



## Worksheet 3: Identifying correct and incorrect statements answers

- 1 An outward shift in production possibility curves (PPC) may initially raise unemployment.

Correct ☒ Incorrect ☐

*An outward shift in PPC raises the potential to produce and may initially raise unemployment in case this additional production capacity is not brought into use instantly.*

- 2 Buying shares of a profitable company is considered to be an investment and raises Aggregate Demand (AD).

Correct ☐ Incorrect ☒

*Investment, in macroeconomics, involves new fixed capital formation, such as machines and equipment, increase in stocks of raw materials or finished goods and new constructions. Since the purchase of shares does not instantly raise the demand for goods and services, it is not investment and cannot be considered a component of AD.*

- 3 A falling inflation rate does not mean that the price level is falling as well.

Correct ☒ Incorrect ☐

*A falling inflation rate is disinflation, which means that the price level will continue to rise at a falling rate. The price level will fall only when the inflation rate is negative.*

- 4 There is a higher number of people in employment in a country where the unemployment rate is low compared to a country with a high unemployment rate.

Correct ☐ Incorrect ☒

*Unemployment is given as a percentage of labour force. A higher unemployment rate does not necessarily mean a higher number of unemployed or lower number of employed people, as it will depend on the size of the labour force.*

- 5 For the price level to be stable, the rate of inflation must be stable.

Correct ☐ Incorrect ☒

*For the price level to be stable, the inflation rate should be zero. A stable inflation rate means the price level continues to rise at a constant/stable rate.*

- 6 All goods provided by the government are public goods.

Correct ☐ Incorrect ☒

*The government not only provides public goods but also many private goods such as roads, public parks, hospitals, and schools. Some of the private goods provided by the government are merit goods.*

- 7 Public goods must only be provided by the government.

Correct ☒ Incorrect ☐

*Public goods, such as defence and streetlights, are non-excludable and non-rival. Since it is not possible to restrict their use only to those who pay a price, a price for their provision cannot be charged and no profits can be made. Therefore, a profit maximizing private sector firm will not produce these goods, making their provision the sole responsibility of the government.*



- 8 Roads and motorways are examples of public goods; therefore, they must be provided by the government.

Correct ☐ Incorrect ☒

*Roads and motorways are not public goods. They are excludable and those who do not pay a toll tax can be stopped from using the road. They are also rivals, as there could be road congestion during rush hours, forcing an average commuter to spend more time in travel than they normally would.*

- 9 Higher income taxes force consumers to consume less and save more.

Correct ☐ Incorrect ☒

*Higher income taxes reduce disposable income and force consumers to consume as well as to save less.*

- 10 A product has price elastic demand (PED) when a rise in its price causes a fall in its quantity demanded.

Correct ☐ Incorrect ☒

*A rise in price always causes a fall in the quantity demanded of a product, irrespective of PED. However, the fall in quantity demanded is proportionately higher for goods with price elastic demand.*

- 11 A perfectly competitive firm maximises profits where its sale price equals the marginal cost of the last unit produced.

Correct ☒ Incorrect ☐

*For a perfectly competitive firm, sale price equals marginal revenues.*

- 12 The higher the Gini Coefficient, the greater would be the income inequalities.

Correct ☒ Incorrect ☐

*Gini coefficient is the ratio between the area of the Lorenz curve and the entire area below the line of complete equality. The higher the Lorenz curve, the higher the Gini coefficient would be and the greater the income disparities.*

- 13 According to the law of diminishing returns, adding more and more variable inputs will result in falling output.

Correct ☐ Incorrect ☒

*Adding more and more variable inputs, such as labour, to a given quantity of fixed input, such as capital, initially raises the output at an increasing rate (increasing returns), but later at a decreasing rate (decreasing returns). Output rises throughout, but it is the rate at which it rises that determines whether the returns are rising or falling.*



- 14 Lowering income taxes and lowering interest rates are demand side tools as well as supply side tools.

