developing economies?

A a relatively small agricultural sector

B extensive underemployment

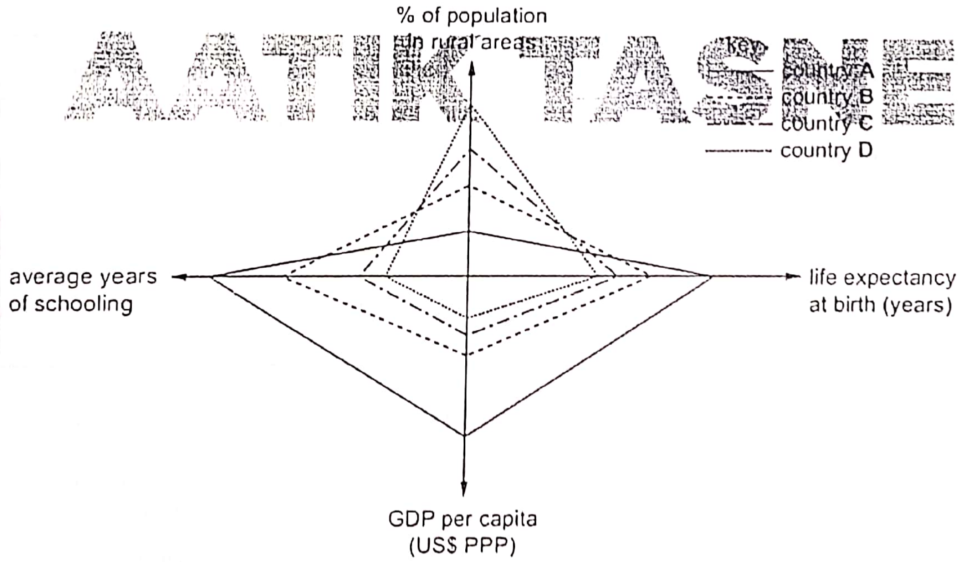
C high saving rates

D stable export earnings

Q26 | [O/N 2016/Q22]

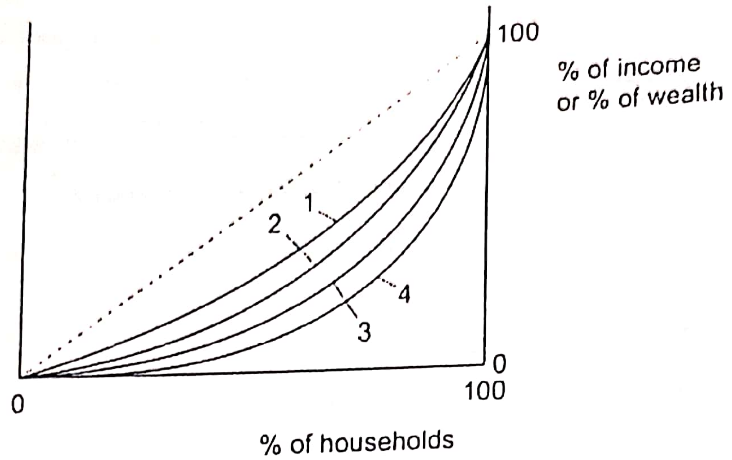
The diagram shows data on various aspects of four countries.

Which country is likely to be **least** developed?



Q27 | **[M/J 2017/Q15]**

The Lorenz curves in the diagram show different distributions of income and of wealth.



Income in a country is more equally distributed than wealth.

In a period the distribution of income becomes more unequal but the distribution of wealth becomes more equal.

Which movement would show the effects of these changes on the distribution of income and wealth within the country?

	distribution of income	distribution of wealth
A	shift from curve 1 to curve 2	shift from curve 4 to curve 3
B	shift from curve 2 to curve 1	shift from curve 3 to curve 4
C	shift from curve 3 to curve 4	shift from curve 2 to curve 1
D	shift from curve 4 to curve 3	shift from curve 1 to curve 2

Q28 | **[M/J 2017/Q20]**

What is typically associated with a relatively low level of income per capita in a country?

A low exports

B low inflation

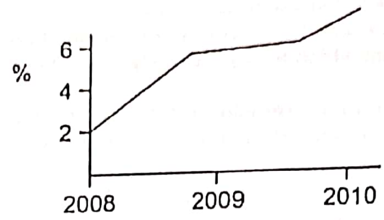
C low investment

D low population

Q29 | [M/J 2017/Q22]

The graphs below show percentage changes in money GDP and consumer prices in a country between 2008 and 2010.

% change in money GDP



% change in consumer prices

Which conclusion may be drawn from the graphs?

A Between 2009 and 2010 money GDP fell but consumer prices continued to rise.

B Consumer prices and money GDP both continued to rise throughout the period.

C In real terms GDP grew throughout the period.

D When consumer prices rose, money GDP fell.

Q30 | [M/J 2017/Q25]

Which could cause the official statistics for the national income per head of a developing country to overstate the true level of economic well-being of its inhabitants?

A if there is dependence on barter in internal trade

B if subsistence agriculture dominates total economic activity

C if services are an important component of exports

D if there is extreme income inequality

Q31 | [M/J 2017/Q26]

The table shows some United Nations population statistics for 2010 and estimates for 2050.

types of region	total population (m) 2010	total population (m) 2050	urban population (m) 2010	urban population (m) 2050	population urbanised (%) 2010	population urbanised (%) 2050
more developed regions	1237	1275	930	1100	75	86
less developed regions	5671	7875	2556	5186	45	66
least developed regions	855	1673	249	914	29	55

Which relationship can be confirmed from the table?

A The least developed regions have the largest urban populations, actual or predicted, in both years.

B The more developed regions have the lowest growth rate of urbanisation between 2010 and 2050.

C The type of region with the greatest total population in 2010 is predicted to have the greatest rate of population growth by 2050.

D The type of region with the greatest urban population in 2010 is predicted to have the highest level of urbanisation by 2050.

Q32 | [O/N 2017/Q21]

To combat a rising crime rate, the government decides to recruit additional police officers who are paid a wage equal to that which they previously earned in the private sector.

As long as their previous jobs remain unfilled, what effect will the recruitment of the additional police officers have on the national income and on economic welfare?

	effect on national income	effect on economic welfare
A	increase	unchanged
B	uncertain	decrease
C	unchanged	decrease
D	unchanged	uncertain

Q33 | [O/N 2018/Q20]

When is economic growth most likely to promote economic development?

A when it achieves maximum rates of extraction of raw materials

B when it concentrates on increasing production

C when it discovers valuable new resources in remote natural environments

D when it provides the funds to finance cleaner production processes

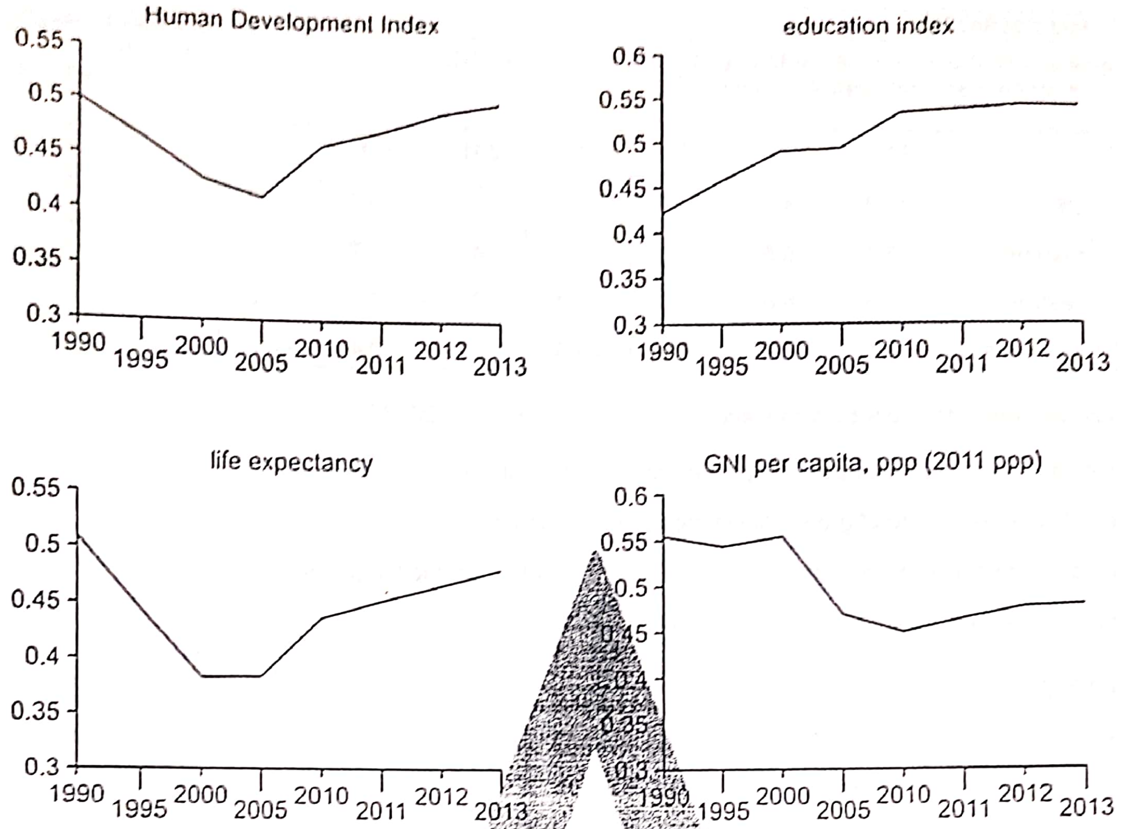
Q34 | [O/N 2018/Q21]

Which items in the table are classified as foreign aid?

	foreign direct investment	official development assistance	portfolio investment flows
A	no	no	yes
B	no	yes	no
C	yes	no	yes
D	yes	yes	no

Q35 | [M/J 2019/Q20]

The graphs show the Human Development Index and its component parts for Zimbabwe.



Between 2005–2010, which components of HDI have comparable changes to its overall change?

A education and GNI per capita

B education and life expectancy

C education, GNI per capita and life expectancy

D GNI per capita and life expectancy

Q36 | [M/J 2019/Q21]

What makes it possible for the increase in real national output to exceed the increase in labour productivity?

A an increase in employment

B an increase in the inflation rate

C an increase in the money supply

D an increase in total earnings

Q37 | [M/J 2019/Q22]

The table shows the annual percentage (%) change in China's GDP and the contribution of some of its component parts between 2006 and 2012.

	2006	2007	2008	2009	2010	2011	2012
GDP	12.7	14.2	9.6	9.2	10.4	9.3	7.7
consumption	5.1	5.6	4.2	4.6	4.5	5.2	4.2
investment	5.5	6.0	4.5	8.1	5.5	4.5	3.9
net exports	2.1	2.6	0.9	–3.5	0.4	–0.4	–0.4

What can be concluded about China's economy between 2006 and 2012?

A China's current account was in surplus more years than it was in deficit.

B China's economic rate of growth fell in more years than it rose.

C China's growth was greater overall in consumer goods than in capital goods.

D China's standard of living rose at a decreasing rate.

Q38 | [O/N 2019/Q23]

What will be the **most** likely consequence of an increase in the dependency ratio?

A a decrease in GDP per head

B a decrease in labour productivity

C an increase in the labour force

D an increase in unemployment

Q39 | [O/N 2019/Q24]

Which statement is correct?

A Economic development is necessary for economic growth.

B Economic growth and economic development are directly proportional.

C Economic growth enables economic development.

D Economic growth is always sustainable.

Q40 | [O/N 2019/Q26]

It has been estimated by the United Nations that the total external debt of developing countries has been increasing by about $425 billion each year.

What is **least** likely to have contributed to this?

A disincentives for foreign direct investment through political instability

B increased government subsidies for the development of tourism industries

C withdrawal of multinational companies due to delays in the award of government contracts

D worsening of the terms of trade with partners in developed economies

Q41	[O/N 2019/Q27]

The following are four conditions sometimes attached to IMF loans to developing countries.

Which condition would conflict with the 'infant industry' argument?

A the need to allow free trade

B the need to control inflation

C the need to have a contractionary fiscal policy

D the need to privatise government enterprises

TOPIC 3: ECONOMIC DEVELOPMENT

Q1	C

Since the productivity is higher in the secondary sector (manufacturing) than the primary sector (subsistence agriculture) therefore the GDP per worker will increase. Option A is incorrect because it increases total output not output per worker as the labor force is also increasing. Option B does not necessarily increase GDP per worker as it might increase only the output. Option D is incorrect because it is suggesting a shift from the working secondary sector to the primary sector.

[M/J 2008/Q24]

Q2	D

Higher output due to rising productivity would result in an increase in output (real income) available per person. Option A is wrong because if labor is productive the exports will increase and the deficit will clear. Option B is incorrect because it cannot be deduced because high labor productivity might lead to less labor being employed reducing the cost. Option C is incorrect because when exports increase the country's currency appreciates.

[O/N 2008/Q24]

Q3	B

Outward migration is when more people leave a country than the ones coming in. When this happens it tends to improve the balance of payments by increasing inflows of current transfers as when they work abroad they send money back in the form of foreign remittances. Option A & D are not related to outward migration. Option C is incorrect because reduction on imports would tend to improve the currency.

[M/J 2009/Q23]

Q4	A

Economic development is related to improvement in the quality of life. Hence B, C & D since they only relate to quantitative measures which is not what economic development is about.

[M/J 2009/Q25]

Q5	A

Multilateral reduction means that both countries to specialize in goods they are good at. Hence the developing countries can specialize in food items and can export to developed countries. Option B is incorrect because removal of tariffs would lead to infant industries being under threat. Option C is incorrect because the subsides are removed hence the imports will get expensive. Option D is incorrect because since tariffs are being reduced the tariff revenues are declining.

Key Point: Whenever trade restrictions are reduced the benefit is always specialization.

[M/J 2009/Q27]

Q6	B

Impact on Economic Growth: When the labor force increases it lead to higher growth.
Impact on Inflation: Due to increase in supply of labor the supply will increase and hence puts a downward pressure on the price level.

[O/N 2009/Q26]

Q7	C

Purchasing power parity exchange rate is an exchange rate based on the ratio of price of a basket of products in different country. This is used to solve the problem of measurement of Real GDP and will not be affected by the market changes in the price of currencies on the foreign exchange market. Hence a relatively lower price of goods not traded internationally will only impact the domestic goods and not the currency.

[O/N 2010/Q24]

Q8	A

Saving Ratio: Lower incomes in general result in a lower saving ratio, in developing countries.
Capital Output Ratio: Production in these countries uses traditional tools and equipment therefore low capital output ratio.

[M/J 2011/Q20]

Q9	A
Productivity growth is likely to improve they country's cost competitiveness; therefore, exports are likely to increase resulting in an appreciation in its currency. Option B is incorrect because higher exports reduce the trade deficit. Option C is incorrect because productivity brings costs down and hence inflation. Option D is incorrect because higher labor productivity might lead to less labor being hired and hence lower relative cost. [O/N 2011/Q24]	

Q10	C
Import substitution means producing domestic alternatives of imported goods. Therefore, a policy of increasing exports in which the country already enjoys comparative advantage is unrelated. [O/N 2011/Q28]	

Q11	B
Economic growth is increase in GDP whereas economic development is the process by which a nation improves the economic, political, and social well-being of its people. If investment in human capital increases efficiency of human resources are therefore likely going to result in both growth and development. Option A is incorrect because lower savings leads to lower investments and hence reduce growth. Option C will lead to harm long-run development. Option D is going to lead to a decline in the social well-being of its people. [M/J 2012/Q25]	

Q12	B
It is likely to increase the country's export earnings or decrease its import bill. Either way the country's real exchange rate will increase. [M/J 2012/Q26]	

Q13	A
Multilateral reduction means that both countries to specialize in goods they are good at. Hence the developing countries can specialize in food items and can export to developed countries. Option B is incorrect because removal of tariffs would lead to infant industries being under threat. Option C is incorrect because the subsides are removed hence the imports will get expensive. Option D is incorrect because since tariffs are being reduced the tariff revenues are declining. **Key Point:** Whenever trade restrictions are reduced the benefit is always specialization. [O/N 2012/Q27]	

Q14	D
In developing countries, the primary sector has the highest percentage whereas the tertiary sector has the lowest percentage of employment. Therefore, country D fits this criterion. [M/J 2013/Q23]	

Q15	C
If the workers shift the agriculture to the manufacturing industry the GDP per worker would be more since the productivity of the worker is higher in manufacturing rather than the agricultural sector. Option A & B is incorrect because it will keep the output per worker the same. Option D is incorrect because agricultural is less productive than manufacturing. [M/J 2014/Q25]	

Q16	D
When a policy encourages the developing countries to only produce agricultural goods it will tend to depend more on its exports. Since agriculture is the least productive sector and the developing country won't be able to diversify in other sectors this will restrict economic development. Option A & C are incorrect because TOT will improve as prices are higher in developing countries. Option B is irrelevant in this context. [M/J 2014/Q30]	

Q17	D

Rapid increase in labor productivity leads to increase in real incomes per head because it will increase real national income and hence increase the real national income per head. Option A is incorrect because labor productivity decreases trade deficits as exports tend to rise. Option B is incorrect because higher costs would be offset by the labor productivity. Option C is incorrect because labor productivity will increase exports and hence the currency of the country.

[O/N 2014/Q24]

Q18	B

This shows that the labor productivity has increased as the economy is achieving higher output by employing fewer workers. Option A cannot be deduced for the given information. Option C is incorrect because if the working age population falls then level of employment could have gone up as well as now the ones who are part of the working population might all be employed. Option D is incorrect because real output increases removed the impact of inflation from the decision and if it is demand pull inflation it would have increased employment.

[O/N 2014/Q26]

Q19	C

There is economic growth because real GNP per head in increasing. There is development because both life expectancy and enrolment ratios have improved. Option A is incorrect because he economic growth was 10% between Year 2 and Year 3. Option B is incorrect because economic development was better in year 1. Option D is incorrect because economic development can be concluded as economic development was less in year 3 than year 4.

[M/J 2015/Q29]

Q20	A

Investments always lead to development in the economy and hence this can be done by acceleration of technology transfer. Option B is incorrect because investment is not a debt. Option C is incorrect because it reduces the trade deficit as the potential to export increases. Option D is incorrect because now the rural-urban migration will increase due to the opportunities in the cities.

[O/N 2015/Q29]

Q21	B

This statement implies that anything that increases trade will benefit the economy and promote development. Hence if developing countries are given access to markets in developed countries this will lead to greater economic development. Option A & D talk about aid which makes the options incorrect. Option C is incorrect because it is no use to in export industries if these countries don't have any access to markets.

[O/N 2015/Q30]

Q22	D

1. Developing countries usually have low savings ratios because the incomes in these countries are low hence people end up spending most of the income and a smaller percentage is saved.
2. Population growth is high because due to lack of knowledge about family planning programs the population growth is high.

[M/J 2016/Q21]

Q23	B

Economic growth is increase in GDP whereas economic development is the process by which a nation improves the economic, political, and social well-being of its people. If investment in human capital increases efficiency of human resources are therefore likely going to result in both growth and development. Option A is incorrect because lower savings leads to lower investments and hence reduce growth. Option C will lead to harm long-run development. Option D is going to lead to a decline in the social well-being of its people.

[M/J 2016/Q22]

Q24	D

FDI results in more production of goods and services hence increasing the per capita levels of consumption. Option A is incorrect because FDI improves trade balances. Option B is incorrect because migration to urban areas will increase. Option C is incorrect because FDI leads to transfer of technology.

[M/J 2016/Q29]

Q25	B

Options A, C & D are typical features of developed countries. Hence only option B highlights developing economies.

[O/N 2016/Q21]

Q26	D

The country with the following features would be the least developed:
1. Percentage of Population in Rural Area: High
2. Life Expectancy at birth: Low
3. GDP per Capita: Low
4. Average years of schooling: Low

Hence the only country to fit this criterion the most is country D.

[O/N 2016/Q22]

Q27	A

On the Lorenz Curve the closer the curve is to the dotted line the greater the equality. Hence:
Distribution of Income: Since the inequality increased the curve will shift from 1 to 2.
Distribution of Wealth: Since the equality increased the curve will shift from 4 to 3.

[M/J 2017/Q15]

Q28	C

Low income leads to low savings and hence low investment.

[M/J 2017/Q20]

Q29	B

From the graphs we can see that the inflation is raising at an increasing rate and GDP is increasing at a decreasing rate. Hence option B is correct because since the rate was positive both continued to increase.

Option A and D are incorrect because both of the values increased. Option C is incorrect because the growth in money GDP remained less than the percentage change in prices.

Key Point: Always remember to read the axis. It it is percentage written, then until the value goes into negative the value will continue to rise as long as it is in the positive quadrant. If the only values are given, then read the graph as it is.

[M/J 2017/Q22]

Q30	D

The national income doesn't take into account the distribution of income hence the national might be showing a very high value however it is just because few people have a lot than the rest of the population.

Option A & B are incorrect because barter would understate the GDP as it is not recorded and so is subsistence agricultural because this is what framers do for themselves and not to retail purposes. Option C is incorrect because exports will have no impact as they are recorded in the national income.

[M/J 2017/Q25]

Q31	B

As we can see that the growth rate of more developed was 11% increase. Whereas for Less developed regions it was 21% and least developed was 26%.

[M/J 2017/Q26]

Q32	B

The national income remains unchanged since the same amount is being generated in the economy. Economic welfare is a value judgement and cannot be determined hence uncertain.

