ANSWERS TO MULTIPLE CHOICE QUESTIONS

MULTIPLE CHOICE - 30 QUESTIONS

1. What is the most basic economic issue for all societies?

A Scarcity

B Taxation

C Inflation

D Recession

1. Cigarettes have been used as money in exceptional circumstances.

What is the most likely reason that they are not acceptable as money in normal circumstances

A Cigarettes lack durability

B Cigarettes lack intrinsic value

C Cigarettes lack portability

D Cigarettes lack uniformity

1. Tina has enough money to buy either a weave or to go to a show with her friends. In economics, what is the choice that Tina “gives up” called?

A Positive cost

B Negative cost

C Opportunity cost

D. Marginal cost

1. What is the main idea behind the study of economics?

A Monetary policy

B Efficiency of production

C Allocation of scarce resources

D Business decisions

1. In every economic system, what must people choose to do?

A Satisfy all the wants of their society

B Make the best use of scarce resources

C Create an equal distribution of income

D Save money to reduce the national debt

1. In a market economy, what determines the price and quantity of most goods produced?

A Substitute goods

B Supply and demand

C Economic policies

D Quality of goods

1. What is the most likely to happen when consumers want to buy more bicycles than the store has available for sale?

A Profit on bicycle sales will be smaller.

B Price of the bicycle will increase.

C Manufacturers will stop making it.

D Stores will make a different model.

1. Assume the government subsidizes the production of a good every year. Which of these would be the most likely result if that government stopped the subsidies?

A Increase in the number of producers

B Better selection of products

C Increase in the price of products

D Better wages for workers

1. Which factor will decrease the demand for a product?

A Increased popularity of a product

B A decrease in the number of buyers

C A decrease in the price of a complementary good

D An increase in the price of a substitute good

1. Wanderer’s tickets are sold out every year in spite of price increases. Therefore, Wanderer’s tickets are which of the following?

A Elastic

B Equilibrium

C Inelastic

D Trade off

1. Which financial instrument is the most “Liquid?”

A Checks

B Bonds

C Cash

D Savings accounts

Study the table below and then answer the following question.

TAX TABLE

|  |  |
| --- | --- |
| **Income** | **Percentage Tax Rate** |
| K0 – K20,000 | 0 |
| K20,001 – K25,000 | 15 |
| K25,001 and above | 30 |

1. What of the following is described in the above tax table?

A A progressive income tax

B A flat tax on income

C A regressive income tax

D A value added tax on income

1. Which of the following would result in a decrease in consumer spending?

A Increasing income taxes

B Decreasing the reserve requirement

C Increasing government spending

D Decreasing the interest rate

1. Which of these best reflects how the government attempts to manage the economy through fiscal policy?

A Controlling interest rates

B Controlling the money supply

C Taxing and spending

D Buying and selling securities

1. What happens when a country’s money supply increases faster than the goods and services it produces?

A Inflation

B Unemployment

C Equilibrium

D Stability

1. Which of these does the Gross Domestic Product (GDP) represent?

A The amount of reserve funds that banks are required to hold

B The rate of interest charged on reserve funds lent to banks

C The total value of finished goods and services produced in a year

D The change in the average price of consumer goods and services

1. Which of the following government actions is designed to decrease inflation?

A Hire more government employees

B Decrease federal income tax

C Reduce the money supply

D Increase government spending

Read the excerpt below, then answer the question which follows.

“If a foreign country can supply us with a [product] cheaper than we ourselves can make it, better buy it [from] them…”

-Adam Smith*, The Wealth of Nations,* 1776

1. Which of these is an economic benefit of tariffs on goods imported into Malawi?

A Prices of goods made in Malawi will decrease.

B Malawian businesses will attract more imports from other nations.

C Malawian businesses will have less competition from foreign companies.

D Competition among producers in Malawi will remain the same.

1. When a nation imports more than it exports, economists say it has which of the following?

A A trade surplus

B A balance of trade

C A trade deficit

D A national debt

1. If Great Britain has a comparative advantage over France in the production of cars, which of the following is true?

A Britain and France should not trade.

B Britain should export cars to France.

C France should export cars to Britain.

D Neither Britain or France will gain from trade.