Correct ☒

Incorrect ☐

*Lowering income taxes raises the disposable income and encourages consumers and investors to spend more, raising the Aggregate Demand (AD). Therefore, they are a demand side tool. Lowering income taxes also promotes incentives to work and enterprise, so they are a supply side tool as well.*

*Lower interest rates reduce the cost of borrowing and reward for saving, so they discourage saving and induce borrowing and spending, resulting in higher AD. Hence, lower interest rates are a demand side tool. Lower interest rates encourage more borrowing to invest in modern and more sophisticated technology and capital equipment. Such investments may raise the production potential of an economy, causing a rightward shift in Aggregate Supply (AS), therefore they are a supply side tool as well.*

- 15 Rising marginal cost leads to a rise in average cost.

Correct ☐

Incorrect ☒

*Average cost continues to fall, as long as the marginal cost is below the average cost. The average cost rises only when the marginal cost is above it.*

- 16 A comparatively higher inflation rate in country X than country Y necessarily means that the price level in country X is higher.

Correct ☐

Incorrect ☒

*A higher inflation rate means prices rise faster, but it does not necessarily mean that goods are more expensive in the country with a comparatively higher inflation rate.*

- 17 Minimum price should be imposed on demerit goods and maximum prices should be imposed on merit goods to change their consumption to the optimal level.

Correct ☒

Incorrect ☐

*An effective minimum price is set above the market equilibrium and discourages the consumption of demerit goods by making them expensive.*

*An effective maximum price is set below the market equilibrium and encourages the consumption of merit goods by making them more affordable. However, some suppliers refuse to sell the goods at lower prices, resulting in increased shortages.*

- 18 According to Keynesians, a market economy is inherently unstable, and the government must play a stabilising role through monetary and fiscal policies.

Correct ☒

Incorrect ☐

*Keynesian economists believe that an active government role is essential for a stable economy.*

- 19 A business should shut down immediately if it is incurring a loss.

Correct ☐

Incorrect ☒

*A business making losses may continue to operate in the short run, as long as its revenues exceeds the variable cost and contributes to the fixed cost.*



- 20 Persuasive advertisement can help prevent a market failure.

Correct ☒ Incorrect ☐

*Persuasive advertisement may help overcome information failure and encourage people to raise the consumption of merit goods and reduce the consumption of demerit goods.*

- 21 Tax revenues rise when tax rates are raised.

Correct ☐ Incorrect ☒

*Higher tax rates may slow down the economic activity and may also encourage people to evade taxes. This may result in lower tax revenues.*

- 22 Increased government expenditures financed by borrowing from the central bank raises the money supply by an amount higher than the increase in government expenditures.

Correct ☒ Incorrect ☐

*Increased government expenditures financed by borrowing from the central bank will raise the liquidity available with commercial banks, allowing them to create credit money. Because of the monetary multiplier, the impact on money supply will be larger than the increase in government spending.*

- 23 Decreasing the period when the unemployed are eligible for welfare payments will help reduce the natural rate of unemployment.

Correct ☒ Incorrect ☐

*Decreasing the period for welfare payments will compel workers to put in more effort to find a job, leading to reduced frictional unemployment (frictional unemployment is a part of natural unemployment).*

- 24 According to Phillips curve, it is possible to achieve low inflation and high economic growth at the same time.

Correct ☐ Incorrect ☒

*According to Phillips curve, there is an inverse relationship between the rate of unemployment and the rate of inflation. Higher economic growth would mean lower unemployment and lower unemployment may trigger inflation.*

- 25 The exchange rate should be raised, and the interest rate should be decreased to reduce unemployment.

Correct ☐ Incorrect ☒

*A higher exchange rate makes exports expensive and imports cheaper and may reduce net exports and AD, leading to higher unemployment. Lower interest rates, however, may help reduce unemployment by raising AD.*