[O/N 2017/Q21]

Q33	D
Economic development is when the overall wellbeing of the people improves. Hence option D is the only option that will lead to it. Cleaner production process will tend to improve the quality of life. Option A, B & C all relate to reducing economic development. [O/N 2018/Q20]	

Q34	B
Foreign Aid is the money that the country does not have to return and there is no interest payment on it as well. Hence only official development assistance is classified as foreign aid. Foreign direct invests and portfolio investments need to be retuned and interests on these transfers needs to be paid. [O/N 2018/Q21]	

Q35	B
As we can see that the HDI increased between 2005 – 2010. Hence Only education and life expectancy index followed that. Therefore option B is correct. [M/J 2019/Q20]	

Q36	A
This is only possible because of an increase in employment. This is because when employment increases the output will go up but the productivity is only calculated on the basis of Output/Labor. Hence the output does not increase at the same rate. [M/J 2019/Q21]	

Q37	B
As we can see that the growth rate fell in more years that it increase. It decreased in 2008, 2009, 2011, 2012. Whereas it only rose in 2006, 2007, 2010. Hence option B is correct. Option A is incorrect because the balance on the current account cannot be calculated from the percentage change in net exports. Option C is incorrect because it is only showing percentage change and actual consumption cannot be deduced. Option D is incorrect because GDP is not the only standard of living. [M/J 2019/Q22]	

Q38	A
A dependency ration is an age-population ratio of those typically not in the labor force and those typically in the labor force. It is used to measure the pressure on the productive population. Hence when this ratio rises the GDP per head drops because the people who are working now have to carry more burden of the ones that are not working hence output per worker will drop. [O/N 2019/Q23]	

Q39	C
Economic growth enables economic development. This I because economic growth is a narrow concept that only measures that increase in GDP however Economic development is much broader than that. It goes steps because just the GDP and also comes with other variables like education, healthcare, freedom of expression. [O/N 2019/Q24]	

Q40	B
Options A, C & D will all lead to government borrowing. Lack of foreign investments, withdrawals of multinationals and worsening of terms of trade will all require foreign assistance. Option B is least likely to cause the problem subsidy to develop an industry will most likely solve the problem of debt crises. [O/N 2019/Q26]	

Q41	A
Infant industry argument states that small businesses need to be protected against large and foreign competition. If the country opens free trade this will result in foreign goods to enter the domestic market and destroy the small business. Option B & D support the infant industry argument. Option C will not just impact small businesses but all businesses in the economy. [O/N 2019/Q27]	

A2 – ECONOMICS (9708)

MACRO

CHAPTER 2

Keynesian Theory of Income & Employment

TOPIC 1: NATIONAL INCOME STATISTICS

Q1 [M/J 2008/Q18]

The table shows data on a country's gross domestic product at market prices and on domestic spending.

	year 1 ($m)	year 2 ($m)	year 3 ($m)
GDP at market prices	630	650	680
private consumption	480	470	480
government consumption	160	160	150
gross investment	20	30	40

In which of these years will the country be faced with a balance of trade deficit?

	year 1	year 2	year 3
A	no	no	yes
B	yes	yes	no
C	no	yes	yes
D	yes	no	no

Q2 [O/N 2009/Q15]

The information in the table is taken from a country's national income accounts.

	$ million
national income	600
consumer spending	400
investment spending	80
government spending on goods and services	100
taxation	90
imports	120

What is the value of exports?

A $100 million B $120 million C $140 million D $230 million

Q3 [M/J 2010/Q14]

Between 2008 and 2009 a country's national income at current prices increased by 15%. At the same time the country experienced 5% inflation.

Which index number most closely represents the country's national income in 2009 at 2008 prices (2008 = 100)?

A 103 B 110 C 115 D 120

Q4 | [M/J 2011/Q13]

The table shows data on a country's gross national product at market prices and on domestic spending.

	year 1 ($m)	year 2 ($m)	year 3 ($m)
GNP at market prices	420	440	560
private consumption	200	260	300
government consumption	120	120	140
gross investment	90	80	130

In which of these years will the country be faced with a deficit on the current account of the balance of payments?

	year 1	year 2	year 3
A	✗	✓	✓
B	✗	✓	✗
C	✓	✗	✓
D	✓	✗	✗

Q5 | [O/N 2015/Q18]

The information in the table is taken from a country's national income accounts.

	$ million
national income	600
consumer spending	400
investment spending	80
government spending on goods and services	100
exports	140

What is the value of imports?

A $100 million B $120 million C $140 million D $240 million

Q6 | [M/J 2018/Q23]

The information in the table is taken from a country's national income accounts.

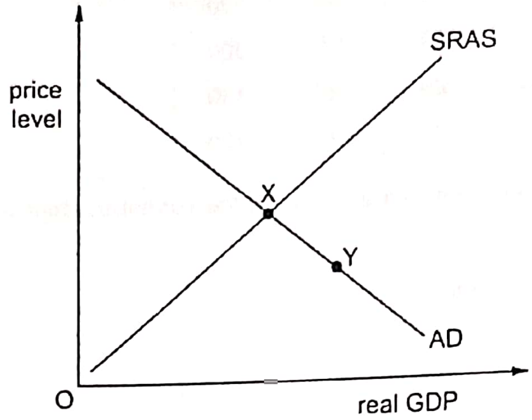
income	US $ (millions)
wages	8000
salaries	7000
unemployment benefit	1000
pensions	1000
rent	3000
interest	2000

What is the value of national income?

A 17 000 B 19 000 C 20 000 D 21 000

Q7	[O/N 2018/Q28]

The diagram shows an economy in equilibrium at point X.



What would be most likely to cause the economy to move from point X to point Y?

- **A** an increase in government spending on transfer payments
- **B** an increase in income tax
- **C** an increase in the average wage rate
- **D** an increase in the productivity of labour

Q8	[M/J 2019/Q19]

What is **not** included in the measurement of national income?

- **A** age-related pensions
- **B** dividends obtained from foreign investments
- **C** housing authorities' income from rent
- **D** profits distributed to shareholders

TOPIC 2: CIRCULAR FLOW

Q1 | [M/J 2009/Q16]

Which of the following correctly identifies net leakages from the circular flow of income?

	trade surplus (exports - imports)	government budget deficit (government spending - taxes)	private sector surplus (saving - investment)
A	✓	✓	✗
B	✓	✗	✗
C	✗	✓	✓
D	✗	✗	✓

Q2 | [O/N 2010/Q16]

What is **not** a leakage from the circular flow of income?

A expenditure on foreign goods

B indirect taxes

C undistributed profits

D unemployment benefits

Q3 | [O/N 2011/Q19]

The table shows some data for an economy.

investment $m	exports $m	government expenditure $m	savings $m	imports $m	taxation $m	national income $m
200	100	50	125	62.5	62.5	600
200	100	50	150	75	75	700
200	100	50	175	87.5	87.5	800
200	100	50	200	100	100	900

What is the equilibrium level of national income?

A $600 m B $700 m C $800 m D $900 m

Q4 | [M/J 2012/Q19]

Which represents an injection into an economy's circular flow of income?

A a balance of trade surplus

B a government budget surplus

C the retained profits of private companies

D household saving

Q5 | [M/J 2013/Q20]

Which correctly identifies injections into a country's circular flow of income?

	private sector I > S	government sector G > T	trade sector M > X
A	no	yes	yes
B	yes	no	no
C	yes	yes	no
D	no	no	yes

Q6 | [M/J 2015/Q19]

Which is **not** an injection into a country's circular flow of national income?

A inward direct investment by multinational corporations

B private gross domestic fixed capital formation

C the sale of government bonds to members of the public

D wages paid to civil servants

Q7 | [O/N 2015/Q19]

Which represents an injection into a country's circular flow of income?

A corporate taxes

B interest payments on government bonds

C the payment of dividends to foreign shareholders

D the repayment of bank loans

Q8 | [O/N 2016/Q24]

Which row correctly identifies net leakages from the circular flow of income?

	trade surplus (exports - imports)	government budget deficit (government spending - taxes)	private sector surplus (saving - investment)
A	✓	✓	✗
B	✓	✗	✗
C	✗	✓	✓
D	✗	✗	✓

Q9 | [O/N 2017/Q25]

What represents a leakage from the circular flow of income in an economy?

A a balance of trade surplus

B a government budget surplus

C reduction in funds for research and development

D re-investment of a firm's profits

Q10 | [M/J 2019/Q24]

Which row correctly identifies leakages from a country's circular flow of income?

	private sector (S > I)	public sector (T > G)	trade sector (X > M)
A	no	no	yes
B	no	yes	yes
C	yes	no	no
D	yes	yes	no

Q11 | [O/N 2019/Q22]

What represents an injection into a country's circular flow of income?

A corporate taxes

B interest payments on government bonds

C the payment of dividends to foreign shareholders

D the repayment of bank loans.

TOPIC 3: KEYNESIAN THEORY OF INCOME & EMPLOYMENT

Q1 | [M/J 2008/Q20]

In a closed economy, the full employment level of income is $200 million.

$C = \frac{3}{4}Y$,

$I = \$(50 - 5r)$ million,

where C = consumption,

Y = income,

I = investment,

r = the rate of interest.

If planned government expenditure is $30 million, what rate of interest would be required for there to be full employment?

A 2% per annum

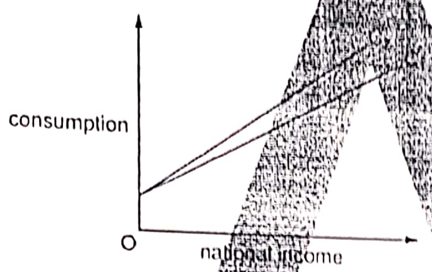
B 4% per annum

C 6% per annum

D 8% per annum

Q2 | [M/J 2008/Q21]

In the diagram, C_1 shows the initial relationship between consumption and national income.



What could cause the consumption function to shift to C_2?

A an increase in exports

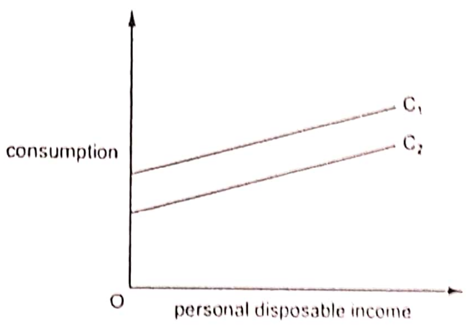
B an increase in investment

C a decrease in the rate of unemployment benefits

D a decrease in the standard rate of income tax

Q3 | [M/J 2009/Q18]

A country's initial consumption function is C_1.



What would be most likely to cause the consumption function to shift from C_1 to C_2?

A a decrease in personal disposable income

B a decrease in the expected future rates of income tax

C an increase in interest rates

D an increase in wealth

Q4 | [M/J 2009/Q19]

In a closed economy with no government $C = 30 + 0.7Y$, where C is consumption and Y is income.

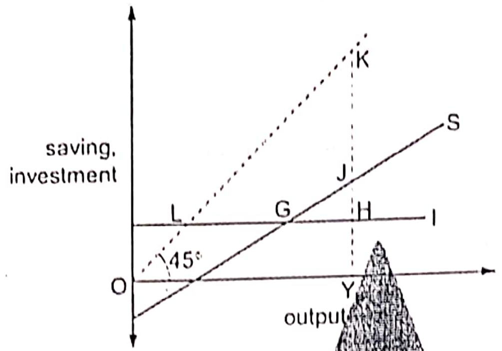
The equilibrium level of income is 300.

What is the level of investment?

A 60 B 100 C 210 D 270

Q5 | [M/J 2009/Q20]

The diagram shows the saving and investment curves of a closed economy with no government.



The potential level of output is OY_P.

Which distance measures the gap between actual and potential output?

A LG B GH C JH D KJ

Q6 | [O/N 2009/Q18]

The table gives the national income of a country over six years.

year	national income (Y)
1	2100
2	2110
3	2125
4	2145
5	2160
6	2170

According to the accelerator principle, in which year did net investment first fall to a level below that of the previous year?

A year 3 B year 4 C year 5 D year 6

Q7 | [O/N 2009/Q19]

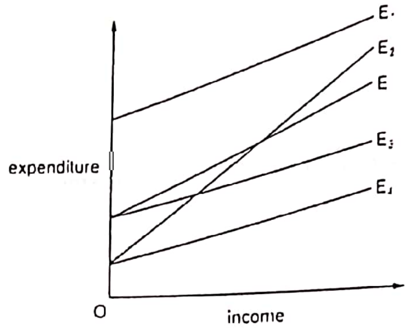
Out of any addition to national income, 20 % is spent on imports, 15 % is paid in taxes, 5 % is saved and the rest is spent on domestically-produced goods.

What is the value of the multiplier?

A 2.5 B 5 C 6 D 20

Q8 | [O/N 2009/Q20]

The diagram shows a number of expenditure functions. The original expenditure function is shown by E



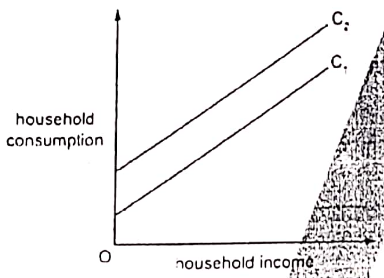
The government announces a decrease in government expenditure on goods and services and reduces the standard rate of income tax.

Which line shows the new expenditure function resulting from these changes?

A E_1 B E_2 C E_3 D E_4

Q9 | [M/J 2010/Q17]

The diagram shows the relationship between household income and household consumption.



What would be likely to cause the household consumption curve to shift from C_1 to C_2?

A a decrease in household income

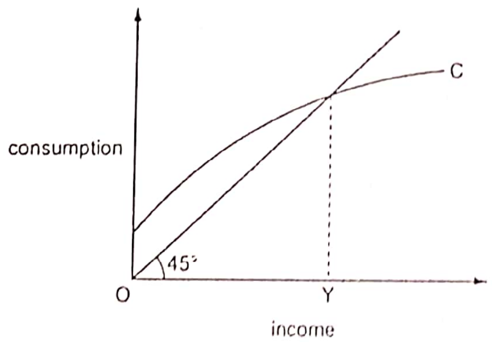
B a decrease in the value of household assets

C an increase in interest rates

D an increase in the expected future level of household income

Q10 | [M/J 2010/Q18]

The diagram shows a consumption function for a closed economy with no government.



What can be concluded from the diagram?

A At income levels below OY, saving is negative.

B At income levels below OY, there is an inflationary gap.

C The equilibrium level of income is OY.

D The marginal propensity to consume increases as income increases.

Q11 | [M/J 2010/Q19]

When national income equals $40 000 million and government spending equals $15 000 million, an economy is in equilibrium below full employment. Out of every increase of $100 in national income, $15 is taken in taxes, $30 is spent on imports and $5 is saved.

To raise national income to the full employment level of $50 000 million, to which level will the government need to raise its own spending?

A $15 500 million

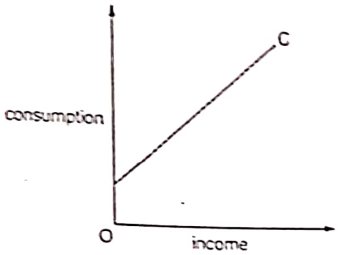
B $20 000 million

C $25 000 million

D $35 000 million

Q12 | [O/N 2010/Q19]

The diagram shows the relationship between consumption expenditure and income.



Which statement is correct?

A The average propensity to consume is constant.

B The average propensity to consume is rising.

C The marginal propensity to consume is equal to the average propensity to consume.

D The marginal propensity to consume is less than the average propensity to consume.

Q13 | [O/N 2010/Q20]

In a closed economy with no government

the full employment level of income = $400 billion

and the equilibrium level of income = $380 billion.

If the deflationary gap is $4 billion, what is the marginal propensity to consume?

A $\frac{1}{5}$ B $\frac{1}{4}$ C $\frac{3}{4}$ D $\frac{4}{5}$

Q14 | [M/J 2011/Q15]

What will reduce the value of the investment multiplier?

A a low marginal propensity to import

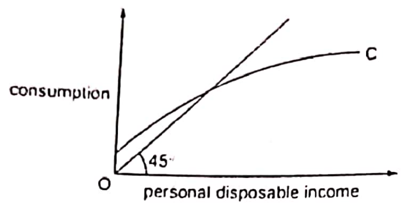
B automatic stabilisers

C low marginal tax rates

D low rates of unemployment benefit

Q15 | [M/J 2011/Q16]

The diagram shows a consumption function.



As income increases, what happens to the average propensity to save and the marginal propensity to save?

	average propensity to save	marginal propensity to save
A	decreases	decreases
B	decreases	increases
C	increases	decreases
D	increases	increases

Q16 | [O/N 2011/Q18]

In a closed economy, households pay $0.10 in tax on every $1 increase in their gross income, and spend $^5/_6$ of every increase in their disposable income.

What is the value of the multiplier?

A 1.5 **B** 4.0 **C** 6.0 **D** 7.5

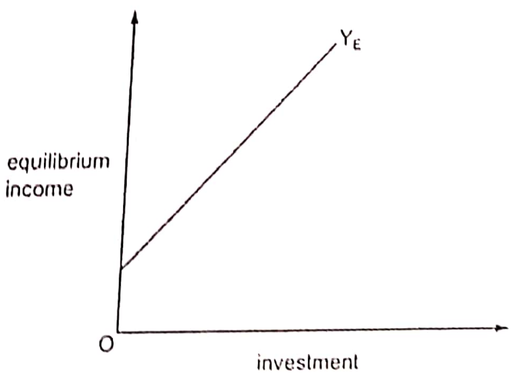
Q17 | [O/N 2011/Q20]

What will be the effect, in the short run, on the price level and on national output of an increase in aggregate demand if firms are working at full capacity?

	price level	national output
A	rise	rise
B	rise	unchanged
C	unchanged	rise
D	unchanged	unchanged

Q18 | [M/J 2012/Q21]

In the diagram, Y_E indicates the equilibrium level of income corresponding to different levels of investment.



What does the slope of the line Y_E measure?

A the investment multiplier

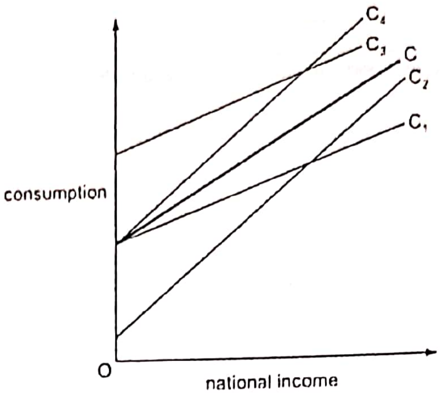
B the marginal propensity to save

C the rate of growth of investment

D the rate of growth of national income

Q19 | [M/J 2012/Q22]

In the diagram, C is an economy's initial relationship between consumption and national income.



Which curve could show the economy's new consumption function following a reduction in the rate of unemployment benefits?

A C_1 B C_2 C C_3 D C_4

Q20 | [O/N 2012/Q18]

In a closed economy with no government, the level of investment is \$5 million, the equilibrium level of income is \$22 million, the full employment level of income is \$25 million and there is a deflationary gap of \$1 million.

What can be deduced from this information?

A The marginal propensity to consume is $\frac{2}{3}$.

B The marginal propensity to consume is $\frac{1}{3}$.

C The value of the investment multiplier is 5.

D The value of the investment multiplier is 1.5.

Q21 | [O/N 2012/Q19]

The table gives the national income of a country over six years.

year	national income (Y)
1	2100
2	2110
3	2125
4	2135
5	2140
6	2135

According to the accelerator principle, in which year did net investment first fall to a level below that of the previous year?

A year 3 B year 4 C year 5 D year 6

Q22 | [O/N 2012/Q28]

During a recession, a government increases its expenditure on goods and services by $10 million but leaves tax rates unchanged.

Why might the subsequent increase in national income be less than $10 million?

A Increased government borrowing increases interest rates.

B The marginal propensity to consume is less than 1.

C The marginal propensity to import is greater than 0.

D There is no accelerator effect on investment.

Q23 | [O/N 2012/Q30]

In an economy, the marginal propensity to consume of the unemployed is higher than that of taxpayers.

The government increases expenditure on unemployment benefits by $10 million.

What will the government need to do if it wishes to keep aggregate demand unchanged?

A raise taxation by less than $10 million

B raise taxation by more than $10 million

C raise taxation by $10 million

D leave taxes unchanged

Q24 | [M/J 2013/Q29]

What will increase the multiplier effect of an increase in government spending on national income?

A an increase in direct taxation

B an increase in interest rates

C an increase in the marginal propensity to consume

D an increase in the marginal propensity to import

Q25 | [O/N 2013/Q20]

In an economy, the marginal propensity to consume of the unemployed is higher than that of taxpayers.

The government increases expenditure on unemployment benefits by $10m and increases taxation by $10 million.

What will be the impact on aggregate demand?

A It will be unchanged.

B It will increase by less than $10 million.

C It will increase by $10 million.

D It will decrease by $10 million.

Q26 | [M/J 2014/Q18]

What will cause the level of investment to fall according to the accelerator model?

A a decrease in business confidence

B a decrease in the rate of growth of national income

C an increase in the price of capital equipment

D an increase in the rate of interest

Q27 | [M/J 2014/Q19]

In a closed economy with no government, consumption is 4/5 of income at all levels of income.

The present equilibrium level of income is $220 million.

The full employment level of income is $240 million.

By how much would investment have to increase to reach full employment?

A $2 million B $4 million C $16 million D $20 million

Q28 | [M/J 2014/Q20]

Other things being equal, what will result in a decrease in aggregate demand?

A a decrease in interest rates

B a decrease in the balance of trade deficit

C a decrease in the government's budget deficit

D a decrease in the household saving ratio

Q29 | [M/J 2014/Q27]

What will be the impact of an increase in marginal tax rates?

A an increase in the propensity to save

B an increase in the value of the investment multiplier

C a strengthening of work incentives

D a strengthening in the operation of automatic stabilisers

Q30 | [O/N 2014/Q23]

In a closed economy with no government C = 40 + 0.8 Y and I = 60, where C is consumption, Y is income and I is investment.

What is the equilibrium level of income?

A 80 B 100 C 300 D 500

Q31 | [M/J 2015/Q20]

The national income is initially in equilibrium.

If there is an increase in exports, which change of equivalent value will restore national income to its initial equilibrium level?