**SECTION B: 5 QUESTIONS OF 20 MARKS EACH**

QUESTION 1

1. Give four (4) roles of government (**4 marks**)

Page 12

Regulating natural monopolies 1

Providing public goods 1

Dealing with externalities 1

Ensuring full employment, price stability and economic growth 1

Correcting market failure/establishing & enforcing the rules 1

Ensuring more equitable distribution of income 1

1. Provide four (4) reasons why government would encourage protectionism (**4 marks**)

Page 150

Saves and promotes domestic jobs although the costs outweigh the benefits 1

Infant industries – a subsidy is less costly 1

Natural defence- ignores stockpiling & purchases from friendly countries 1

Fair trade – unlikely to force other countries to lower their trade barriers 1

1. Explain how VAT would affect the supply curve. Include a diagram to show demand and supply before the tax and after the tax. Clearly indicate government revenue ( **12 marks**)

Page 100-101

6 marks for correctly drawn and labeled diagram

Causes a pivotal shift in the producers supply curve 1

Rise in equilibrium price 1

Fall in the quantity traded 1

Supply curve shifts to the left 1

Lines diverge because VAT is an ad valorem tax - % of selling price of the good or service 1

Hence the higher the price, the higher the amount of tax paid 1

Danger that indirect taxes damage specific industries, encourages cross border shopping and job losses 1

QUESTION 2

1. What is hyperinflation? (**5 marks**)

Page 120

Inflation that is high or out of control 1

Example of Zimbabwe or Germany 1

Prices increase rapidly as currency losses value 1

Value of money becomes worthless 1

People lose all confidence in money as a store of value 1

Often drastic action is needed to stabilize the economy 1

This leads to political & social instability 1

IMF is often brought into the process 1

1. Why is it important for policymakers to make credible announcements regarding their monetary policies? (**15 marks**)

P 118-119

If private agents believe gov is committed to lowering inflation, they will anticipate prices to fall (adaptive expectations) 1

If an employee expects prices to increase, he will negotiate a contract with a high wage to match future prices 1

Hence expectation of lower wages is reflected in wage setting behavior between employees and employers 1

Since wages are lower there is no demand pull inflation because employees are receiving a smaller wage 1

And no cost pull inflation because employers are paying out less in wages 1

In order to achieve this lower inflation agents must believe the announcements will reflect actual future policy 1

If an announcement about low inflation targets isn’t believed, wage setting will anticipate higher inflation and wages 1 and inflation will rise 1

If policymakers believe agents anticipate low inflation, they have an incentive to adopt an expansionary monetary policy (marginal benefit of increasing economic output outweighs marginal cost of inflation 1

Assuming agents are rational, they’ll know that policymakers have the incentive 1

Therefore agents expect high inflation 1

The expectation is fulfilled through adaptive expectation (wage setting)1

Which will cause high inflation 1 without benefit of increased output 1

Unless credible announcements are made, expansionary monetary policy will fail 1

Announcements can be made credible by establishing an independent central bank with low inflation targets 1

Hence agents will believe it because it is set by an independent body 1

Central banks can be given incentives to meet targets 1

A policymaker with a reputation for low inflation can make the announcements 1

QUESTION 3

1. What is the type of exchange rate system used in Malawi? Describe four (4) characteristics of this type of exchange rate system. (**5 marks**)

Page 159

Floating ER 1

ER is determined solely by demand and supply 1

Trade flows & capital flows are main factors affecting ER

In the long run, macro performance drives the value of the currency 1

No official target is set by Gov 1

Rare for pure free floating ER, Gov almost always manages ER 1

1. Describe four (4) fundamental factors that drive an exchange rate (**8 marks**)

P162

Interest rates (1) when i is high relative to elsewhere, it attracts inflows of money1 The interest rate differential boosts demand for the currency and it can appreciate 1

Economic Growth 1 countries in recession often have a weakening currency 1

Vice versa 1

Inflation 1 countries with higher than average inflation see their ER fall in the longrun 1

When inflation is high, a country becomes less competitive causing less exports 1 and a rise in imports 1 a fall in the currency may be needed to restore a country’s competitiveness 1

BOP 1 exporting represents a demand for domestic currency from importers 1 vice versa 1 if a country is running a trade surplus, there is large demand for the currency and the currency should appreciate 1 vice versa 1

Market Speculators 1 special factors e.g political events, changing commodity prices can influence currency 1 when speculators decide that a currency will fall in value, they sell it and buy ones they anticipate will rise 1

1. With the aid of a diagram, describe the effect of a reduction in exports on the demand for Kwachas in a floating exchange rate system (**7 marks**)

P158

4 marks for correctly labeled diagram

Depreciation of value of Kwacha 1

Demand curve shifts left 1

Fall in demand for Kwacha 1

QUESTION 4

One aim of government economic policies is balance of payments stability. Whether a country has a deficit or a surplus in its current account is influenced by a number of factors, including its exchange rate and interest rates.