A a decrease in imports

B a decrease in investment

C an increase in government expenditure on goods and services

D a reduction in taxation

Q32 | [M/J 2015/Q21]

In a closed economy with no government, investment increases by $400.

At the new equilibrium level of income, consumption has increased by $1200.

What is the value of the investment multiplier?

A 2 B 3 C 4 D 8

Q33 [M/J 2016/Q26]

In a 4-sector economy, consisting of households, firms, government and foreign trade, the level of national income is in equilibrium where

$$C + I + G + (X - M) = Y.$$

What must Y include for an equilibrium to exist?

A C + S + M

B C + S + T

C S + T

D S + T + M

Q34 [M/J 2016/Q30]

What will increase the multiplier effect of an increase in government spending on national income?

A an increase in direct taxation

B an increase in interest rates

C an increase in the marginal propensity to consume

D an increase in the marginal propensity to import

Q35 [O/N 2016/Q23]

If the marginal propensity to consume in an economy in a given period becomes greater than unity, this must mean that

A consumers will be spending more than they are earning.

B inflation will be generated in the economy.

C the country will suffer a trade deficit.

D the marginal propensity to save will be negative.

Q36 [O/N 2016/Q25]

The table shows the levels of consumption expenditure and savings for given family incomes.

disposable family income ($)	consumption expenditure ($)	savings ($)
2000	2150	−150
3000	3100	−100
4000	4000	0
5000	4850	150
6000	5650	350
7000	6380	620

Over the range of disposable income shown, as income rises the marginal propensity to consume

A falls and then rises.

B falls continuously.

C rises and then falls.

D rises continuously.

Q37 | [M/J 2017/Q24]

The table shows the levels of consumption expenditure for given family incomes.

disposable family income ($)	consumption expenditure ($)
2000	2150
3000	3100
4000	4000
5000	4850
6000	5650
7000	6380

Over the range of disposable income shown, as income rises what happens to the marginal propensity to consume?

A It falls and then rises.

B It falls continuously.

C It rises and then falls.

D It rises continuously.

Q38 | [M/J 2017/Q30]

In an economy with unemployed resources the government increases its expenditure.

When would this be least likely to increase national income by the full multiplier effect?

A when the level of autonomous private investment is increased

B when the marginal propensity to save is reduced

C when the government allows money supply to expand

D when the level of interest rates rises

Q39 | [O/N 2017/Q20]

Which combination of circumstances is most likely to lead to an increase in a country's budget deficit?

	total GDP	unemployment	discretionary government spending
A	decreases	rises	decreases
B	decreases	rises	no change
C	increases	falls	increases
D	increases	falls	no change

Q40 | [O/N 2017/Q22]

What could not exist in a closed, mixed economy?

A a balance of trade deficit

B a budget deficit

C household debt

D national debt

Q41 | [O/N 2017/Q23]

What does the accelerator principle state?

A Consumption is a function of the rate of change of income.

B Income is a function of the rate of change of investment.

C Investment is a function of the rate of change of income.

D Investment is a function of the rate of interest.

Q42 | [O/N 2017/Q26]

What will cause a downward shift in the aggregate demand curve of an economy?

A an increase in firms' stocks of raw materials

B a decrease in the export of goods

C a decrease in the propensity to import

D a decrease in saving

Q43 | [M/J 2018/Q22]

What would **not** exist in a free market, open economy?

A autonomous investment

B household saving

C import spending

D indirect taxation

Q44 | [M/J 2018/Q24]

What is a part of Keynesian economic analysis?

A a liquidity trap below which interest rates are ineffective

B an equilibrium price that always clears the market

C a small value for the government expenditure multiplier

D a vertical short-run aggregate supply curve

Q45 | [M/J 2018/Q25]

What will definitely increase a country's Gross National Product?

A an increase in income taxes

B an increase in the marginal propensity to import

C an increase in the value of a country's currency

D increased government expenditure on education

Q46 | [M/J 2018/Q26]

According to the accelerator theory, what determines this year's net investment?

A last year's consumption

B last year's output

C the change in last year's investment

D the change in last year's national income

Q47 | [O/N 2018/Q25]

In an open economy, when autonomous investment increases by 100, equilibrium national income increases by 300.

Which conclusion can be drawn?

A The accelerator is 3.

B The marginal propensity to consume is $\frac{2}{3}$.

C The marginal propensity to import is $\frac{2}{3}$.

D The marginal propensity to save plus marginal tax rate is $\frac{1}{3}$.

Q48 | [M/J 2019/Q25]

In a closed economy with no government expenditure and no taxation, the initial income is $5000 million. All savings are carried out by consumers, who save 20% of any additional income received above $5000 million. Firms plan to invest $1000 million.

What is the value of the multiplier?

A 0.8 B 4 C 5 D 8

Q49 | [M/J 2019/Q27]

An increase in which of the following will cause a decrease in investment spending?

A business confidence

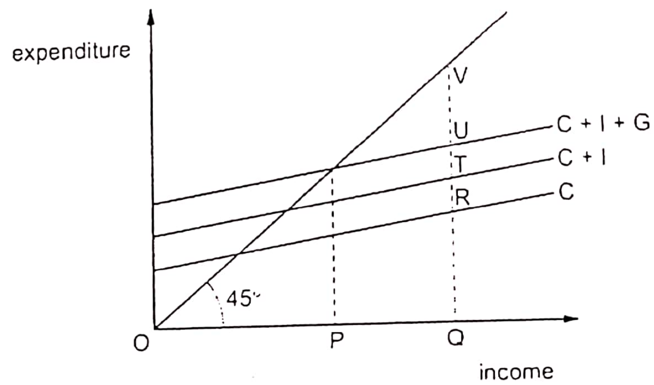
B company profits

C interest rates

D national income

Q50 | [O/N 2019/Q21]

In the diagram, OP is the equilibrium level of income and OQ the full employment level of income in a closed economy.



What is the deflationary gap?

A PQ B RV C TV D UV

A2 – ECONOMICS (9708)

MACRO

CHAPTER 2
Keynesian Theory of Income & Employment

ANSWERS

TOPIC 1: NATIONAL INCOME STATISTICS

Q1 | B

GDP = C + I + G + (X – M). We need to calculate it for every year and then check the answers:

Year	GDP	C	I	G	X – M
1	630	480	20	160	–30
2	650	470	30	160	–10
3	680	480	40	150	+10

Hence option B is the correct choice.

[M/J 2008/Q18]

Q2 | C

GDP = C + I + G + (X – M).
600 = 400 + 80 + 100 + X – 120
X = 140m

Common Mistake: Some students deducted taxes from G this is not true, taxes are not part of the calculation.

[O/N 2009/Q15]

Q3 | B

Index of GDP at 2008 Prices = [Index of GDP at 2009 Prices / Price Index of 2009] x 100
110 = 115 / 105

Key Point: When a value of an index is increased we add that amount into 100, whenever of an index falls we subtract that value.

[M/J 2010/Q14]

Q4 | A

GDP = C + I + G + (X – M). We need to calculate it for every year and then check the answers:

Year	GDP	C	I	G	X – M
1	420	200	90	120	+10
2	440	260	80	120	–20
3	680	300	130	140	–10

Hence option A is the correct choice.

[M/J 2011/Q13]

Q5 | B

GDP = C + I + G + (X – M).
600 = 400 + 80 + 100 + 140 – M
M = 120m

Common Mistake: Some students deducted taxes from G this is not true, taxes are not part of the calculation.

[O/N 2015/Q18]

Q6 | C

One to calculate national income is to sum up all the income generated by the factors of production.
National Income = 8000 + 7000 + 3000 + 2000 = 20,000

Key Point: Transfer payments are not added because no corresponding output is generated. Hence items like unemployment benefits and pensions are not part of the national income.

[M/J 2018/Q23]

Q7 | D

In order for the economy to point Y the SRAS needs to shift to the right. Hence anything that increase SRAS would be the answer. An increase in labor productivity will increase the SRAS. Option A increases AD. Option B & C will lead to a fall in SRAS.

[O/N 2018/Q28]

Q8	A
Any form of transfer payment is not part of transfer payments like pensions hence option A. This is because against these payments no corresponding output is generated. [M/J 2019/Q19]	

TOPIC 2: CIRCULAR FLOW

Q1	D

I + G + X [Injections] and S + T + M [Leakages].
1. Trade Surplus: This shows X are more than M hence a net injection
2. Govt Budget Deficit: This shows that G are more than T hence net injection.
3. Private Sector Surplus: This shows that the S are more than the I hence net leakages.

[M/J 2009/Q16]

Q2	D

Unemployment benefits fall in the category of injections as they are part of the government spending. Option A fall under imports which are leakages. Option B is a leakage. Option C is a leakage as this is the money that the company holds and does not reinject back into the circular flow.

[O/N 2010/Q16]

Q3	C

Where the sum of leakages is equal to the sum of injections national income is said to be in equilibrium. i.e. I + G + X = S + T + M. We need to check this for all the options:

National Income	I + G + X [Injections]	S + T + M [Leakages]
600	200 + 50 + 100 = 350	125 + 62.5 + 62.5 = 250
700	200 + 50 + 100 = 350	150 + 75 + 75 = 300
800	**200 + 50 + 100 = 350**	**175 + 87.5 + 87.5 = 350**
9000	200 + 50 + 100 = 350	200 + 100 + 100 = 400

Hence option C is correct 800m is the national income.

[O/N 2011/Q19]

Q4	A

If the balance of trade is surplus that means that X is greater than M and hence a positive injection into the economy. Option B, C & D refer to leakages.

Common Mistakes: Some students choose retained profits thinking that profits add to the economy however this is incorrect because retained profits are the ones that the company keep and does not return them back into the circular flow think of this like savings for the company.

[M/J 2012/Q19]

Q5	C

I + G + X [Injections] and S + T + M [Leakages]. Hence where injections are greater than leakages would lead to an injection in the country's circular flow.
1. I > S → net injection
2 G > T → net injection
3. M > X → net leakage
Hence Option C.

[M/J 2013/Q20]

Q6	C

People buying bonds will result in savings and will result in money going out of the circular flow of income. Other options simply mention injections into the circular flow.

[M/J 2015/Q19]

Q7	B

Interest payments on government bonds are the returns on investment will act as injection. Option A is taxes, Option B acts as an import and Option D keeps less money available for consumption hence acts as a withdrawal.

[O/N 2015/Q19]

Q8	D

I + G + X [Injections] and S + T + M [Leakages]. Hence where injections are greater than leakages would lead to an injection in the country's circular flow and where the leakages are greater than the injections that would lead to net leakages.
1. Trade Surplus (X > M) → net injection
2. Budget Deficit (G > T) → net injection
3. Private Sector Surplus (S > I) → net leakage
Hence Option D.

[O/N 2016/Q24]

Q9	B

A government budget surplus represents a leakage because a budget surplus shows that the government (G) spent less and took more out in the form of taxes (T).

[O/N 2017/Q25]

Q10	D

Injections are: I + G + X
Leakages are: S + T + M

Hence option D is correct because leakages will only exist when (S > I), (T > G), (M > X).

[M/J 2019/Q24]

Q11	B

There are <u>THREE</u> injections in the Keynesian Model:
(1) Investment
(2) Government Spending
(3) Exports
Hence option B is correct because interest payments enter the economy back in the form of income.

[O/N 2019/Q22]

TOPIC 3: KEYNESIAN THEORY OF INCOME & EMPLOYMENT

Q1	C

Since the economy is closed that means it does not have a foreign sector and its national income would be:

Y = C + I + G

200 = 0.75Y + 50 – 5r + 30

200 = 0.75(200) + 50 – 5r + 30

r = 6%

We just to plug the values in the equation and find the missing variable.

[M/J 2008/Q20]

Q2	D

Since the cure is getting steeper that means the MPC has increased because higher the gradient the greater the slope. A decrease in the marginal rate of tax results in an increase in MPC, hence consumption function shifts pivotal upward. Option A & B are unrelated and option C shifts consumption function downwards because lesser the benefits lesser the money available for consumption.

Key Point:
1. Parallel Shift is when autonomous consumption goes up
2. Pivotal Shift is when the MPC changes.
3. MPC is the slope of the consumption function.

[M/J 2008/Q21]

Q3	C

A parallel downward shift shows that the consumption decreased. If the interest rate rise less money is available for consumption. Option A is incorrect because he variable on the X axis cannot cause a shift it only causes movement on the curve. Option B & D are likely going to increase consumption.

Common Mistake: Some students choose option A however this is incorrect because this is the variable on the X-axis and it cannot cause a shift.

Key Point:
1. Parallel Shift is when autonomous consumption goes up
2. Pivotal Shift is when the MPC changes.
3. MPC is the slope of the consumption function.

[M/J 2009/Q18]

Q4	A

Since the economy is closed and has no government sector that means it does not have a foreign sector and its national income would be:

Y = C + I

300 = 30 + 0.7Y + I

300 = 30 + 0.7 (300) + I

I = 60

We just to plug the values in the equation and find the missing variable.

[M/J 2009/Q19]

Q5	B

Actual Output: Where the equilibrium meets [I = S]. Which is Point G

Potential Output: Which it is Yp.

Hence the difference is the horizontal difference between G and Yp which is GH.

[M/J 2009/Q20]

Q6	C

This shows the relationship between net investment and rate of change in national output. The accelerator assumes a constant capital to output ratio, Example: $2 of capital has to be purchases to able to increase output by $1. This makes the capital to output ration 2:1. Accelerator = $\Delta I/\Delta Y$. To calculate this we need to check the level of investment in every year:

Year	Change in Investment
2	10
3	15
4	20
5	15
6	10

Hence it was year 5 in which for the first time the investment was below that of the previous year.

[O/N 2009/Q18]

Q7	A

We will use the formulae for the multiplier. Since the data of the questions gives marginal propensity of leakages we will use the second one.

$K = \frac{1}{1-MPC}$ or $K = \frac{1}{MPS + MPT + MPM}$

$K = \frac{1}{0.05 + 0.15 + 0.20}$

$K = 2.5$

Key Point: The formulas necessarily tell the same thing. Always write both of them and check which one can be used in the question.

[O/N 2009/Q19]

Q8	B

1. Government reducing government expenditure: Since it is an autonomous injection this will lead to a parallel downward shift in the AE curve.
2. Reduces rate of Tax: If the MRT falls this means the MPC will rise and hence a parallel upward shift.

There would be shown by line E2.

[O/N 2009/Q20]

Q9	D

Since the curve has shifted upwards this would lead to an increase in consumption. When the expected income of the consumer increases in the future the consumer increases consumption today. Option A will cause a movement on the curve. Option B will reduce consumption. Option C will reduce consumption because borrowing is expensive.

[M/J 2010/Q17]

Q10	A

At point OY the consumption function cuts the 45 degree line which shows that the consumption = income. This shows that at this point we have no savings. However below this point we had negative savings showing that we were borrowing as our consumption was above our income. Option B & C cannot be concluded from the given information. Option D is incorrect because MPC is the gradient of the C function, and since the curve is getting flatter the gradient is falling.

Common Mistake: Some students choose option C thinking that the line of C = Y is the equilibrium, however this is not correct. Equilibrium is established where the AE = Y. As in we have to take I + G + Xn into account to calculate that.

[M/J 2010/Q18]

Q11	B

Desired Increase in National Income = Multiplier x New Injection
10,000 = 2 x J
J = $5000

Hence the new government expenditure needs to be $20,000 [15,000 + 5,000].

Key Point: This formulae is the key to solving these types of questions. Every time the examiner will ask for a different missing variable however the formulae will always remain the same.

[M/J 2010/Q19]

Q12	D

The autonomous consumption causes the value of APC to be higher than the value of the MPC.

[O/N 2010/Q19]

Q13	D

Desired Increase in National Income = Multiplier x New Injection
20 = K x 4
K = 5
Since K equals 1/1-MPC = 5
Hence the value of the MPC = 4/5

Key Point: This formula is the key to solving these types of questions. Every time the examiner will ask for a different missing variable however the formulae will always remain the same.

[O/N 2010/Q20]

Q14	B

Any form of leakage will decrease the value of the investment multiplier. Hence an automatic rise in tax rate along with an increase in national income dampens the size of the investment multiplier. A lower value of MPM and MPT is likely to generate a higher value of multiplier. Option A & C are incorrect. Option D does not impact the size of the multiplier.

[M/J 2011/Q15]

Q15	D

As the income goes up the MPC tends to fall hence the MPS tends to increase. Similarly, as the income goes up the APC tends to fall hence the APS tends to rise. This is because 1 – MPC = MPS And 1 – APC = APS.

[M/J 2011/Q16]

Q16	B

Since the he spends 5/6 of his disposable income that means out of his income of 0.9 he will spend 0.75. Hence Since K equals 1/1-(0.75) = 4

[O/N 2011/Q18]

Q17	B

At full employment level the prices rise but the national output remains the same.

[O/N 2011/Q20]

Q18	A

The slope of this curve shows the investment multiplier because a change in investment causes a proportionately large change in in national income equilibrium. In order to calculate the slope of any curve we divide the y-axis by the x-axis. Hence this will be $\Delta Y/\Delta I$, which is the formulae for the investment multiplier.

[M/J 2012/Q21]

Q19	B

A reduction in unemployment benefits will cause both autonomous consumption to fall and MPC to rise. [M/J 2012/Q22]

Q20	A

Desired Increase in National Income = Multiplier x New Injection
3 = K x 1
K = 3
Since K equals 1/1-MPC = 3
Hence the value of the MPC = 2/3

Key Point: This formula is the key to solving these types of questions. Every time the examiner will ask for a different missing variable however the formulae will always remain the same. [O/N 2012/Q18]

Q21	B

This shows the relationship between net investment and rate of change in national output. The accelerator assumes a constant capital to output ratio, Example: $2 of capital has to be purchases to able to increase output by $1. This makes the capital to output ration 2:1. Accelerator = ΔI/ΔY. To calculate this we need to check the level of investment in every year:

Year	Change in Investment
2	10
3	15
4	**10**
5	5
6	−5

Hence it was year 4 in which for the first time the investment was below that of the previous year. [O/N 2012/Q19]

Q22	A

Impact of increase in government spending will be offset by increasing interest rate leading to a fall in both consumption and investment. [O/N 2012/Q28]

Q23	B

This is because the tax payers have lower MPC and therefore lower size of the multiplier. [O/N 2012/Q30]

Q24	C

A multiplier's value goes up if the MPC increases because the larger the size of multiplier the more the consumers will increase the percentage of income. Therefore, when the government spending increases it will have the greatest effect on national income. [M/J 2013/Q29]

Q25	B

Only part of the change in income is spent therefore the AD rises but by less than 10million. [O/N 2013/Q20]

Q26	B

Accelerator theory suggests that investment is the function of rate of change in national income.

Common Mistake: Some students thought that the answer choice was D. This is incorrect because interest rates and investments are linked in the investment schedule. The accelerator model deals with investment and national income. [M/J 2014/Q18]

Q27	B

Desired Increase in National Income = Multiplier x New Injection
20 = 5 x J
J = 4

Since it is given in the question that (4/5) is spent from the income. Hence K=1/1-0.8 = 5
Hence the new level of investment is 4million.

Key Point: This formula is the key to solving these types of questions. Every time the examiner will ask for a different missing variable however the formulae will always remain the same.
[M/J 2014/Q19]

Q28	C

A fall in budget deficit suggests either a fall in G or an increase in T thus results in a fall in AD.
Options A, C & D would increase consumption, investment and X–M, and hence AD.
[M/J 2014/Q20]

Q29	D

It will help to reduce fluctuations in national income. A rising MPT will act as a disincentive, therefore option C is incorrect. It may not reduce MPS however a rising MPT reduces the value of multiplier therefore A & B are incorrect.
[M/J 2014/Q27]

Q30	D

Since the economy is closed and has no government sector that means it does not have a foreign sector and no government spending and its national income would be:
Y = C + I
Y = 40 + 0.8Y + 60
0.2Y = 100
Y = 500

We just have to plug the values in the equation and find the missing variable.
[O/N 2014/Q23]

Q31	B

Exports and investment are classified as injections, therefore a fall in investment will offset a rise in exports.
[M/J 2015/Q20]

Q32	C

This question was a plug-in question. We had to test all the multiplier:

Option	Injection x Multiplier = Change in Income	MPC	ΔConsumption
A	400 x 2 = 800	0.5	400
B	400 x 3 = 1200	0.67	804
C	**400 x 4 = 1600**	**0.75**	**1200**
D	400 x 8 = 3200	0.875	2800

Hence only at multiplier of 4 we experience a change in consumption of 1200.
[M/J 2015/Q21]

Q33 | **B**

For the equilibrium to be established the injections must equal to the leakages.
C + I + G + X – M = C + S + T
Since C would be cut on both sides and if we take M on the other side then
I + G + X = S + T + M

Common Mistake: Some students choose D thinking that that would balance the equation however if put the value that would not be the case as C on the left hand side of the equation would still not make the equation where injection = leakages.
C + I + G + X – M = S + T + M [This equation does not balance]

[M/J 2016/Q26]

Q34 | **C**

A multiplier's value goes up if the MPC increases because the larger the size of multiplier the more the consumers will increase the percentage of income. Therefore when the government spending increases it will have the greatest effect on national income.

[M/J 2016/Q30]

Q35 | **D**

Since MPC + MPS = 1 Hence if the MPC becomes greater than 1 then that means that MPS to save will be negative.

[O/N 2016/Q23]

Q36 | **B**

MPC = ΔC / Δ Y

Disposable Family Income	Consumption Expenditure	MPC = ΔC / Δ Y
2000	2150	–
3000	3100	950/1000 = 0.95
4000	4000	900/1000 = 0.90
5000	4850	850/1000 = 0.85
6000	5650	800/1000 = 0.80
7000	6380	730/1000 = 0.73

Hence we can conclude that the MPC falls continuously.

[O/N 2016/Q25]

Q37 | **B**

MPC = ΔC / Δ Y

Disposable Family Income	Consumption Expenditure	MPC = ΔC / Δ Y
2000	2150	–
3000	3100	950/1000 = 0.95
4000	4000	900/1000 = 0.90
5000	4850	850/1000 = 0.85
6000	5650	800/1000 = 0.80
7000	6380	730/1000 = 0.73

Hence we can conclude that the MPC falls continuously.

[O/N 2016/Q25]

Q38 | **D**

A high amount of interest rate will lead to move savings hence the MPS will increase and reducing the value of the multiplier.

Option A is incorrect because autonomous investments do not impact the multiplier. Option B & C will lead to an increase in the multiplier.

[O/N 2016/Q30]

Q39 | **B**

An increase in the budget deficit is a situation where the government spending increases and the tax revenue falls. So if the GDP falls and unemployment rises with no government spending the tax revenues will decline hence leading to a budget deficit.

[O/N 2017/Q20]

Q40	A

A closed missed economy has a government sector but does not trade with other countries. Hence it can't have a balance of trade deficit.

[O/N 2017/Q22]

Q41	C

Investment is a function of rate of change in income. This is by definition.

Key Point: Always remember consumption has nothing to do with accelerator.

[O/N 2017/Q23]

Q42	B

If exports fall (X) will decline this will result in a downward shift in the AD curve. Option A is incorrect because increase in stocks will impact AS. Options C & D will both lead to an increase in AD.

[O/N 2017/Q26]

Q43	D

A free market open economy is the one with no government but has a foreign sector. Hence its aggregate expenditure will look like this: AE = C + I + (X-M). Therefore since there is no government there is no indirect taxation.

[M/J 2018/Q22]

Q44	A

The Keynesians believe in the liquidity trap as they value the fiscal policy and have a view at extremely low interest rate any increase in money supply will have no change in the economy.

Option B is incorrect because Keynesian do not believe that. Option C is incorrect because they believe the government expenditure is the most important part to stimulate an economy. Option D is incorrect because they believe that the SRAS curve is upward sloping.

[M/J 2018/Q24]

Q45	D

Government expenditure will boost the AE and hence national output. Option A, B & C will all lead to a fall in national output because they reduce the elements of aggregate expenditure. Taxes will decrease consumption. If the marginal propensity to import goes up the AE will fall because import is a leakage. If the currency increases in value the exports will drop and imports will increase reducing the aggregate expenditure.

[M/J 2018/Q25]

Q46	D

This shows the relationship between net investment and rate of change in national output. The accelerator assumes a constant capital to output ratio, Example: $2 of capital has to be purchases to able to increase output by $1. This makes the capital to output ration 2:1. Accelerator = ΔI/ΔY. Hence option D.

[M/J 2018/Q26]

Q47	B

Since due to an increase in autonomous investment when national income increases this is known as the multiplier effect. Hence Option A is incorrect. In order to calculate the MPC we need to put the values into the formulae:

$$K = \frac{1}{1-MPC}$$

$$3 = \frac{1}{1-MPC}$$

MPC = 2/3

[O/N 2018/Q25]

Q48	C

This economy is a two sector economic where only Consumption and Investment are present.

$$K = \frac{1}{1-MPC} = \frac{1}{MPS} = \frac{1}{0.20} = 5$$

Common Mistake: The information on $1000 million was irrelevant in this question. Some students adjusted the national income which was not required.

[M/J 2019/Q25]

Q49	C

Interest rates and investments have a negative relationship. Hence when interest rate increase the investment will fall. Option A & B will lead to an increase in investment. Option D is irrelevant.

[M/J 2019/Q27]

Q50	D

A deflationary gap is the excess above the full employment level. A closed economy will have only have 3 sectors C + I + G hence the third curve will be used for this question. Therefore the deflationary gap would be UV.

[O/N 2019/Q21]

A2 – ECONOMICS (9708)

MACRO

CHAPTER 3

Money, Interest Rate Determination & Monetary Policy

Q1 | **[M/J 2008/Q23]**

In a banking system, all banks maintain 20% of deposits as cash.

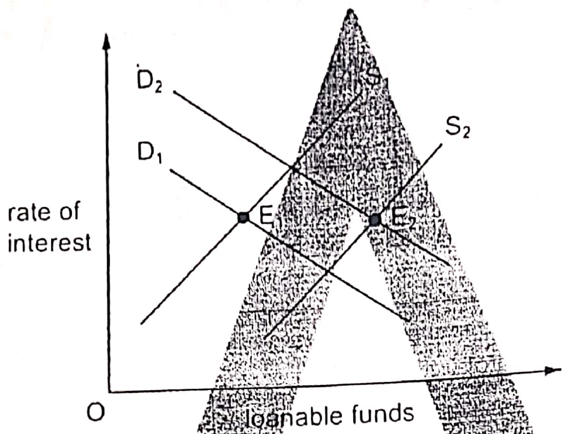
One bank receives a new cash deposit of $200. Subsequent net withdrawals of cash from the banking system are zero.

What will be the resulting increase in bank loans and the total increase in bank deposits?

	increase in bank loans	total increase in deposits
A	$160	$200
B	$160	$360
C	$800	$1000
D	$1000	$1000

Q2 | **[M/J 2008/Q25]**

The diagram shows the market for loanable funds.



Which changes could cause the equilibrium to move from E_1 to E_2?

A an increase in the propensity to save and an increase in bank lending

B the discovery of oil reserves and an increase in the propensity to save

C advances in technology and a decrease in bank lending

D a decrease in the propensity to save and the introduction of new products

Q3 | **[O/N 2008/Q15]**

What will be the short-run effect on the level of output of an increase in the money supply, according to Keynesian theory (assuming the liquidity trap does not apply) and according to monetarist theory (assuming the increase is unanticipated)?

	effect on output	
	Keynesian theory	monetarist theory
A	increase	increase
B	increase	unchanged
C	unchanged	increase
D	unchanged	unchanged

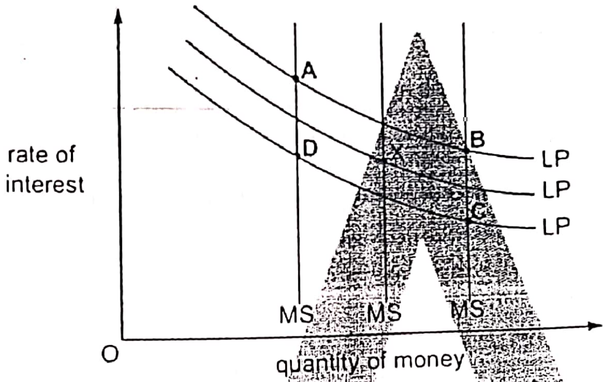
in a year, while the quantity of money rises by 5%.

If the velocity of circulation of money remains the same, what will be the approximate increases in the money value of national income and the price level?

	increase in money value of national income	increase in price level
A	5%	2%
B	5%	3%
C	8%	2%
D	8%	3%

Q5 **[O/N 2008/Q20]**

The diagram shows three different levels of money supply (MS) and three different demand curves for holding money balances (LP). The initial equilibrium is at point X.



Banks create more credit and people decide to hold less money as a precaution against emergencies.

What is the new equilibrium point?

Q6 **[M/J 2009/Q17]**

According to monetarist theory, which policy objectives are in conflict in the short run but not in the long run?

A economic growth and full employment

B economic growth and price stability

C price stability and full employment

D price stability and equilibrium in the balance of payments

Q7 **[M/J 2009/Q22]**

According to Keynesian theory, in which circumstance would there always be an increase in the demand for money?

	real income	price level	interest rates
A	increase	decrease	increase
B	constant	constant	increase
C	increase	increase	decrease
D	constant	decrease	decrease

Q8 | [O/N 2009/Q16]

Assuming a constant income velocity of circulation of money, if the rate of growth of the money supply is 8 % and the average price level increases by 5 %, what will be the approximate change in real output?

A –3 % B +3 % C +8 % D +13 %

Q9 | [O/N 2009/Q17]

According to monetarist theory, what will be the short-run effect of an unexpected increase in the money supply?

A an appreciation of the foreign exchange rate

B an increase in employment

C an increase in real wages

D an increase in the rate of interest

Q10 | [O/N 2009/Q22]

The government sells $1 million of bonds to the commercial banks. It uses the proceeds from the sale to provide subsidies to sugar producers who pay them into their bank accounts.

Assuming that notes and coins in circulation remain unchanged, what will be the immediate effect on the assets and liabilities of the commercial banks?

	assets	liabilities
A	bonds +$1 million reserves –$1 million	unchanged
B	bonds +$1 million	deposits +$1 million
C	reserves –$1 million	deposits –$1 million
D	unchanged	unchanged

Q11 | [O/N 2009/Q23]

According to loanable funds theory, what will cause the rate of interest to rise?

A an increase in the rate of investment

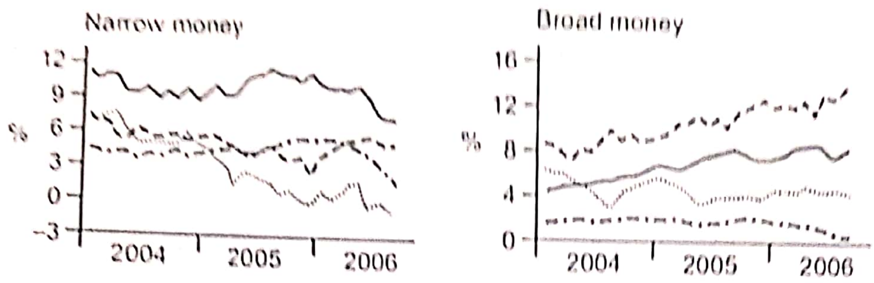
B an increase in liquidity preference

C an increase in the level of savings

D an increase in the supply of money

Q12 | [M/J 2010/Q15]

The diagram shows changes in broad and narrow measures of money supply between 2004 and 2006.



key
—— Euro area
--- Britain
-·-· Japan
······ United States

Which is the only area to have experienced a contraction in either of its measures of money supply?

A Euro area

B Britain

C Japan

D United States

Q13 | [M/J 2010/Q16]

What is a central assertion of monetarist economics?

A Fiscal policy should be used for the continuous management of the economy.

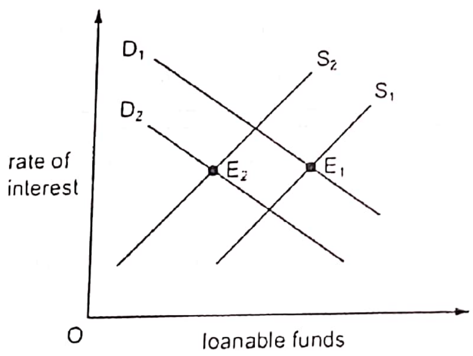
B Major recessions can occur despite an unchanged money supply.

C The money supply is the main determinant of aggregate monetary expenditure.

D The velocity of circulation of money is unstable over time.

Q14 | [M/J 2010/Q21]

The diagram shows the demand curves and supply curves of loanable funds.



Which changes could cause the equilibrium in the market for loanable funds to move from E_1 to E_2?

A a decrease in bank lending combined with a decrease in business confidence

B a decrease in the money supply combined with an increase in the propensity to consume

C an increase in bank lending combined with an increase in the productivity of capital

D an increase in the money supply combined with a decrease in the productivity of labour

Q15 | [M/J 2010/Q22]

If the money supply is fixed, a decrease in economic activity

A increases interest rates.

B increases the transactions demand for money.

C raises the liquidity preference schedule.

D reduces the income velocity of circulation.

Q16 | [O/N 2010/Q17]

According to Keynesian theory, when will an increase in the money supply leave the level of output unchanged?

A when the liquidity trap is operative

B when the money supply increase was not anticipated

C when there is a floating exchange rate

D when there is an immediate adjustment to expectations about future price levels

Q17 | [O/N 2010/Q18]

According to monetarist theory, what will be the short-run and the long-run effect of an unexpected increase in the money supply on the real wage level?

	short-run	long-run
A	decrease	increase
B	decrease	unchanged
C	unchanged	increase
D	unchanged	unchanged

Q18 | [O/N 2010/Q22]

An increase in the money supply leads to a fall in interest rates. What else will decrease as a result of these changes?

A the desire to hold idle money balances

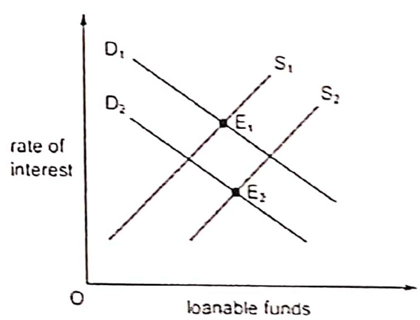
B the price of equities

C the price of government bonds

D the velocity of circulation of money

Q19 | [O/N 2010/Q23]

The diagram shows the market for loanable funds.



Which changes could cause the equilibrium to move from E_1 to E_2?

A a decline in business confidence and an increase in bank lending

B a decrease in bank lending and depletion of natural resources

C an increase in the propensity to save and the discovery of new mineral deposits

D improvements in technology and reduction in the propensity to save

Q20 | [M/J 2011/Q18]

What will expand the money supply in an open economy?

A a current account balance of payments deficit

B an increase in the cash reserve ratio of commercial banks

C government borrowing from domestic residents

D government intervention to prevent an appreciation in the foreign exchange value of domestic currency

Q21 | [M/J 2011/Q19]

According to Keynesian theory, in which circumstance will there always be an increase in the demand for money?

	real income	price level	interest rates
A	constant	decrease	increase
B	constant	increase	decrease
C	increase	decrease	decrease
D	increase	increase	increase

Q22 | [O/N 2011/Q17]

Despite a government budget deficit, a country's money supply remains unchanged.

What could explain this?

A The country has a balance of payments surplus equal to the government budget deficit.

B The country's foreign exchange rate is fixed.

C The government budget deficit is financed by borrowing from the central bank.

D The government budget deficit is financed by selling government bonds to members of the public.

Q23 | [O/N 2011/Q22]

According to Keynesian analysis, what will be the result of a decrease in the money supply?

A The rate of interest will be reduced, thereby reducing the levels of investment and income.

B The rate of interest will be increased, thereby reducing the levels of investment and income.

C The level of income will be increased as a result of a lower rate of interest and a higher level of investment.

D The price level will fall by the same percentage change as the decrease in the money supply.

Q24 | [O/N 2011/Q23]

What will be the likely effects on interest rates and bond prices of an increase in the demand for money?

	interest rates	bond prices
A	fall	fall
B	fall	rise
C	rise	fall
D	rise	rise

Q25 | [M/J 2012/Q20]

According to monetarist theory, what will be the short-run effect of an unexpected increase in the money supply?

A an appreciation of the foreign exchange rate

B an increase in output

C an increase in real wages

D an increase in the rate of interest

Q26 | [M/J 2012/Q23]

What would result in an increase in the volume of bank deposits?

A an increase in the public's desire to hold cash

B an increase in government expenditure financed by borrowing from the central bank

C an increase in the proportion of their deposits that banks hold in cash

D an open market sale of securities by the central bank

Q27 | [M/J 2012/Q24]

In a banking system all banks maintain 10% of deposits as cash.

Customers withdraw $20 000 in cash.

Assuming no subsequent net change in notes and coins in circulation, by how much will the banks have to reduce their net loans?

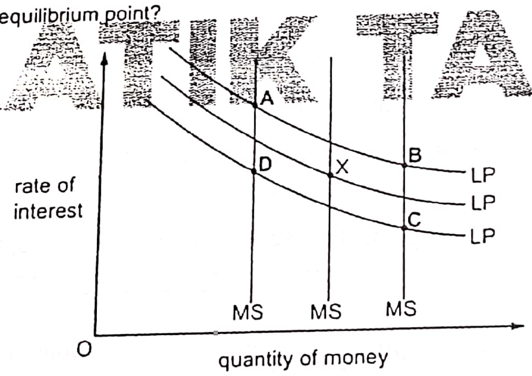
A $2000 B $18 000 C $180 000 D $220 000

Q28 | [O/N 2012/Q21]

The diagram shows three different levels of money supply (MS) and three different demand curves for holding money balances (LP). The initial equilibrium is at point X.

Banks create more credit and people decide to hold more money as a precaution against emergencies.

What is the new equilibrium point?



Q29 | [M/J 2013/Q18]

A country's central bank engages in a policy of quantitative easing (open market purchase of securities).

How is this policy meant to affect the quantity of narrow money and the quantity of broad money?

	effect on narrow money	effect on broad money
A	increase	increase
B	increase	decrease
C	decrease	increase
D	decrease	decrease

Q30 | [M/J 2013/Q19]

According to monetarist theory, what will be the short-run effect on the level of output and on the price level of an unanticipated increase in the money supply?

	effect on output	effect on the price level
A	increase	increase
B	increase	no change
C	no change	increase
D	no change	no change

Q31 | [M/J 2013/Q21]

Other things remaining unchanged, what is likely to be a consequence of an increase in net cash withdrawals from the commercial banks?

A an inflationary spiral

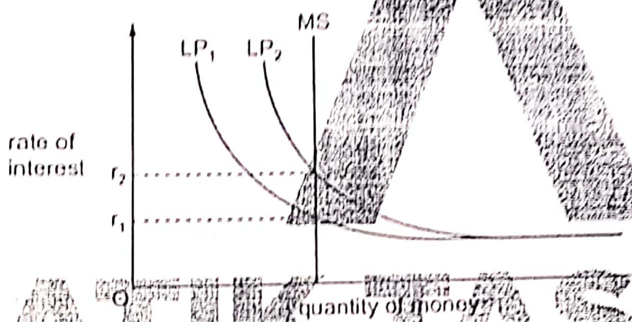
B an increase in the cash reserves of the commercial banks

C an increase in the liquidity of the commercial banks

D a restriction in the ability of the commercial banks to lend

Q32 | [M/J 2013/Q22]

The diagram shows the determination of the rate of interest in an economy where MS represents the money supply and LP represents liquidity preference.



The rate of interest rises as a result of a shift in the liquidity preference curve from LP_1 to LP_2.

Which policy might be used to try to maintain the rate at r_1?

A increased government expenditure

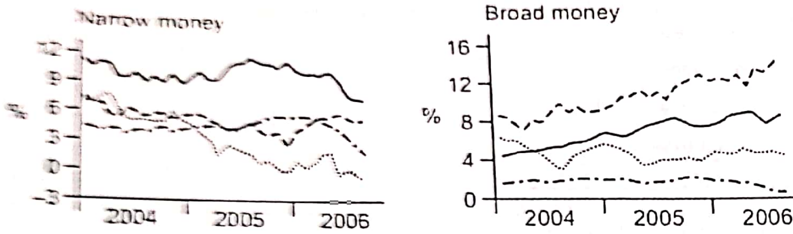
B increases in indirect taxes

C reductions in income tax rates

D the purchase of bonds in the open market

Q33 | [O/N 2013/Q18]

The diagram shows changes in broad and narrow measures of money supply between 2004 and 2006.



Key
- Euro area
- Britain
- Japan
- United States

Which is the only area to have experienced a contraction in either of its measures of money supply?

A Euro area

B Britain

C Japan

D United States

Q34 | [O/N 2013/Q19]

Which assertion could be described as monetarist rather than Keynesian?

A The interest elasticity of investment expenditure is close to zero.

B The money supply is the main determinant of aggregate monetary expenditure.

C The money supply is the main determinant of output in the long-run.

D The velocity of circulation of money is unstable over time.

Q35 | [O/N 2013/Q21]

According to loanable funds theory, what will cause the rate of interest to rise?

A a decrease in the demand for money

B an increase in the level of savings

C an increase in the rate of investment

D an increase in the supply of money

Q36 | [M/J 2014/Q16]

Over a given period, money income in an economy increased by 6%. Over the same period, prices rose on average by 4%.

What can be deduced from this?

A Real income increased by 2%.

B The income velocity of circulation decreased by 2%.

C The money supply increased by 10%.

D The volume of output decreased by 2%.

Q37 | [M/J 2014/Q17]

A closed economy has a banking system consisting of a single bank. The bank operates with a cash ratio of 10%.

Customers deposit $20000 in cash.

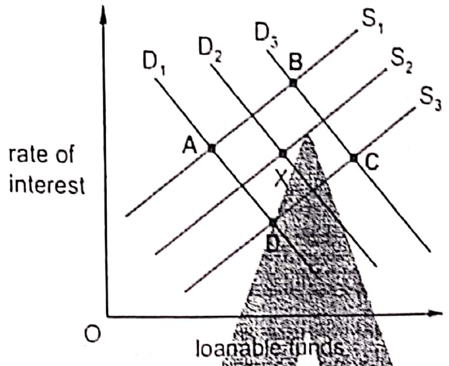
Assuming subsequent net withdrawals of cash from the banking system are zero, what is the maximum amount of loans that the bank can create?

A $2000 B $18 000 C $180 000 D $200 000

Q38 | [M/J 2014/Q21]

The diagram shows the market for loanable funds. The market is in equilibrium at point X.

What could be the new equilibrium point if there was a decline in business confidence and an increase in bank lending?



Q39 | [O/N 2014/Q22]

According to monetarist theory, if there is an unanticipated increase in the money supply what will be the short-run effect on money wages, real wages and the level of employment?

	money wages	real wages	employment
A	decrease	decrease	increase
B	decrease	increase	decrease
C	increase	decrease	increase
D	increase	increase	decrease

Q40 | [M/J 2015/Q18]

Other things being equal, the money supply in an open economy will increase if

A domestic banks increase their lending to foreign borrowers.

B the central bank buys foreign currency in the foreign exchange market.

C the government sells bonds to domestic residents.

D there is an increase in the volume of imports to the economy.

Q41 | [M/J 2015/Q22]

Assuming a constant income velocity of circulation of money, if the price level increases by 5% and the money supply grows by 2%, what will be the approximate change in real output (transactions)?