1. Describe three aims of government economic policy, other than balance of payments stability. ( **6 marks**)

a government will seek to achieve as low unemployment 1 as possible to ensure it is making best use of resources 1

price stability 1 can create certainty and encourage investment 1

economic growth 1 has the potential to raise living standards 1

a redistribution of income 1 from the rich to the poor may reduce poverty 1

1. Explain why a country may have a trade in goods (visible trade) deficit but still have a current account surplus in its balance of payments (**4 marks**)

P152

Another component/components of the current account must have a surplus1

The surplus must be greater than the deficit on the trade in goods balance 1

Reference to another component/components i.e. trade in services (invisible balance) or capital account income and current transfers 1

Country is importing more goods than it is exporting 1

1. Discuss five (5) causes of interest rates (**10 marks**)

P86

Deferred consumption 1 when money is loaned, lender delays spending on consumption goods 1 time preference theory states that people prefer goods now than later 1 in a free market interest rates will be positive1

Inflationary expectations 1 borrowers need to be compensated for inflation 1

Alternative investments 1 different investments effectively compete for funds 1

Risks of investments 1 risk premium is necessary to compensate for borrower going bankrupt, absconding or otherwise defaulting 1

Liquidity preference 1 preference for resources to be available in a form that can be immediately exchanged 1

Taxes 1 compensation because gains from interest may be subject to taxes 1

QUESTION 5

Malawi is under the Extended Credit Facility (ECF) programme under the International Monetary Fund (IMF).

1. Explain the purpose of the IMF and why it was established (**5 marks**)

P164

Established to promote international financial stability 1

lends to member countries with BOP problems 1

to restore short run stability 1

and support long term adjustment and reform policies aimed at correcting the underlying problems 1

role is evolving 1

IMF insists on Structural Adjustment Programmes (SAPs) as a condition 1

1. Discuss the World Bank (WB) (**15 marks**)

P166-167

Owned by 181 member countries 1

Promotes institutional, structural & social development 1

By providing low interest loans for domestic investment projects 1

And technical assistance 1

Comprises several institutions 1

Main ones are International Finance Corporation 1 finances private sector developments 1 helps private companies raise finance in international finance markets 1 offers advice 1

And International Development Association (IDA) 1 provides long term loans at zero interest 1 to the poorest countries for projects that address people’s basic needs e.g education, health, water and sanitation 1

Raises funds on the world’s financial markets 1

Uses a comprehensive development framework (CDF) which sets out country driven mechanisms for development stakeholders to reach consensus 1

Poverty reduction strategy (PRSP) translates CDF into action 1

Country assistance strategy (CAS) sets out the level of WB financial & technical assistance for a country 1

Advocates argue loans and aid alone do not guarantee growth 1

Pricing 1 good governance 1 ensuring macro stability 1 and opening up trade 1 and involving all stakeholders is essential 1

Critics argue that one size fits all strategy does not take into account individual countries context 1 the burden of structural adjustment involved falls disproportionately on the most vulnerable 1 poverty is still widespread 1 aid rather than loans or cancelling third world debt is more effective than loans 1.

QUESTION 6

1. Discuss the income elasticity of demand for luxury goods (**4 marks**)

P32

Income elasticity of demand is greater than 1

Demand rises more than proportionate to a change in income 1

Because we can do without luxuries, when incomes are rising strongly, demand for luxury goods will grow 1

Vice versa 1

Definition of luxury good 1

1. Explain the concept of price elasticity of supply (**5 marks**)

P27-28

Measures the relationship between change in quantity supplied and change in price 1

Percentage change in quantity supplied /percentage change in price 1

Value is positive 1

because of the positive relationship between price and quantity supplied 1

Increase in price is likely to increase the quantity supplied to the market 1

Vice versa 1

1. List the five (5) factors which determine the value of price elasticity of demand (**5 marks**)

P26

Availability and number of close substitutes with the market 1

Luxuries and necessities 1

Percentage of income spent on a good 1

Habit forming goods 1

Time period under construction 1

1. Explain perfect elasticity of supply. Include a diagram (**6 marks**)

P29

4 marks for clearly labeled diagram

A firm can supply any amount at the same price 1

Occurs when a firm can supply at a constant cost per unit and has no capacity limits to production 1

A change in demand alters equilibrium quantity but not the market clearing price 1