A −3% B −2.5% C +3% D +7%

Q42 | [M/J 2016/Q23]

Why will an inflationary process be brought to a halt if the money supply is held constant?

A Consumption will decrease as money incomes decline.

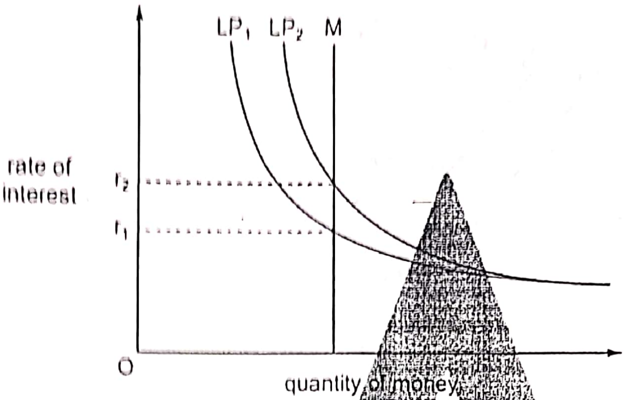
B Government expenditure will have to be reduced as government revenues decline.

C The rate of interest will rise as more money is required for transactions purposes.

D The stimulus to invest will decline as the real burden of company debt rises.

Q43 | [M/J 2016/Q24]

The diagram shows the determination of the rate of interest in the economy, where M represents the money supply and LP represents liquidity preference.



What could cause the rise in the rate of interest from r_1 to r_2?

A an increase in national income

B an increase in the money supply

C a reduction in investment expenditure

D a reduction in the loans made by the private sector

Q44 | [O/N 2015/Q21]

What is likely to be the effect on interest rates and the supply of money of a purchase of government securities by a central bank?

	interest rates	money supply
A	increase	increase
B	increase	decrease
C	decrease	decrease
D	decrease	increase

Q45 | [M/J 2016/Q25]

According to Keynesian theory, when will an increase in the money supply leave the level of output unchanged?

A when the liquidity trap is operative

B when the money supply increase was not anticipated

C when there is a floating exchange rate

D when there is an immediate adjustment to expectations about future price levels

Q46 | [O/N 2016/Q26]

What would cause an increase in the transactions demand for money?

A a fall in the price of bonds

B an increase in nominal national income

C an increase in the rate of interest

D an increase in unemployment

Q47 | [M/J 2018/Q28]

What is likely to follow if a central bank sets negative interest rates?

A an increase in government revenue

B an increase in the rate of inflation

C a reduction in bank lending

D deflation in the economy

Q48 | [O/N 2018/Q26]

The diagram outlines the monetary transmission mechanism following an expansionary central bank intervention (quantitative easing). Key actions have been omitted from the process.

central bank ......1...... government assets

↓

short-term interest rates ......2......

↓

investment demand ......3......

↓

real GDP rises

Which words complete gaps 1, 2 and 3?

	1	2	3
A	buys	fall	rises
B	buys	rise	falls
C	sells	fall	rises
D	sells	rise	falls

Q49 | [O/N 2018/Q27]

In Keynesian monetary theory, when will an increase in the supply of money **not** cause a fall in interest rates?

A if bond prices are expected to rise

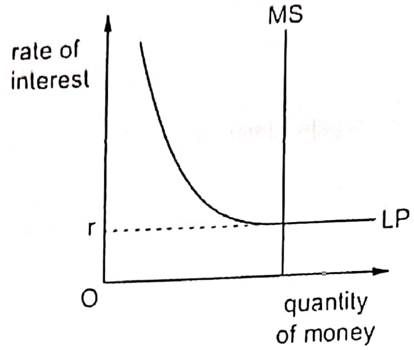
B if investment demand is interest-inelastic

C if the liquidity preference schedule is perfectly elastic

D if the velocity of circulation of money increases

Q50 | [M/J 2019/Q26]

The diagram shows a liquidity preference curve (LP) representing the demand to hold money in relation to the rate of interest and the money supply (MS) in an economy. The market is in equilibrium at interest rate r.



If the government increases the money supply, what will be the effect on the interest rate?

A falls below zero

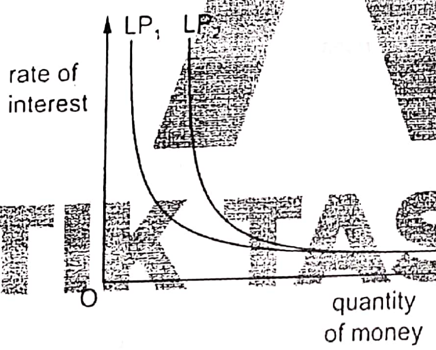
B falls to zero

C increases

D no effect

Q51 | [M/J 2019/Q28]

The graph shows a shift in the liquidity preference curves for an economy from LP_1 to LP_2.



What might have caused this shift?

	an increase in real national income	increased pessimism about the future of the economy
A	✓	✓
B	✓	✗
C	✗	✓
D	✗	✗

A2 – ECONOMICS (9708)

MACRO

CHAPTER 3
Money, Interest Rate Determination & Monetary Policy

ANSWERS

Money, Interest Rate Determination & Monetary Policy

Q1 | C

The extent of the credit creation depends on the size of cash ratio bank maintain. Thus if cash ratio is 20% then the credit multiplier is 5.

STEP 1: Credit Multiplier = 1 / Reserve Ratio = 1/0.20 = 5

STEP 2: Calculate the total increase in cash by multiplying credit multiplier with the new cash deposit. Hence increase in bank deposit would be 200 x 5 = 1000

STEP 3: Check how much loans is generated: Since the bank keeps 20% as cash deposit it will give the rest 80% out as bank loans (1000 x 80% = 800)

[M/J 2008/Q23]

Q2 | B

The demand and supply for loans increased. Discovery of oil reserves leads to increase in demand for loans since people want to take loans and maybe start up a business. Higher MPS leads to more funds available to lend money.

[M/J 2008/Q25]

Q3 | A

Both Keynesians and Monetarists agree that an increase in money supply would result in an increase in AD and hence an increase in output. In the long-run however monetarists assume that the economy operates at full employment and increase in money supply would not result in an increase in output.

[O/N 2008/Q15]

Q4 | A

MV = PT

A 5% increase in money supply (M) while V is constant must result in the same increase in PT (monetary value of national income). Since output T increased by 3% and the money value of NY by 5% therefore the price level must have increase by 2%.

[O/N 2008/Q18]

Q5 | C

Higher credit creation results in increase in money supply and people preferring to hold less cash reduces the demand for money (the speculative demand for money) which shifts the LP curve downwards because LP is also the demand for money.

[O/N 2008/Q20]

Q6 | C

Monetarist believe in a tradeoff between inflation and unemployment in the short-run only. According to them no such trade off exists in the long-run.

[M/J 2009/Q17]

Q7 | C

Increase in real income or price level both result in an outward shift in demand for money whereas a decrease in interest rate causes people to prefer higher cash balances.

[M/J 2009/Q22]

Q8 | B

MV = PV

Change on the left side of the equation is 8%. The combine change in PY on the right side of the equation must also be 8%. Thus if the change in P=5% then change in real output must have been 3%.

[O/N 2009/Q16]

Q9	B
An increase in MS causes the interest rates to fall and AD to rise, this employment is likely to increase. Option A & D are the reverse of expected outcome. Option C is incorrect because increase in MS would increase both the money wages and price level. [O/N 2009/Q17]	

Q10	B
When the govt. sold bonds: These are assets for the bank. As the commercial bank can cash bonds and get their money from the government. [Hence assets increase by $1million Bonds] When sugar producers deposit: The cash is deposited back in the bank this increases the liability of the bank. This is because whenever cash comes into the bank it is a liability of the bank. [Liabilities increase by $1milion]. [O/N 2009/Q22]	

Q11	A
If the rate of investment increases demand for funds thus causes rate of interest to rise. Option B and D indicate Keynesian LP theory whereas option C would increase supply of funds hence driving the rate of interest down. [O/N 2009/Q23]	

Q12	D
Only US registered negative growth of narrow money supply. Euro area, Britain and Japan experienced positive growth of both broad and narrow money supply. [M/J 2010/Q15]	

Q13	C
Options A & B reflect Keynesian economics hence incorrect. Option D is incorrect because in monetarist economies velocity of circulation of money is assumed unstable only in the short-run. [M/J 2010/Q16]	

Q14	A
A decrease in bank lending would shift S1 to S2 (fall in supply of funds) whereas a decrease in business confidence would shift D1 to D2 (fall in demand for funds). Decrease in MS and increase in MPC both will cause supply of funds to fall hence B is incorrect. An increase in bank lending will cause S to rise whereas an increase in productivity causes D to rise hence C is incorrect while increase in MS would increase S and a decrease in labor productivity would reduce D for funds. [M/J 2010/Q21]	

Q15	D
The reason is that MV = PY. If M is fixed and the right hand side of the equation (PY) declines hence V (velocity of circulation) must have declined to keep the equation balanced. [M/J 2010/Q22]	

Q16	A
When a liquidity trap exists the change in money supply does not lead to any change interest rate and hence no change in investment leading to no change in the output. [O/N 2010/Q17]	

Q17	B
Rising prices will reduce real wage in the short-run but workers would not accept wage increase less than the inflation rate in the long-run because now they can shift to another job or a better paying opportunity. [O/N 2010/Q18]	

Q18	D
If the interest rates go down, people tend to keep idler money as keeping it in savings does not yield good results. Price of equities and bonds are inversely related to interest rates. Hence the velocity of circulation will decline. [O/N 2010/Q22]	

Q19	A

The demand decrease and the supply for money increased. Since there is a decline in the business confidence the demand for funds will fall, but since banks have increased lending the supply of loans will increase. In Option B the bank lending decreases which shifts the supply curve backward hence the option is incorrect. Option C will lead to increase in supply but also an increase in demand. Option D will lead to an increase in supply but also an increase in demand which is not correct.

[O/N 2010/Q23]

Q20	D

In order to prevent the appreciation government will have to buy foreign currency and sell local currency in the foreign exchange market therefore it will increase money supply. Option A and B suggest a fall in money supply. This is because a current account deficit will lead to more money flow Option C will leave MS unchanged.

[M/J 2011/Q18]

Q21	B

The Keynesian model is the liquidity preference theory. A rise in price level will cause transitionary demand for money and subsequently the overall demand for money to rise. While a decrease in interest rate reduces the opportunity cost of holding cost and therefore will increase the quantity demanded of money. Real income is assumed to be constant.

[M/J 2011/Q19]

Q22	D

A budget deficit means that the government earns less from taxes and spends more on the people. In order to keep the money supply unchanged the government somehow has to take the money back from the people. Hence if the government sells bonds to the public the same amount is taken back by the government therefore there is no change in the money supply.

Option A is incorrect because this will increase AD therefore the national income will increase. Option B is irrelevant. Option C is incorrect because if the government borrows from the central bank it will just increase the money supply as more money will enter the economy.

[O/N 2011/Q17]

Q23	B

A decrease in money supply causes the interest rates to increase, leading to a fall in investment and hence income. This relationship is only mentioned in option B.

[O/N 2011/Q22]

Q24	C

When the demand for money increases, it increases the interest rates. Now the interest rate and the price of bonds are always inversely proportional. Hence if interest rates increase the price of bonds will go down. Hence option C.

[O/N 2011/Q23]

Q25	B

An increase in money supply increases the AD therefore the output will increase in the short-run only.

[M/J 2012/Q20]

Q26	B

Bank deposits will only increase when the money supply goes up. Hence option B is correct because it leads to an increase in money supply.

Option A is incorrect because if people want to hold more money they will not deposit it in the bank. Option C is incorrect because if the bank holds more in cash its deposits will decline because less loans would be generated and hence lower deposits. Option D is incorrect because if securities are sold by the central bank then then money supply would fall and so will the deposits.

[M/J 2012/Q23]

Q27	C

The extent of the credit creation depends on the size of cash ratio bank maintain. Thus if cash ratio is 10% then the credit multiplier is 10.

STEP 1: Credit Multiplier = 1 / Reserve Ratio = 1/0.10 = 10

STEP 2: Calculate the total decrease in cash by multiplying credit multiplier with the cash withdrawal. Hence increase in bank deposit would be 20,000 x 10 = 200,000

STEP 3: Check how much loans is reduced: Since the bank keeps 10% as cash deposit it will reduce the loans by 200,000 – 20,000 = 180,000

Key Point: whether the question asks about loan generation or loan withdrawal the method to the question remains the same.

[M/J 2012/Q24]

Q28	B

Banks generating more credit: This shifts the MS rightwards
People increasing cash holding: This increases the speculative demand for money hence shifts the LP outwards.

O/N 2012/Q21]

Q29	A

1. Narrow Money: This includes only notes and coins circulating in the economy. \
2. Broad Money: This includes Narrow money + Bank Deposits
3. Quantitative Easing: This method is used to increase money supply in the economy. Hence both narrow and broad money will increase.

[M/J 2013/Q18]

Q30	A

Monetarists short-run: They believe that in the short-run an increase in MS could increase both Prices and output.

Monetarists long-run: In the long run output does not change therefore only increases the Price level.

[M/J 2013/Q19]

Q31	D

When money is withdrawn from a commercial bank it leads to a reduction in the bank's ability to lend. Option A is irrelevant. Options B & C are incorrect because it will reduce the amount of deposit and hence the liquidity.

[M/J 2013/Q21]

Q32	D

Purchase of bonds in the open market will lead to an increase in MS and therefore maintains the rate at r1. Options A & C will increase income hence leading an increase in LP increasing the interest rate. Option B will cause price level of rise again increasing the LP and interest rate.

[M/J 2013/Q22]

Q33	D

Only US registered negative growth of narrow money supply. Euro area, Britain and Japan experienced positive growth of both broad and narrow money supply.

[O/N 2013/Q18]

Q34	B

Monetarists believe that MS in the main source of aggregate monetary expenditure demand. Whereas Keynesians believe in government intervention and more on the demand side of things.

[O/N 2013/Q19]

Q35	C

The interest rate will go up either the money supply decreases or the demand for money goes up. Hence Option C is correct as when the rate of investment increases the demand for money increases hence pushing the interest rates up. Option A will reduce the interest rate. Option B will reduce interest rate. Option D will reduce the interest rate.

[O/N 2013/Q21]

Q36	A

MV = PV

Change on the left side of the equation is 6%. The combine change in PY on the right side of the equation must also be 6%. Thus if the change in P=4% then change in real output must have been 2%.

[M/J 2014/Q16]

Q37	C

The extent of the credit creation depends on the size of cash ratio bank maintain. Thus if cash ratio is 10% then the credit multiplier is 10.

STEP 1: Credit Multiplier = 1 / Reserve Ratio = 1/0.10 = 10

STEP 2: Calculate the total increase in cash by multiplying credit multiplier with the new cash deposit. Hence increase in bank deposit would be 20,000 x 10 = 200,000

STEP 3: Check how much loans is generated: Since the bank keeps 10% as cash deposit it will give the rest 90% out as bank loans (200,000 x 90% = 180,000)

[M/J 2014/Q17]

Q38	D

Decline in Business Confidence: This will shift the demand curve to the left.
Increase in Bank Lending: This will shift the supply curve to the right.

Hence the new equilibrium would be D.

[M/J 2014/Q21]

Q39	C

An increase in MS is likely to increase money income, and real wages in the short-run. While increase in money wages could reduce employment. However real income falls due to increase in price level.

[O/N 2014/Q22]

Q40	B

Buying foreign currency will lead to selling of local currency in the foreign market hence increasing the money supply. All the other options result in money supply to fall as they suggest outflow of money from the economy.

[M/J 2015/Q18]

Q41	A

MV = PY

Change on the left side of the equation is 2%. The combine change in PY on the right side of the equation must also be 2%. Thus if the change in P=5% then change in real output must have been -3%.

[M/J 2015/Q22]

Q42	C

Option C is correct because when the transitionary demand for money increase it shifts LP towards the right. As a result, the interest rates goes up. Hence reducing investments and consumption which leads to a fall in AD leading to lower inflation.

[M/J 2015/Q23]

Q43	A
The liquidity preference will increase. Therefore, the increase in money demand will result from increase in national income. Increase in money supply causes interest rates to fall this B is incorrect. Option C & D are not related. [M/J 2015/Q24]	

Q44	D
If the government buys back the securities this will increase the money supply and this will lead to a fall in the interest rates. [O/N 2015/Q21]	

Q45	A
A liquidity trap exists when demand for money becomes perfectly elastic and any change in money supply fails to bring a change in interest rates and hence output. [M/J 2016/Q25]	

Q46	B
An increase in national income causes the transaction demand for money. Options A & C will affect speculative demand for money. Option D is likely to reduce transaction demand for money. [O/N 2016/Q26]	

Q47	B
A negative interest rate environment is in effect when the nominal interest rate drops below zero percent for a specific economic zone, meaning banks and other financial firms would have to pay to keep their excess reserves stored at the central bank rather than receive positive interest income. Changing the interest rates is part of the monetary policy. If the interest rates are negative that shows that the government wants to implement an expansionary monetary policy. This will lead to increase in AD and ultimately increase in output and inflation. [M/J 2018/Q28]	

Q48	A
In quantitative easing the aim is to increase the money supply. When the government **buys** back the bonds. This lead to an increase in money supply which **reduces the interest rates**. As a result the **AD increases.** [O/N 2018/Q26]	

Q49	C
Liquidity trap is a situation where a change in money supply does not impact the interest rate. This happens when the liquidity preference curve becomes perfectly elastic. [O/N 2018/Q27]	

Q50	D
The diagram shows a liquidity trap hence increasing money supply will have no impact on the interest rate. [M/J 2019/Q26]	

Q51	A
The demand for money increased. This happens when the national income increase and pessimism has increased so people want to hold more money. [M/J 2019/Q28]	

A2 – ECONOMICS (9708)

MACRO

CHAPTER 4

Unemployment & Phillips Curve

Q1 [M/J 2008/Q19]

An economy is operating initially at its natural rate of unemployment.

According to monetarist theory, what will be the effect on unemployment in the short run and in the long run of an unanticipated increase in the money supply?

	short run	long run
A	no change	no change
B	no change	reduction
C	reduction	no change
D	reduction	reduction

Q2 [M/J 2008/Q27]

The number of people employed in a country and the level of unemployment both increase.

What could make this possible?

A net inward immigration

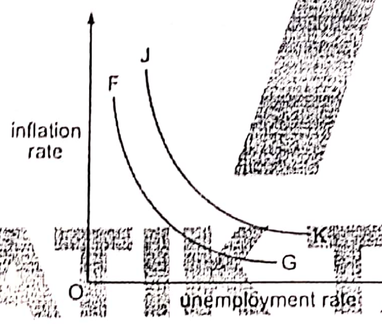
B a decrease in the level of unemployment benefits

C a decrease in the age at which state pensions are payable

D an increase in the number of students

Q3 [M/J 2008/Q28]

The diagram shows the relationship between the rate of inflation and the rate of unemployment.



What would cause the curve FG to shift to JK?

A a decrease in government expenditure

B a fall in the level of employment

C an increase in the rate of change of wages

D the expectation of an increase in inflation

Q4 [O/N 2008/Q22]

Which pattern of labour market data is likely to indicate an increase in cyclical unemployment?

	changes in	
	compulsory redundancies	voluntary resignations
A	decrease	increase
B	increase	increase
C	decrease	increase
D	increase	decrease

Q5 [O/N 2008/Q23]

The natural rate of unemployment in an economy is 5%.

What will happen if a government persists in trying to achieve a target rate of unemployment of 3% by expansionary monetary policy?

A an accelerating rate of inflation

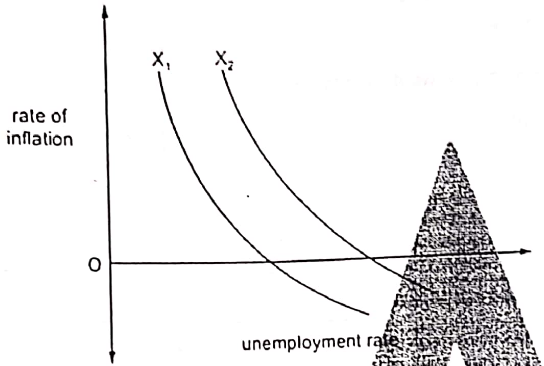
B a diminishing rate of inflation

C a high but constant rate of inflation

D a negative rate of inflation

Q6 [O/N 2009/Q24]

In the diagram, the curve X_1 shows an economy's initial trade-off between inflation and unemployment.



What could cause the curve to shift to X_2?

A an increase in the natural rate of unemployment

B a decrease in the money supply

C the expectation of a decrease in the inflation rate

D an increase in the rate of interest

Q7 [M/J 2010/Q24]

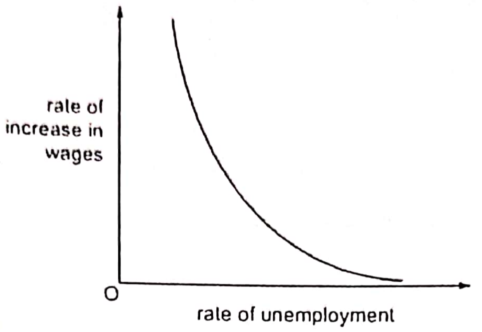
An economy is operating at its natural rate of unemployment.

According to monetarist theory, what will be the effect on unemployment in the short run and in the long run of an unanticipated increase in the money supply?

	short run	long run
A	no change	no change
B	no change	reduction
C	reduction	no change
D	reduction	reduction

Q8 [M/J 2010/Q25]

The diagram shows the relationship between the rate of increase in wages and the rate of unemployment.



What would be likely to cause the curve in the diagram to shift downwards and to the left?

A a reduction in regional differences in unemployment rates

B an increase in the proportion of the workforce belonging to trade unions

C an increase in the unemployment rate

D the expectation of a higher rate of inflation

Q9 [M/J 2010/Q27]

Which is most likely to result in an increase in the natural rate of unemployment?

A a decrease in government expenditure on goods and services

B a decrease in the level of government payments to the unemployed

C an increase in trade union membership

D an increase in interest rates

Q10 [M/J 2011/Q14]

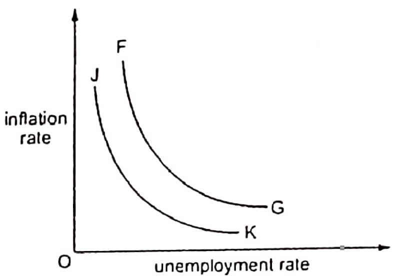
An economy is operating at its natural rate of unemployment.

According to monetarist theory, what will be the effect on unemployment in the short run and in the long run of an unanticipated increase in the money supply?

	short run	long run
A	no change	no change
B	no change	reduction
C	reduction	no change
D	reduction	reduction

Q11 [M/J 2011/Q23]

The diagram shows the relationship between the rate of inflation and the rate of unemployment.



What would cause the curve FG to shift to JK?

A a lower exchange rate

B a lower expected rate of inflation

C an increase in government expenditure

D a rise in the level of employment

Q12 | [O/N 2011/Q6]

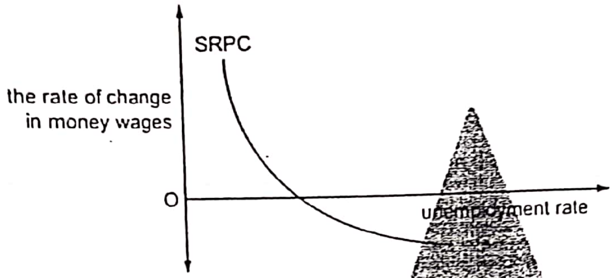
The table shows the labour market for an economy in four separate years.

In which year was there excess demand in the labour market?

	working population (millions)	unemployment rate (%)	job vacancies (thousands)
A	19	1.0	180
B	19	2.0	80
C	20	1.1	240
D	20	1.5	100

Q13 | [O/N 2011/Q26]

The diagram shows an economy's short-run Phillips curve (SRPC).



What is assumed to remain constant when drawing this curve?

A the average price level

B the exchange rate

C the expected rate of inflation

D the money supply

Q14 | [M/J 2012/Q28]

The number of people employed in a country and the level of unemployment both decrease.

What could explain this?

A net inward immigration

B an increase in the level of unemployment benefits

C an increase in the age at which state pensions are payable

D an increase in the number of students

Q15 | [O/N 2012/Q22]

An economy's unemployment rate is below the natural rate.

What is likely to be the implications of this for inflation and what can be deduced from this about the economy's actual level of output?

	inflation	actual output
A	accelerating	below potential output
B	accelerating	above potential output
C	decelerating	below potential output
D	decelerating	above potential output

Q16 | [O/N 2012/Q24]

What is most likely to lead to an increase in the natural rate of unemployment?

A more rapid technological and structural change

B a widening in regional wage differentials

C a narrowing in regional house price differentials

D a decrease in trade union membership

Q17 | [O/N 2012/Q25]

Which type of unemployment arose from the worldwide decline in the demand for electronic goods beginning in the summer of 2001?

A seasonal

B voluntary

C frictional

D structural

Q18 | [M/J 2013/Q24]

Which policy is specifically designed to reduce the level of structural unemployment?

A an increase in the level of state benefits paid to the unemployed

B a reduction in interest rates

C a reduction in the level of direct taxation

D the provision of retraining schemes

Q19 | [O/N 2013/Q23]

A country experiences cyclical unemployment due to a decrease in domestic spending.

If the government takes no action in response, what will be a likely consequence?

A an increase in the current account deficit on the balance of payments

B an increase in the government's budget deficit

C an increase in the rate of inflation

D an increase in the volume of investment

Q20 | [O/N 2013/Q24]

What is a possible combination of a cost and a benefit of rising levels of unemployment?

	cost	benefit
A	a deterioration in human capital	an increase in capital expenditure
B	an increase in import expenditure	a decrease in government tax revenue
C	an increase in the rate of economic growth	a more responsive workforce
D	an irretrievable loss of output	a reduction in inflationary pressure

Q21 | [O/N 2015/Q25]

An economy is operating at its natural rate of unemployment.

According to monetarist theory, what will be the effect on unemployment in the short run and in the long run of an unanticipated increase in the money supply?

	short run	long run
A	no change	no change
B	no change	reduction
C	reduction	no change
D	reduction	reduction

Q22 | [M/J 2016/Q23]

Which type of unemployment occurs when aggregate demand is deficient?

A cyclical unemployment

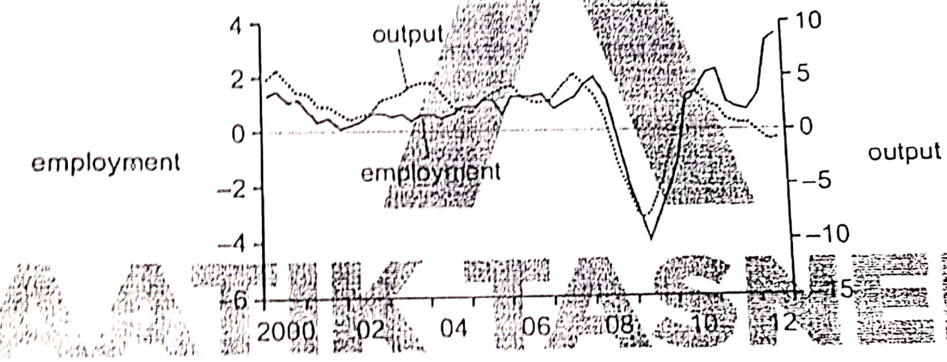
B regional unemployment

C seasonal unemployment

D structural unemployment

Q23 | [M/J 2016/Q24]

The diagram shows the annual percentage (%) change in employment and output in the UK private sector between 2000 and 2012.



In which year did labour productivity increase the most?

A 2003 B 2007 C 2009 D 2012

Q24 | [M/J 2017/Q19]

Which policy is specifically designed to reduce the level of structural unemployment?

A an increase in the level of state benefits paid to the unemployed

B a reduction in interest rates

C a reduction in the level of direct taxation

D the provision of retraining schemes

Q25 | [M/J 2017/Q23]

Why do some economists suggest there may be positive benefits from frictional unemployment?

A A short spell of frictional unemployment may lead workers to become discouraged.

B Frictional unemployment allows time for retraining in newly emerging skills.

C Job search during frictional unemployment may lead to a better match of workers and jobs.

D The psychological effects of frictional unemployment are less than the economic effects.

Q26 | [O/N 2017/Q24]

What would **not** be classified as structural unemployment?

A a car worker who is replaced by a robot on the production line

B a coal miner whose mine closes because of increased use of solar power

C a fruit picker who cannot find work in the winter months

D a textile worker whose factory closes as production moves abroad

Q27 | [M/J 2018/Q19]

A country has a population of 100 million. There are 5 million people unemployed and the country has an unemployment rate of 10%.

What is the size of the labour force?

A 10 million B 50 million C 90 million D 95 million

Q28 | [M/J 2018/Q20]

Which type of unemployment is correctly linked to the description of its cause?

	type of unemployment	description of the cause
A	cyclical	a change in demand due to holiday periods
B	frictional	a lack of sufficient information
C	structural	a temporary change in consumers' expenditure
D	technological	a general decrease in the demand for goods

Q29 | [O/N 2018/Q23]

In 2007 Turkey had a population of 73 m. Its labour force was 36 m, of which 12 m were trained for the primary sector and 24 m were trained for the secondary and tertiary sectors. The unemployment rate was 10%.

What was the number of people unemployed?

A 1.2 m B 2.4 m C 3.6 m D 7.3 m

Q30 | [O/N 2018/Q24]

An economy's manufacturing share of real GDP fell from 30% in 1970 to 12% in 2016.

What type of unemployment would result from this?

A cyclical

B frictional

C structural

D voluntary

Q31 | [M/J 2019/Q23]

What is a cause of seasonal unemployment?

A a general decrease in the demand for goods and services

B a lack of necessary skills in the workforce

C a temporary change in the pattern of consumers' expenditure

D an unwillingness of workers to move to other parts of the country where there is work

Q32 | [O/N 2019/Q20]

Which type of unemployment is associated with a deficiency in aggregate demand?

A cyclical

B frictional

C structural

D voluntary

Q33 | [O/N 2019/Q29]

What is measured on the vertical axis of the Phillips curve?

A the rate of change of real wages

B the rate of change of take-home pay

C the rate of inflation

D the rate of interest

A2 – ECONOMICS (9708)

MACRO

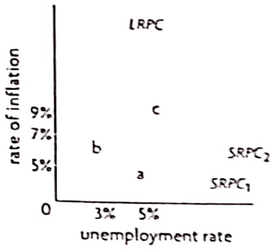
CHAPTER 4
Unemployment & Phillips Curve

ANSWERS

TOPIC 1: UNEMPLOYMENT & PHILLIPS CURVE

Q1 | C

NRU represents the structural and frictional unemployment which will always exist in the economy. Monetarists believe that although in the short-run there is an inverse relationship between unemployment and the rate of inflation due to excess money supply however in the long run no such relationship exist. This concept is shown ins short-run Philips curve and the long-run Philips curve.



[M/J 2008/Q19]

Q2 | A

Net inward immigration means that more people are coming to the country than leaving because this the demand for goods increases but some people also lose their job as some jobs might be taken over by the foreign nationals. Option B is incorrect because this will just reduce the unemployment. Option C is incorrect because this will only reduce unemployment as the labor force will shrink. Option D this will lead to less labor force hence reduce unemployment.

[M/J 2008/Q27]

Q3 | D

A rightward shift shows the price levels and the rate of unemployment both have increased. This can only happen if there is a leftward shift in the AS. Hence in the short-run Philips curve shifts rightward due to expectation of increase in inflation rate. This means the same level of unemployment but with a higher level of inflation.

[M/J 2008/Q28]

Q4 | D

Cyclical unemployment happens due to insufficient aggregate demand. In a recessionary period lack of AD forces the firms to lay off workers hence an increase in compulsory redundancies. Also due to lack of job opportunities the tendency of voluntary resignations decreases as people know that they won't find jobs if they leave the current ones.

[O/N 2008/Q22]

Q5 | A

On the Philips curve when any factor moves the AD the movement is on the Philips curve. Hence the government is trying to use expansionary monetary policy this will shift the AD rightwards, increasing employment and increasing the rate of inflation. Hence a persistent expansionary policy would only accelerate inflation rate without reducing NRU.

Common Mistake: Some students were able to figure out that the inflation will go up, but were confused with accelerating, diminishing or constant rate. The reason it was accelerating because wherever money supply is continuously increased the NRU will not change and hence it will keep pushing prices without changing the level of employment.

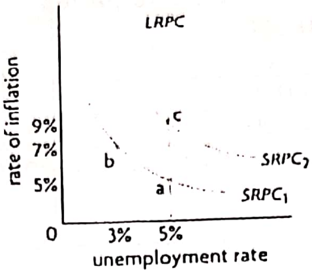
[O/N 2008/Q23]

Q6 | A

The NRU is indicated at zero rate of inflation. X2 curve indicates a higher level of NRU.

[O/N 2009/Q24]

Monetarists believe that although in the short-run ... money supply however in the long run no such unemployment and the rate of inflation due to excess money supply however in the long run no such relationship exist. This concept is shown ins short-run Philips curve and the long-run Philips curve.



[M/J 2010/Q24]

Q8	C

NRU comprises of frictional and structural unemployment. An increase in trade union memberships will lead to firms less likely to hire employees and replace them with machines. Option A, B & D are likely to increase NRU but the question specifically asks which of the options is the most likely to lead to an increase in NRU.

[M/J 2010/Q25]

Q9	A

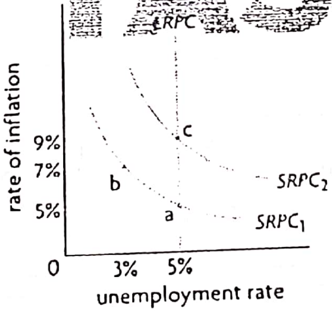
A leftward shift in the Philips curve shows that the AS is increased because rate of unemployment and inflation are both going down. Hence a reduction in regional unemployment disparity would cause a downward shift in the Philips curve. Option B & D would shift the Philips curve outward hence incorrect. While Option C would produce a movement along the cure rather than shift the curve.

Key Point:
1. Rate of increase in wage / inflation is the same thing.
2. The PC shifts due to AS factors or due to other reasons for unemployment other than frictional.

[M/J 2010/Q27]

Q10	C

NRU represents the structural and frictional unemployment which will always exist in the economy. Monetarists believe that although in the short-run there is an inverse relationship between unemployment and the rate of inflation due to excess money supply however in the long run no such relationship exist. This concept is shown ins short-run Philips curve and the long-run Philips curve.



[M/J 2011/Q14]

Q11	B

The Philips curve is shifting leftward this shows that the AS increased because both the inflation and unemployment fell. Expectations of lower prices and higher real wages would decrease the NRU therefore the Philips curve would shift leftwards.

Key Point:
1. Rate of increase in wage / inflation is the same thing.
2. The PC shifts due to AS factors or due to other reasons for unemployment other than frictional.
3. Anything the increases the NRU will shift the curve outward and vice versa.

[M/J 2011/Q23]

Q12 | C

We need to calculate the number of workers unemployed for every year and then compare them.

No. of Unemployed	Job Vacancies	Excess or Shortfall
190,000	180,000	-10,000
380,000	80,000	-200,000
220,000	240,000	+10,000
300,000	100,000	-200,000

Hence in Year 3 there was an excess of workers since there were more job vacancies than the number of people unemployed.

[O/N 2011/Q8]

Q13 | C

Whenever a curve is drawn the factors that cause a shift are held constant. Hence a change in the expected rate of inflation shifts the SRPC therefore it is held constant.

[O/N 2011/Q25]

Q14 | D

If the number of students increases it will result in the fall of labor force and will reduce unemployment.

Key Point: The number of people employment and level of unemployment is the same thing.

[M/J 2012/Q22]

Q15 | B

When the unemployment is below the NRU this means that the economy is facing accelerating inflation and the output is above the potential one. Accelerating inflation rate causes NRU to decrease. People who are not considered part of labor force and the potential output is measured by the available labor force.

[O/N 2012/Q22]

Q16 | A

Technological changes increase structural changes are part of the structural unemployment and since structural unemployment is present in NRU if it increases the NRU will increase. Option B represents.

[O/N 2012/Q24]

Q17 | D

A decline in demand for a product results in job losses in that particular industry. This is called structural unemployment.

[O/N 2012/Q25]

Q18 | D

Structural unemployment is caused by the destruction of jobs in a particular occupation therefore workers must get retrained before they join other occupation. Option A will encourage people to remain unemployed. Option B & C will reduce cyclical unemployment.

[M/J 2013/Q24]

Q19 | B

Since the unemployment is increasing the government would have to spend more on unemployment benefits. This will cause the government to suffer a budget deficit.

[O/N 2013/Q23]

Q20 | D

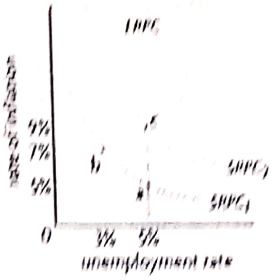
Cost: The loss of output is the cost of unemployment as less workers will produce less output.

Benefit: Since now more people are unemployed the level of consumption declines. When (C) falls AD shifts backwards and hence reduces inflationary pressure.

[O/N 2013/Q24]

Q21 | C

NRU represents the structural and frictional unemployment which will always exist in the economy. Monetarists believe that although in the short-run there is an inverse relationship between unemployment and the rate of inflation due to excess money supply however in the long run no such relationship exist. This concept is shown ins short-run Philips curve and the long-run Philips curve.



[O/N 2015/Q25]

Q22 | A

Deficiency of aggregate demand suggests recession that is associated with business cycle which is called cyclical unemployment.

[M/J 2016/Q23]

Q23 | A

In 2003 the output percentage increased by the greatest as compared to the increase in employment percentage. Hence in 2003 the labor productivity was the highest.

[M/J 2016/Q24]

Q24 | D

Structural unemployment means that when a particular industry in a country declines and the labor is unemployed because of that. Hence if there is a provision for retaining that means that rather than firing labor the companies are supposed to retain people.

Option A will lead to people have an incentive not to work hence it will increase unemployment. Options B & C will reduce unemployment but cyclical (demand-deficit).

[M/J 2017/Q19]

Q25 | C

Option C is correct because during this time worker and look for a job that matches their skill sets. Options A, B & D are all negative impacts of frictional unemployment.

[M/J 2017/Q23]

Q26 | C

Structural unemployment means that when a particular industry in a country declines and the labor is unemployed because of that. Hence if a worker can't find work in the winter season that shows seasonal unemployment. Option A, B & D all refer to structural unemployment.

[O/N 2017/Q24]

Q27 | B

Rate of Unemployment = $\frac{\text{Number of unemployed}}{\text{Labor Force}} \times 100$

$10\% = \frac{5}{x} \times 100 = 50\text{million}.$

Common Mistake: Some students started using the figure of population 100million for this calculation. Always remember that population has nothing to do with unemployment we need the labor force for its formulae. For students generally took 10% of 100million and choose 90million thinking that if 10% is unemployment then 90million must be the working which was incorrect.

[M/J 2018/Q19]

Q28 | B

Cyclical: This happens because of reduction in AD. [FASLE]
Frictional: Cannot find a job due after leaving the previous one due to lack of information. [TRUE]
Structure: Due to a collapse of a particular industry. [FALSE]
Technological: This happens when technology replaced humans. [FALSE]

[M/J 2018/Q20]

Q29 | C

Rate of Unemployment = $\frac{\text{Number of unemployed}}{\text{Labor Force}} \times 100$

$10\% = \frac{X}{36} \times 100 = 3.6$million.

Common Mistake: Some students started using the figure of population 73million for this calculation. Always remember that population has nothing to do with unemployment we need the labor force for its formulae.

[O/N 2018/Q23]

Q30 | C

This will result in structural because structural unemployment happens when a particular industry collapses. Option A is incorrect because Cyclical happens because of reduction in AD. Option B is incorrect because Frictional happens when cannot find a job due after leaving the previous one due to lack of information. Option D is incorrect because voluntary unemployment happens when the people are reluctant to accept jobs which are low-paid or have low job satisfaction.

[O/N 2018/Q24]

Q31 | C

Seasonal unemployment is when there is temporary change in consumer demand pattern. Option A will lead to cyclical unemployment. Option B can be due to frictional. Option D can be due to regional unemployment.

[M/J 2019/Q23]

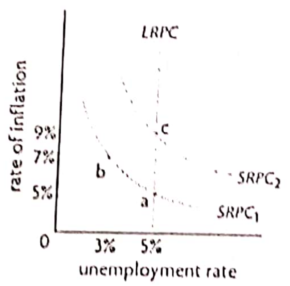
Q32 | A

Cyclical: This happens because of reduction in AD. [TRUE]
Frictional: Cannot find a job due after leaving the previous one due to lack of information. [FALSE]
Structure: Due to a collapse of a particular industry. [FALSE]
Voluntary: This happens when the terms of the job is not favorable. [FALSE]

[O/N 2019/Q20]

Q33 | C

On the vertical axis we have rate of inflation and on the horizontal axis we have unemployment rate.



[O/N 2019/Q29]

A2 – ECONOMICS (9708)

MACRO

CHAPTER 5

Govt. Macroeconomic Intervention

Q1 | **[M/J 2008/Q29]**

Other things being equal, what is likely to result from an increase in interest rates in a country?

A a capital outflow from the country

B a depreciation of the country's currency

C a decrease in consumption

D an increase in investment

Q2 | **[M/J 2008/Q30]**

Why might a reduction in domestic interest rates improve the current account of a country's balance of payments?

A It will cause an appreciation in the exchange rate.

B It will reduce the amount of interest paid to foreign holders of the country's financial assets.

C The resulting higher level of economic activity is likely to increase imports.

D There will be an outflow of capital from the country.

Q3 | **[O/N 2008/Q19]**

What is likely to be the effect on interest rates and the supply of money of a sale of government securities to the public by a central bank?

	interest rates	money supply
A	increase	increase
B	increase	decrease
C	decrease	decrease
D	decrease	increase

Q4 | **[O/N 2008/Q28]**

The European Union imposes a quota on the volume of garments imported from China.

What is likely to be a consequence?

A a reduction in the profit margins on garments produced by Chinese textile firms

B a reduction in the inflation rate in the EU

C a switch to producing higher-value garments by Chinese textile firms

D the closure of Chinese-owned textile factories in Thailand

Q5 | **[O/N 2008/Q29]**

Without any change in government policy, what will be the effect of an economic recession on tax revenue and on government expenditure?

	tax revenue	government expenditure
A	decrease	decrease
B	decrease	increase
C	increase	increase
D	increase	decrease

Q6 [O/N 2008/Q30]

A country's government wishes to switch demand away from private consumption towards investment and net exports.

Which combination of policy measures would be most likely to help it achieve this objective?

	interest rates	rate of income tax
A	increase	increase
B	increase	decrease
C	decrease	increase
D	decrease	decrease

Q7 [M/J 2009/Q28]

An economy with a floating exchange rate is in recession and at the same time has a deficit on the current account of its balance of payments.

Which policy combination would be most likely to help with both of these problems?

	interest rates	tax rates
A	decrease	unchanged
B	decrease	increase
C	increase	unchanged
D	increase	increase

Q8 [M/J 2009/Q29]

In 2004 China's ability to exploit its comparative advantage in cotton production increased.

What could explain this change?

A a fall in the value of the currency of India, a major cotton producer

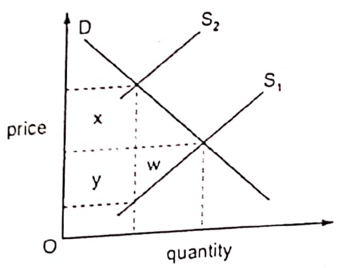
B a reduction of the import quota on Chinese cotton into the European Union

C a rise in the wages of Brazilian cotton workers matched by an increase in their productivity

D the removal of the United States of America's subsidy to its cotton growers

Q9 [M/J 2009/Q30]

In the diagram D is the demand curve for Indian tea exports and S_1 is the initial supply curve.



The Indian government imposes a tax on tea exports, which causes the supply curve to shift to S_2.

Which areas in the diagram measure the resulting gain in tax revenue to the Indian government and the resulting loss in producer surplus to its tea producers?

	gain in tax revenue	loss in producer surplus
A	x	w + y
B	x + y	y
C	x	y
D	x + y	w + y

Q10 | [O/N 2009/Q27]

An economy has unemployed resources and a flexible exchange rate. It lowers interest rates below the level prevailing in other countries.

What will be the likely effect on the level of domestic demand for goods and services and on the demand for the country's exports?

	domestic demand	export demand
A	increase	increase
B	increase	decrease
C	decrease	decrease
D	decrease	increase

Q11 | [O/N 2009/Q28]

Which policy is most likely to help to correct an adverse balance on the current account of the balance of payments?

A abolishing tariffs

B devaluing the currency

C reducing direct taxes

D reducing indirect taxes

Q12 | [O/N 2009/Q29]

A government decides to pursue a more deflationary fiscal policy and a more reflationary monetary policy.

Which combination of changes in policy instruments is consistent with this?

	government expenditure	interest rate	taxation
A	decrease	decrease	increase
B	decrease	decrease	decrease
C	increase	increase	decrease
D	increase	increase	increase

Q13 | [M/J 2010/Q23]

What could explain why the terms of trade of most developing economies tend to worsen over time?

A Their currencies are over-valued in foreign exchange markets.

B They impose lower barriers on imports than developed economies.

C They produce a narrower range of goods than developed economies.

D They produce goods with a low income elasticity of demand.

Q14 | [M/J 2010/Q26]

Which policy is most likely to reduce a balance of payments deficit without causing inflation?

A a devaluation of the exchange rate

B an increase in import tariffs

C an increase in indirect taxes

D an increase in direct taxes

Q15	[M/J 2010/Q28]

An economy has underemployed resources.

Which method of financing an increase in government expenditure is likely to have the greatest expansionary effect?

A borrowing from the central bank

B borrowing from the non-bank private sector

C increased direct taxation

D increased indirect taxation

Q16	[M/J 2010/Q29]

What will be the impact of an increase in marginal tax rates?

A an increase in the propensity to save

B an increase in the value of the investment multiplier

C a strengthening of work incentives

D a strengthening in the operation of automatic stabilisers

Q17	[O/N 2010/Q25]

What is likely to be the effect of a fall in oil prices on the global economy?

A a decrease in the rate of economic growth

B a decrease in unemployment

C a strengthening of cost-push inflation

D a weakening of demand-pull inflation

Q18	[O/N 2010/Q26]

What is an unavoidable cost of long-run economic growth?

A an increase in inflation

B an increase in the working hours of the population

C a sacrifice of potential present consumption

D greater inequality in the distribution of income

Q19	[O/N 2010/Q27]

What could be expected to increase the pressure of demand-pull inflation in an open economy?

A an appreciation of the foreign exchange rate

B an increase in indirect taxes

C an increase in interest rates

D the imposition of import controls

Q20	[O/N 2010/Q28]

When will taxes be most effective in dampening cyclical changes in national output?

A when the tax yield is independent of national income

B when the tax yield varies inversely with national income

C when the tax yield varies less than proportionately with national income

D when the tax yield varies more than proportionately with national income

Q21 | [O/N 2010/Q30]

A country introduces import quotas.

The suppliers of imported goods charge market-clearing prices.

Assuming the demand for imports is price-inelastic, what will be the impact on the country's balance of trade and on its terms of trade?

	balance of trade	terms of trade
A	improves	improve
B	improves	worsen
C	worsens	improve
D	worsens	worsen

Q22 | [M/J 2011/Q22]

The table shows some indicators of macro-economic performance in the US economy for five decades.

economic target	1950s	1960s	1970s	1980s	1990s
real GDP growth (average %)	4.18	[illegible]	3.28	3.02	3.03
inflation (average %)	2.07	2.33	7.09	5.66	3.00
unemployment (average %)	4.51	4.78	6.22	7.27	5.76

Between which decades did the US government achieve an overall improvement in its performance with no trade-off between individual policy goals?

A 1950s to 1960s

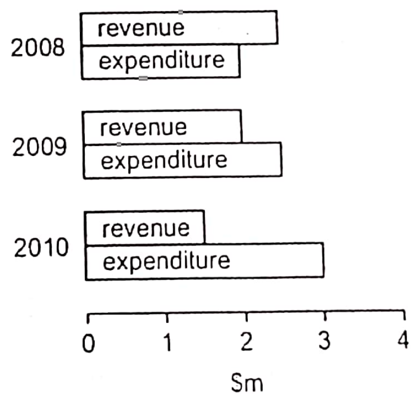
B 1960s to 1970s

C 1970s to 1980s

D 1980s to 1990s

Q23 | [M/J 2011/Q24]

The diagram shows a government's revenue and expenditure for three years.



What can be concluded from the diagram?

A A budget deficit was replaced by a budget surplus.

B A government borrowing requirement emerged.

C The economy moved from a recession into a boom period.

D The yield from taxation continuously increased.

... in domestic interest rates have an adverse effect on a country's balance of payment on current account?

A It will cause a rise in the exchange rate.

B It will make the country's industry less competitive.

C The resulting higher level of economic activity is likely to increase imports.

D There will be an outflow of capital from the country.

Q25 | [M/J 2011/Q27]

What would be classified as a supply side policy measure?

A additional legislation to restrict the power of trade unions

B a reduction in the government's fiscal deficit

C an open market sale of securities

D the imposition of a tariff on imported goods

Q26 | [M/J 2011/Q28]

A country decides to join a group of countries which maintain fixed parities for their currencies and forbid any restriction on foreign trade and payments.

What will the country have to forgo to maintain a fixed parity for its currency?

A an independent anti-monopoly policy

B an independent fiscal policy

C an independent interest rate policy

D an independent prices and incomes policy

Q27 | [M/J 2011/Q29]

What would be an economic benefit to a major economy of imposing a tariff on imported goods?

A It would increase labour productivity.

B It would increase pressure on foreign suppliers to reduce their prices.

C It would make the country's exports more competitive.

D It would reduce the prices paid by consumers for imported goods.

Q28 | [O/N 2011/Q25]

A government currently has a balanced budget. It is considering the possible variations in tax revenue and government expenditure shown.

options	tax revenue	government expenditure
W	increase	increase
X	increase	reduce
Y	reduce	increase
Z	reduce	reduce

Which three options have the potential to move the budget into surplus?

A W, X and Y B W, X and Z C W, Y and Z D X, Y and Z

Q29 | **[O/N 2011/Q27]**

The economy of a country is simultaneously experiencing a balance of payments deficit, a budget deficit, demand-pull inflation and unemployment. The government decides to cut personal income taxes.

What does this suggest is its main macroeconomic objective?

A to improve the balance of payments position

B to reduce the budget deficit

C to reduce the level of unemployment

D to reduce the rate of inflation

Q30 | **[O/N 2011/Q30]**

An economy has a flexible exchange rate. It raises interest rates above the level existing in other countries.

What will be the likely effect on the level of domestic demand for goods and services and on the demand for the country's exports?

	domestic demand	export demand
A	decrease	decrease
B	decrease	increase
C	increase	decrease
D	increase	increase

Q31 | **[M/J 2012/Q29]**

What would be an appropriate government action to reduce both a balance of payments current account surplus and the rate of inflation?

A increase the money supply

B increase direct taxes

C remove tariffs on imports

D devalue the currency

Q32 | **[M/J 2012/Q30]**

The government of Lesotho introduces a programme to promote exports and to encourage firms to grow by subsidising local entrepreneurs.

What effect is this likely to have on incomes, the balance of payments current account deficit and government expenditure in Lesotho?

	incomes	balance of payments current account deficit	government expenditure
A	fall	uncertain	rise
B	rise	reduce	no change
C	fall	reduce	rise
D	rise	uncertain	rise

Q33 | [O/N 2012/Q17]

An economist wishes to judge whether an economy's budget deficit is excessive.

What would be the most appropriate way to measure the budget deficit when making this judgement?

A as a percentage of foreign currency reserves

B as a percentage of GDP

C in inflation adjusted terms

D in purchasing power parity terms

Q34 | [O/N 2012/Q20]

In 2009 the US central bank, the Federal Reserve, increased the money supply.

Which policy measure taken by the Federal Reserve would have achieved this outcome?

A a purchase of government securities in the open market

B a reduction in the issue of short-term government debt

C a requirement for commercial banks to increase their liquidity ratios

D an increase in the bank rate

Q35 | [O/N 2012/Q29]

Why is it more effective to increase regressive taxes rather than progressive taxes when pursuing a deflationary fiscal policy?

A Changes in VAT have minimal effect on consumers' spending.

B It is much more unfair to increase progressive taxes.

C Many workers reduce the hours they work when income taxes are raised.

D Low income households spend a larger proportion of their incomes.

Q36 | [M/J 2013/Q26]

The European Union imposes a quota on the volume of garments imported from Brazil.

What is likely to be a consequence?

A a decrease in the price paid by EU consumers for Brazilian garments

B a reduction in the inflation rate in the EU

C a switch to producing lower-value garments by Brazilian textile firms

D the closure of Brazilian-owned textile factories

Q37 | [M/J 2013/Q27]

Other things being equal, what is likely to result from an increase in interest rates in a country?

A a capital outflow from the country

B a depreciation of the country's currency

C a decrease in consumption

D an increase in investment

Q38 | [M/J 2013/Q28]
What is the main objective of supply side policies?

A to bring a country's potential output up to the level of its actual output

B to ensure a budget surplus

C to ensure that the composition of output matches the pattern of demand

D to increase potential output by increasing efficiency

Q39 | [M/J 2013/Q30]
Without any change in government policy, what will be the effect of an economic recession on tax revenue and on government expenditure?

	tax revenue	government expenditure
A	decrease	decrease
B	decrease	increase
C	increase	increase
D	increase	decrease

Q40 | [O/N 2013/Q26]
Which combination indicates that a country is operating a 'dirty float'?

	nominal exchange rate	foreign currency reserves
A	depreciates by 20%	decrease by $1 billion
B	depreciates by 20%	unchanged
C	unchanged	decrease by $1 billion
D	unchanged	unchanged

Q41 | [O/N 2013/Q27]
What is a reflationary fiscal measure?

A reducing interest rates

B increasing the money supply

C increasing taxes

D increasing government spending

Q42 | [O/N 2013/Q28]
A country's government wishes to switch demand away from private consumption towards investment and net exports.

Which combination of policy measures would be most likely to help it achieve this objective?

	interest rates	rate of value added tax
A	decrease	decrease
B	decrease	increase
C	increase	decrease
D	increase	increase

Q43 | [O/N 2013/Q29]

A government aims to achieve steady and stable growth, in line with the economy's long-run increase in productivity.

If this objective is achieved, how is this likely to affect average living standards and the level of unemployment?

	average living standards	level of unemployment
A	constant	falling
B	falling	unchanged
C	rising	rising
D	rising	unchanged

Q44 | [O/N 2013/Q30]

During year 1, a government announces a temporary one-year reduction in the level of indirect taxation balanced by an equivalent temporary one-year increase in direct taxation.

What is most likely to be the impact on household saving in year 1 and in year 2?

	impact on household saving in year 1	impact on household saving in year 2
A	decrease	decrease
B	decrease	increase
C	increase	decrease
D	increase	increase

Q45 | [M/J 2014/Q28]

A central bank increases interest rates in order to control inflation.

What is likely to increase as a result of this?

A firms' sales revenue

B investment expenditure

C net capital outflows

D the exchange rate

Q46 | [M/J 2014/Q29]

What is most likely to result from a devaluation of the £ sterling?

A an increase in foreign direct investment in the UK by global manufacturing firms

B an increase in the number of UK residents taking holidays abroad

C an increase in the number of UK students applying for places in North American universities

D an increase in the supply of foreign workers seeking temporary employment over the summer in the UK

Q47 | [O/N 2014/Q21]

A central bank pursues a policy of quantitative easing by purchasing government securities.

What is likely to happen to interest rates and aggregate expenditure?

	interest rates	aggregate expenditure
A	fall	fall
B	fall	rise
C	rise	fall
D	rise	rise

Q48 | [O/N 2014/Q27]

A government decides to pursue a more reflationary fiscal policy and a more deflationary monetary policy.

Which combination of changes in policy instruments is consistent with this?

	government expenditure	interest rate	taxation
A	decrease	decrease	decrease
B	decrease	decrease	increase
C	increase	increase	decrease
D	increase	increase	increase

Q49 | [O/N 2014/Q28]

The table shows some indicators of macro-economic performance in the US economy for five decades.

economic target	1950s	1960s	1970s	1980s	1990s
real GDP growth (average %)	4.18	4.43	3.28	3.02	3.03
inflation (average %)	2.07	2.33	7.09	5.66	3.00
unemployment (average %)	4.51	4.78	6.22	7.27	5.76

Between which decades did the US government achieve an overall improvement in its performance with no trade-off between individual policy goals?

A 1950s to 1960s

B 1960s to 1970s

C 1970s to 1980s

D 1980s to 1990s

Q50 | [O/N 2014/Q29]

Why might a reduction in domestic interest rates have an adverse effect on a country's balance of payments on the current account?

A It will cause a rise in the exchange rate.

B It will make the country's industry less competitive.

C The resulting higher level of economic activity is likely to increase imports.

D There will be an outflow of capital from the country.

Q51 | [O/N 2014/Q30]

At present, a country's government has set its central bank a target rate of inflation of 2%.

What is likely to happen to interest rates and the exchange rate if the target inflation rate is raised to 3%?

	interest rates	exchange rate
A	fall	fall
B	fall	rise
C	rise	fall
D	rise	rise

Q52 | [M/J 2015/Q28]

Increased borrowing by the government results in higher interest charges and this leads to less private investment expenditure.

Of what is this an example?

A an automatic stabiliser

B crowding out

C the accelerator

D the substitution effect

Q53 | [M/J 2015/Q30]

A government's budget is balanced at a time when the economy is fully employed, but an aggregate demand shock causes a decline in national income.

What will be the result if the government keeps its tax rates and level of spending unchanged?

A a cyclical budget deficit

B a cyclical budget surplus

C a structural budget deficit

D a structural budget surplus

Q54 | [O/N 2015/Q24]

In the absence of offsetting changes, what will result in an increase in a government's fiscal deficit?

A a decrease in household saving

B a decrease in interest rates on government bonds

C a decrease in private sector investment

D a decrease in the country's trade deficit

Q55 | [O/N 2015/Q26]

What are likely to be the impacts on an economy of increased competition from abroad?

	impact on trade balance	impact on rate of inflation	impact on unemployment rate
A	improve	raise	decrease
B	improve	reduce	decrease
C	worsen	raise	increase
D	worsen	reduce	increase

Q56 | **[O/N 2015/Q27]**

An economy has underemployed resources.

Which method of financing an increase in government expenditure is likely to have the greatest expansionary effect?

A borrowing from the central bank

B borrowing from the non-bank private sector

C increased direct taxation

D increased indirect taxation

Q57 | **[O/N 2015/Q28]**

The table shows how the government finances its budget deficit in a closed economy.

	$
budget deficit	200 billion
sale of government securities to the central bank	50 billion
sale of government securities to the non-bank private sector	150 billion

If there is no change in notes and coins in circulation and commercial banks maintain a 10% cash reserve ratio, what will be the resulting increase in the money supply?

A $50 billion

B $150 billion

C $200 billion

D $500 billion

Q58 | **[M/J 2016/Q27]**

When would an economic recession result in an increase in a government's budget deficit?

A The government increases tariffs on imports with inelastic demand and keeps the total amount it spends on unemployment benefit unchanged.

B The government keeps the unemployment benefit rate and direct and indirect tax rates unchanged.

C The government reduces foreign aid and widens the tax base.

D The government reduces the unemployment benefit rate and decreases the tax free allowance on income tax.

Q59 | **[M/J 2016/Q28]**

What will be most likely to rise if unemployment is increasing in an economy?

A the human capital of unemployed workers

B the living standards of all workers

C the nominal money wage rate of employed workers

D the tax burden on employed workers

Q60 | [O/N 2016/Q27]

Government economic advisers disagree over the relative impact of fiscal and monetary controls.

What is most likely to be the first stage at which a time lag will occur?

A in the introduction of the chosen policy

B in the operational effectiveness of the policy

C in the recognition of the existence of the problem

D in the selection of the appropriate policy

Q61 | [O/N 2016/Q29]

Which policy pursued by a central bank represents a contractionary monetary policy?

A a reduction in the interest rate at which it will lend to banks

B a reduction in the minimum cash to deposit ratios of banks

C the purchase of foreign currency to influence the country's exchange rate

D the sale of government bonds in the open market

Q62 | [O/N 2016/Q30]

Which policy's principal aim is to ensure sound public finances?

A environmental policy

B fiscal policy

C monetary policy

D supply-side policy

Q63 | [M/J 2017/Q27]

In 2015, the World Bank agreed to give a loan of $650 m to Angola to help stabilise the economy. The Bank said Angola needed to have a fiscal policy that would encourage the diversification of its economy.

Which policy would be consistent with this requirement?

A the lowering of interest rates to encourage investment in solar power

B the relaxing of regulations to allow the development of a new hydro-power project

C the spending of the loan supporting its oil industry after oil prices collapsed

D the subsidising of a partnership with a French company to establish a chain of tourist hotels

Q64 | [M/J 2017/Q28]

A country with demand-pull inflation decides to fix its exchange rates against other currencies above the purchasing power parities.

What is likely to happen to the macroeconomic indicators shown?

	interest rate	inflation rate	current account balance
A	decrease	decrease	improve
B	decrease	increase	worsen
C	increase	decrease	worsen
D	increase	increase	improve

Q65	[M/J 2017/Q29]

In the short run, which policy measure would tend to reduce a country's balance of payments deficit but increase its inflation rate?

A a decrease in the level of import tariffs

B an appreciation of the country's currency

C an increase in the level of indirect taxes

D a reduction in government spending

Q66	[O/N 2017/Q27]

Which policy is most likely to raise the level of total demand in an economy?

A an increase in direct taxation matched by a reduction in indirect taxation

B a relaxation of import controls

C cuts in public expenditure matched by tax cuts

D devaluation of the currency

Q67	[O/N 2017/Q28]

The government cuts taxes and increases its spending in order to create jobs during a recession.

When will a resulting budget deficit be **least likely** to cause a permanent reduction in unemployment?

A when households expect higher inflation rates in the future

B when households spend their extra disposable incomes on domestic products

C when the government's extra spending is on new infra-structure projects

D when the government's extra spending is on the salaries of public sector workers

Q68	[O/N 2017/Q29]

In 2011, the global money supply, narrowly defined, rose 11% and broadly defined money increased roughly 8%, as central banks continued efforts to keep interest rates low.

What type of policy does this statement illustrate?

A contractionary fiscal

B contractionary monetary

C expansionary fiscal

D expansionary monetary

Q69	[O/N 2017/Q30]

Which policy measure would be most likely to reduce a developing economy's birth rate and its household saving ratio?

A an increase in student tuition fees

B a relaxation of immigration controls

C the introduction of a basic state pension

D the removal of tariffs on imported foodstuffs

Q70 | [M/J 2018/Q29]

The Consumer Prices Index (CPI) fell by 3% in a year. Unemployment was regarded as unacceptably high.

Which combination of policies would a government be most likely to adopt in such circumstances?

A an appreciation of the currency, together with an increase in the rate of interest

B increased government expenditure on education, together with an increase in taxes to pay for it

C increased indirect taxes, together with a depreciation in the exchange rate

D reduced income taxes, together with a cut in the rate of interest

Q71 | [M/J 2018/Q30]

Other things being equal, what is most likely to result from an increase in a country's interest rates?

A a capital inflow

B a depreciation of the currency

C an increase in consumption

D an increase in investment

Q72 | [O/N 2018/Q29]

The table identifies pairs of possible government aims.

In which case is achievement of aim 1 likely to be consistent with the achievement of aim 2?

	aim 1	aim 2
A	higher foreign exchange rate	lower rate of unemployment
B	low rate of inflation	balance of payments surplus
C	more even distribution of income	higher rate of saving
D	rapid economic growth	sustainable economic development

Q73 | [O/N 2018/Q30]

What is most likely to result from the discovery of oil reserves in a developing economy?

A a more equal distribution of income and wealth

B an increase in the competitiveness of commercial agriculture

C an increase in the exchange rate

D a reduction in the volume of imports of manufactured goods

Q74 | [M/J 2019/Q29]

What is **most** likely to increase in the short run following a rise in an economy's rate of inflation caused by a demand-side shock?

A the current account deficit on the balance of payments

B the price of government bonds

C the purchasing power of the currency

D the rate of unemployment

Q75 | **[M/J 2019/Q30]**

Which combination of policies is **most** likely to increase output?

	fiscal policy	monetary policy
A	decrease budget deficit	decrease interest rates
B	decrease budget deficit	increase interest rates
C	increase budget deficit	decrease interest rates
D	increase budget deficit	increase interest rates

Q76 | **[O/N 2019/Q28]**

In which exchange rate regime would the central bank of a country be best able to pursue an independent monetary policy to control the rate of inflation?

A a freely floating exchange rate system

B a system where the country's currency has a targeted value in relation to the US$

C a system where the central bank buys and sells foreign currency at a fixed rate

D where the country participates in a monetary union with other countries

Q77 | **[O/N 2019/Q30]**

Workers in poor countries are often less productive than workers using the same technology in rich countries.

What would be **most** likely to remedy this situation?

A an increase in the saving ratio in poor countries

B increased freedom of migration from poor countries to rich countries

C increased investment in education in poor countries

D the removal of trade barriers imposed by rich countries on imports from poor countries

A2 – ECONOMICS (9708)

MACRO

CHAPTER 5

Govt. Macroeconomic Intervention

ANSWERS

TOPIC 1: GOVT. MACROECONOMIC INTERVENTION

Q1	C

An increase in interest rate leads to an increase in savings and hence a decline in consumption. Option A is incorrect because higher interest rates attract investments from abroad hence a capital inflow and prevent money from going out of the country hence reduce capital outflow. Option B is incorrect because when interest rates are high the currency appreciates. Option D is incorrect because when interest rates are high investment falls.

Key Point: The interest rate and the currency always move in the same direction.

[M/J 2008/Q29]

Q2	B

Reducing the domestic interest rates will reduce the value of the currency which will lead to capital outflow. Hence the amount of interest to foreign holders will reduces as the net income sent abroad will decrease hence improving the current account. Option A is incorrect because the currency will depreciate. Option C is incorrect because when the currency is weak the currency drops. Option D is incorrect because this is not related to the question.

Common Mistake: Some students choose option D thinking that a fall interest rate leads to outflow. Although this is true however the question asks for improvement in the current account of the balance of payments, not the financial account.

[M/J 2008/Q30]

Q3	B

When the government is selling bonds the money supply falls hence increasing the interest rates.

Key Point:
1. When the government **sells bonds** the **money supply decreases**
2. When the government **buys bonds** the **money supply increases**.

[O/N 2008/Q19]

Q4	C

When a quota is placed the quantity is restricted. Hence the Chinese manufacturers will shift to producing higher value garments because this will enable them to earn more from given quantity of quota. Option A is incorrect because the margin will go up or stay the same as the prices will increase. Option B is incorrect because quota will increase prices and will cause inflation in the EU. Option D is incorrect because quota by one country will not result in a decrease in other countries.

[O/N 2008/Q28]

Q5	B

Recession is a time period when GDP decreases, there is high unemployment and prices are decreasing. Taxes will fall since both less direct and indirect taxes will be corrected. However the government expenditure will increase as the government would be spending more money on unemployment benefits.

[O/N 2008/Q29]

Q6	C

Lower interest rates encourage investment and an increase in rate of income tax reduces private consumption.

[O/N 2008/Q30]

Q7	A

Recession is a time period when GDP decreases, there is high unemployment and prices are decreasing. Similarly, a floating exchange rate is where the forces of demand supply will determine the exchange rate. A current account deficit means that the imports are greater than the exports.
— **Interest Rate (Decrease):** This needs to be decreased because this will lower the currency and hence will lead to an increase in exports. Improving both the current account and the recession.
— **Tax Rate (Unchanged):** If tax rates remain unchanged this will increase consumption and investment hence improving the growth potential and removing recession.

[M/J 2009/Q28]

Q8	D
A subsidy to the local producers gives a country an artificial cost advantage. Removal of subsidy to US cotton growers will erode the cost advantage. Option A is incorrect because if the currency of India falls they will have an added advantage in the cotton market. Option B is incorrect because any form of protectionism will lead to a less cost advantage. Option C is incorrect because a rise in wage of Brazilin cotton workers will increase the cost of production although it might be matched by an increase in productivity but it cannot be deduced which value outweighs the other. [M/J 2009/Q29]	

Q9	D
— **Gain in Tax Revenue:** The area of tax revenue is the difference between the two supply curves multiplied by the quantity, hence in this diagram it is shown by x + y — **Loss in Producer Surplus:** w + y (w is the loss of producer surplus that goes into the dead-weight loss and the y is the loss of original producer surplus) [M/J 2009/Q30]	

Q10	A
— **Domestic Demand (Increases):** When the interest rate is lowered it is cheaper for firms to investment more and consumers tend to consume more goods as it is cheaper to borrow. Hence the domestic demand increases. — **Export Demand (Increases):** The exchange rate decreases when the interest rates reduce. Hence this leads to cheaper exports, which leads to an increase in demand for exports. **Key Point:** The interest rate and exchange rate always move in the same direction. [O/N 2009/Q27]	

Q11	B
A current account deficit is when exports are lower than imports. The way to solve this problem is to increase exports and decrease imports. If a country devalues its currency it leads to an increase in exports as they become cheaper and decreases imports as they are now more expensive. Option A is incorrect if tariffs are removed it will increase imports. Option C is incorrect because if direct taxes are removed individuals will have more income and hence import more goods and services from abroad. If the indirect taxes are reduced it will make imports cheaper hence leading to current account getting worse off. [O/N 2009/Q28]	

Q12	A
Deflationary Fiscal Policy: Taxes [Increase] and Government Expenditure [Decrease] **Reflationary Monetary Policy:** Interest Rates [Decrease] **Key Point:** 1. Deflationary policies revolve around reducing prices and reflationary policies revolve around increasing prices 2. Fiscal Policy tools: Taxes and Government Expenditure 3. Monetary Policy tools: Interest Rate and Money Supply. [O/N 2009/Q29]	

Q13	D
TOT worsen when the average price of exports decrease and average price of imports increase. Low YED suggests stable demand and minimum variation in prices. Hence TOT remains low. In other words when the income of the people will go up they will still not increase the consumption of this product hence low demand and less increase in price of exports. Option A is incorrect because over-valued currencies tend to increase the export price hence improving the TOT. Option B & C are irrelevant. [M/J 2010/Q23]	

Q14	D
If a direct tax is imposed, it will reduce inflation and reduce the demand for imports as well. Option A will reduce the deficit but will cause inflation as exports will increase. Option B & C will reduce imports but will cause cost push inflation. [M/J 2010/Q26]	

Q15	A

If the government borrows from the central bank this will increase the money supply in the economy. Option B, C & D are incorrect because although this will generate finance for the government they will also reduce the consumption and investment in the economy. The greatest effect will always be when money supply in the economy increases.

[M/J 2010/Q28]

Q16	D

Progressive taxation works as an automatic stabilizer. Option A & B are incorrect because a higher MPS and MPT will reduce the value of the multiplier. Option C is incorrect because a higher tax rate reduces the inventive to work as now a greater percentage of the extra income earned will go into taxes.

[M/J 2010/Q29]

Q17	B

A fall in oil prices reduces the cost of production and hence causes economic growth and employment. Option A is incorrect because economic growth will increase. Option C is incorrect because cost push inflation will fall due to lower cost. Option D is incorrect because demand pull inflation will increase due to an increase in AD in the economy.

[O/N 2010/Q25]

Q18	C

Long-run economic growth requires higher output of capital goods. Thus consumer goods must be sacrificed in the short-run. Rising inflation, increase number of working-hours and inequalities can be avoided with suitable policies.

[O/N 2010/Q26]

Q19	D

Reducing imports will increase the AD hence causing demand-pull inflation. Option A is incorrect because an appreciation will lead to fall in demand-pull inflation as exports will decrease and imports will increase. Option B is incorrect because an increase in indirect taxes will cause cost-push inflation. Option C is incorrect because it will reduce investment hence reduce demand-pull inflation.

[O/N 2010/Q27]

Q20	D

Progressive taxation on its own reduces fluctuations in output. The statement in option D highlights progressive taxation this is where the tax yield varies more than proportionately with national income.

[O/N 2010/Q28]

Q21	D

Balance of Trade: This the difference between Exports – Imports. If a quota is introduced and the PED is inelastic it will not lead to a significant drop in the quantity demanded but a higher proportionate increase in prices. Hence the import bill will increase leading to a fall in BOT.

Terms of Trade: TOT is the [Export Price index / Import Price Index] x 100. Hence if a quota is placed it will restrict supply which will increase the import price and hence worsen the TOT.

[O/N 2010/Q30]

Q22	D

Only between 1980s to 1990s all three variables moved in the right direction.

1. The real GDP growth rate increased
2. Inflation rate slowed down
3. Unemployment Rate decreased.

[M/J 2011/Q22]

Q23	B

The government's borrowing requirements increased because in 2008 the government was in a budget surplus (Revenue > Expenditure) however in 2009 and 2010 the government's expenditure went up and the government was running a budget deficit (Revenue < Expenditure). Hence in order to fund the deficit the government needed to borrow money. Option A is incorrect because initially the government was running a surplus. Option C is incorrect because taxes are high when the economy is in a boom. Option D is incorrect because the yield from taxes continuously dropped.

[M/J 2011/Q24]

Q24	C

When interest rate are low the level of economic activity increases leading to higher incomes and ultimately imports which will have an adverse effect on a country's balance of payment. Option A is incorrect because when interest rates of a country declines the exchange rate falls with it. Option B is incorrect because a fall in exchange rate makes the country more competitive in the international market. Option D is incorrect because the outflow of capital is recorded in the financial account of the BOP not the current account.

Key Point: Interest rate and currency always moves in the same direction. **[M/J 2011/Q26]**

Q25	A

A restriction on the power of trade unions leads to an increase in supply. Option B is incorrect because it suggests fiscal policy. Option C is incorrect because it refers to monetary policy. Option D is incorrect because it refers to foreign trade policy. **[M/J 2011/Q27]**

Q26	C

Since the countries tend to maintain a stable currency hence they can't modify the interest rates. When the interest rate changes the currency changes. **[M/J 2011/Q28]**

Q27	B

If a tariff is imposed, it will make the imports more expensive hence forcing the foreign suppliers to reduce their prices otherwise they will lose their market share. Option A & D are incorrect because tariffs will result in both inefficient use of resources and prices of imported goods to rise. Option C is incorrect because tariffs do not make exports more competitive rather can make them less competitive if other countries retaliate. **[M/J 2011/Q29]**

Q28	B

A balanced budget indicates that Tax Revenue = Government Expenditure. For the budget to move into surplus the Tax Revenue > Government Expenditure.
W – This might increase the surplus if the percentage increase in tax revenue is greater than the percentage increase in government expenditure.
X – This will always increase the surplus.
Y – This will never increase the surplus.
Z – This might increase the surplus if the percentage decrease in tax revenue is smaller than the percentage decrease in government expenditure.

Hence options W, X and Z are correct options. **[O/N 2011/Q25]**

Q29	C

1. BOP Deficit = Exports < Imports
2. Budget Deficit = Revenue < Govt. Expenditure
3. Demand-Pull Inflation = Prices increasing
4. Unemployment

Cutting income taxes means the government is trying to use an expansionary fiscal policy. Hence Unemployment will decrease. Whereas all the other objective will further worsen. As lower taxes mean a greater budget deficit, Imports will increase as people will have more income and demand-pull inflation will increase. **[O/N 2011/Q27]**

Q30	A

A higher interest rate leads to an increase in the value of the currency of the country.

– Domestic Demand: Since people would tend to import more as it is cheaper now imports will increase and domestic demand will fall.
– Export Demand: Since currency is appreciated exports tend to become more expensive therefore their demand will drop.

Key Point: Interest rate and currency always moves in the same direction.

[O/N 2011/Q30]

Q31	C

Reduce current account surplus: Exports ↓ Imports ↑
Rate of Inflation: Reduce Cost-push or demand pull inflation.
Option C is correct because by removing tariffs imports will increase and cost-push inflation and demand pull inflation will both fall. Option A is incorrect as it will lead to higher inflation. Option B is incorrect higher direct taxes will fix inflation however will also decrease imports. Option D will increase cost-push inflation and will increase the deficits.

[M/J 2012/Q29]

Q32	D

A subsidy will first increase government expenditure then domestic output and finally incomes. However, its impact on current account of BOP cannot be predicted.

[M/J 2012/Q30]

Q33	B

Budget deficit as a percentage of GDP is considered the most appropriate measure to assess its size.

[O/N 2012/Q17]

Q34	A

When the government buys government securities it makes payments to the private sellers thus causes monev supply to increase.

Key Point:
1. When the government wants to increase money supply it buys back the bonds (Government securities).
2. When the government wants to decrease money supply it sell the bonds (Government securities).

[O/N 2012/Q20]

Q35	D

A deflationary fiscal policy is when the Taxes increase and Government spending is reduced with the aim to reduce prices. Usually regressive taxes are indirect taxes that impact the poor more than the rich. Hence since low income household spend a large proportion of their income the MPC in the economy can be reduced more significantly through this method.

[O/N 2012/Q29]

Q36	D

A quota will increase prices of the goods in EU. Hence Option A is incorrect. Option B is incorrect because higher prices lead to greater cost push inflation hence increasing EU inflation rate. Option C is incorrect because a quota is placed there is no benefit of producing lower quality products as Brazil is still better of producing high value items. Hence some factories in Brazil will close down due to lack of sales.

Common Mistake: Some students choose Option C thinking that producing lower-value garments would solve the problem. Students needed to read the question properly. EU increased a quota that is physical limitation the price of the good had nothing to do with it. If it was tariff then option C would have made sense.

[M/J 2013/Q26]

Q37	C

When interest rates go up it is expensive for consumers to buy goods and services since borrowing is difficult hence the consumption decreases. Option A is incorrect because when interest goes up there is a capital inflow in the country. Option B is incorrect because when interest rates go up the exchange rate goes up with it. Option D is incorrect because when interest rates increase the investment falls. **[M/J 2013/Q27]**

Q38	D

Supply side policies primarily target efficient use of resources in order to increase potential (Long-term growth). **[M/J 2013/Q28]**

Q39	B

Tax Revenue [Decreases]: Recession causes money incomes and tax revenues to fall as income and goods would not be purchased now.

Government Expenditure [Increases]: Since people will not have employment the government would need to spend more on employment. **[M/J 2013/Q30]**

Q40	A

Dirty float exchange rate also known as managed float allows the exchange rate to fluctuate within certain limits, therefore, changes in exchange rate within the limits suggests depreciation and outside the limits suggests use of reserves by the government to keep a check on the currency.

Key Point:
1. Appreciation and Depreciation and is always in Free Float and Revaluation and Devaluation is in fixed exchange rate using reserves.
2. In Dirty Float (Managed Float) both can happen. **[O/N 2013/Q26]**

Q41	D

Reflationary Fiscal policy aims to increase prices in the economy. Since fiscal policy only impacts the aggregate demand (AD) the government would try to increase the AD. Either by reducing taxes or increasing the government spending. Hence option D is incorrect. Option A & B apply to monetary policy. Option C is part of fiscal policy but is part of the deflationary fiscal policy. **[O/N 2013/Q27]**

Q42	B

Interest Rates (Decrease): The government will decrease the interest rates and when interest rates decrease the investment increases. Furthermore, always remember that interest rates and exchange rates always move in the same direction hence when interest rates will decrease this will depreciate the currency hence leading to greater exports and lower imports.

Rate of VAT (Increase): VAT is an indirect tax an increase in VAT discourages local consumers to but the product. **[O/N 2013/Q28]**

Q43	D

Average Standard of Living: Increasing output is likely to improve living standard as more output the more the choice the consumers have and hence leading to greater standard of living.

.evel of Unemployment: *Unemployment is affected when actual growth rate is different from ›otential growth rate. This steady growth in line with long-run productivity suggests no change in nemployment.* **[O/N 2013/Q29]**

Q44	B

Impact on Household Savings Year 1: The savings will decrease as when indirect taxes decrease goods get cheaper and people then to spend more than they save.

Impact on Household Savings Year 2: Since direct taxes increase the income level falls and consumption decreases hence the savings increase.

[O/N 2013/Q30]

Q45	D

Always remember interest rates and exchange rates move in the same direction. Hence when interest rates increases exchange rates increase as well. Option A is incorrect because sales revenue will decrease as people won't be able to borrow to purchase goods and services. Option B is incorrect because when interest rates increases investment falls. Option C is incorrect because when interest rates go up more people invest in the country and hence there is a net capital inflow not outflow.

[M/J 2014/Q28]

Q46	A

When the pound decreases it will cause the value of assets in UK to fall in foreign currency. Hence more people would be interested in moving money to the UK as it is cheaper for them to buy assets. Option B is incorrect because UK residents will reduce holidays as it is expensive for them. Option C is incorrect as UK residents would prefer to apply to local universities as North American universities will get too expensive. Option D is incorrect as people would not prefer to work in the UK as the value of wages would be low.

[M/J 2014/Q29]

Q47	B

Quantitative easing by purchasing government bonds means increase in money supply.

Interest Rates (Fall): When money supply increases the interest rates fall

Aggregate Expenditure (Rise): A fall in interest rates increase the aggregate expenditure as Investment and consumption will increase.

[O/N 2014/Q21]

Q48	C

Reflationary Fiscal Policy: Taxes ↓ Government Expenditure ↑
Deflationary Monetary Policy: Interest Rates ↑ Money Supply ↓

Key Point:
1. Reflationary policies aim to increase prices and Deflationary policies aim to reduce prices.

[O/N 2014/Q27]

Q49	D

Only between 1980s to 1990s all three variables moved in the right direction.
1. The real GDP growth rate increased
2. Inflation rate slowed down
3. Unemployment Rate decreased.

[O/N 2014/Q28]

Q50	C

When the interest rates decrease the exchange rate depreciates. Lower interest rates would lead to economic activity due to more investment and increase consumer incomes and hence higher imports in the future. Option A is wrong because the currency will depreciate. Option B is wrong as the goods will become more competitive as exports will become cheaper. Option D is incorrect because although there would be an outflow of capital, outflow of capital is recorded in the financial account not the current account.

[O/N 2014/Q29]

Q51	A

If the inflation target is increased this will force to government to deploy a reflationary monetary policy. The government would need to reduce the interest rates and as a reduce the exchange rate will fall as well as they follow the same trend. [O/N 2014/Q30]

Q52	B

Crowding Out Effect: When the government borrows more the demand for loanable funds increases which increases the demand for loans and hence higher interest rates. This causes the private investment expenditure to fall.

Key Point: Crowding out effect only happens when there are is full employment. [M/J 2015/Q28]

Q53	A

– The term demand shock suggests cyclical changes.
– A decrease in national income will result in a decrease in tax revenue leading to a budget deficit. [M/J 2015/Q30]

Q54	C

Fiscal Deficit = Tax Revenue < Government Spending. A decrease in private sector investment would force the government to make investments to keep the AD stable. Option A will lead to an increase in demand. Option B will lead to more spending and people won't save in bonds. Option D will lead to an increase in AD. [O/N 2015/Q24]

Q55	D

Impact on Trade Balance (Worsen): An increase in competition will increase the demand for imports and lowering the demand for exports hence worsen the trade balance.

Impact on Rate of Inflation (Reduce): When imports increase the AD falls hence the rate of inflation

Impact of Unemployment Rate (Increase): When AD falls the unemployment in the country increases. [O/N 2015/Q26]

Q56	A

Borrowing from central bank increases the money supply in the entire economy and therefore reduces interest rate that is likely to increase investment for a higher expansionary effect. Option B, C & D are likely to discourage investments that can curtail expansion therefore these options are not correct. [O/N 2015/Q27]

Q57	D

1. Increase in bank deposit is 50 billion and
2. Credit Multiplier = 1 / Reserve Ratio = 1/0.10 = 10

Hence the increase in money supply would be 50 billion x 10 = 500 billion.
Key Point: Always remember the sale of non-bank private sector is never part of this calculation [O/N 2015/Q28]

Q58	B

A budget deficit is achieved when Tax↓ Government Spending↑. No change in tax rate will reduce tax revenue in recession and with the same level of expenditure the government will have to run a budget deficit. [M/J 2016/Q27]

Q59	D

In order to pay unemployment benefits to an increasing number of unemployed the government will have to increase tax burden on those who are employed. Option A is irrelevant. Option B is incorrect because living standards will fall. Option C is incorrect because in times of unemployment the wages decrease as there is excess supply of workers. [M/J 2016/Q28]

Q60	D
The first delay will always come when deciding the policy, as after the policy is decided only then can other delays will occur. [O/N 2016/Q27]	

Q61	D
Contractionary monetary policy aims to reduce prices, reduce employment and slows down economic growth. In this the government will increase interest rates, reduce money supply and increase exchange rates. By selling bonds in the open market the government reduces the money supply. **Key Point:** Whenever the government sells bonds it reduces the money supply and whenever the government buys bonds it increases the money supply. [O/N 2016/Q29]	

Q62	B
The term public finances refers to fiscal policy. [O/N 2016/Q30]	

Q63	D
By giving a subsidy to establish a chain of tourist hotels will the economy achieve diversification. Option A is incorrect because it relates to the monetary policy. Option B is incorrect because it is a supply side measure. Option C is incorrect because spending on existing industry will not help to diversification. [M/J 2017/Q27]	

Q64	C
In order to deal with demand, pull-inflation the government will: **Interest Rate:** They will increase because interest rates and exchange rates always follow the same direction. In order to reduce inflation, the currency always needs to be revalued and appreciated. **Inflation Rate:** Due to an increase in interest rate the inflation will decline. **Current Account Balance:** Since the currency is strong it will make exports expensive and imports cheaper therefore reduce the currency account balance. [M/J 2017/Q28]	

Q65	C
An increase in indirect taxes will lead to inflation because now raw materials becoming more expensive therefore causes inflation. However, since tariffs are type of an indirect tax they will make imports more expensive hence reduces the current account deficit. Option A & B will increase the deficit by making imports cheaper. Option D will lead to a fall in inflation. [M/J 2017/Q29]	

Q66	D
By devaluing the currency the exports will increase and the imports will likely drop hence (X) increases and (M) decreases which shifts the AD outwards. Option A, B & C will all lead to an drop in AD. [O/N 2017/Q27]	

Q67	A
Higher spending raises AD and if firms prefer to increase prices of goods instead of hiring more people and raising output, unemployment is less likely to fall. All other options are likely to increase output and hence employment. [O/N 2017/Q28]	