



Answers and Comments

MCQ 1. Monetary and fiscal policy

Which of the following best reflects the policy differences of two economic schools of thought?

- A. Classical economists and Keynesians both agree that long-run neutrality of money justifies a rules-based monetary framework to guide rational expectations and reduce policy uncertainty.
- B. Neoclassical economists argue that economic agents respond quickly to incentives, implying that policy should focus on ensuring price flexibility and efficient market signals; Keynesian economists, in contrast, see wages and prices as sticky, justifying short-run fiscal intervention to restore output and employment.
- C. Keynesian and Marxist economists share a belief in market efficiency, but differ on whether government intervention should be rule-based or discretionary.
- D. Neoclassical economists and Keynesian economists both support automatic stabilizers as the preferred tool of macroeconomic policy, but differ on whether such stabilizers should be tied to inflation targets.

Correct answer: B

Explanation: Neoclassical economists emphasize flexible prices and rational responses to incentives, while Keynesians focus on sticky prices and advocate short-run fiscal intervention to stabilize output and employment.

MCQ 2. Monetary and fiscal policy

Consider a closed economy where the GDP is given by $Y = C + I + G$ and consumption is a linear function of disposable income with the Marginal Propensity to Consume $MPC = 0.8$. The current GDP is $Y = \$500$. The only source of revenue for the government is taxes and the tax is a flat 22% of income. The government wants to increase G by \$20. It wants to finance it partially through the tax increase and plans to increase the tax to 25%. It will finance the rest by borrowing. Assuming the investment will not change, what will be the new GDP?

- A. \$520
- B. \$525
- C. \$540
- D. \$550

Correct answer: A

Explanation: Before the change in policy: $500 = C_0 + 0.8 \times 500 \times (1 - 0.22) + I + G$, where C_0 is the fixed part of consumption. Thus, $C_0 + I + G = 188$.

After the change in policy: $Y = 188 + 20 + 0.8 \times Y \times (1 - 0.25)$. Expressing G , we get 520.

MCQ 3. Currencies, currency unions, exchange rates, and Interest rates parity

From 2016 to 2018, the European Union experienced a rise in its capital and financial account surplus within its balance of payments. Assuming all other factors remain unchanged, which of the following is the most probable explanation for this growth in the EU's capital and financial account surplus?

- A. A rise in foreign direct investment (FDI) and portfolio investments coming into the EU.
- B. An increase in EU exports' value and a decrease in EU imports' value.
- C. A rise in public sector borrowing alongside an increase in public sector debt.
- D. A higher inflow of funds into the primary income part of the EU's balance of payments.

Correct answer: A

Explanation: A capital and financial account surplus indicates more capital is flowing into the EU than out, typically through FDI and portfolio investment inflows.

MCQ 4. Labor market (microeconomics)

Being a refuse collector might be an unpleasant job for many people. Instead of compensating these workers with higher wages in order to attract a sufficient number of employees, in many countries the opposite pattern is observed, i.e. the job is still poorly paid. What is most likely the reason for this observation?

- A. There is a high rate of union membership among these workers.
- B. There is a large supply of labor for this type of unskilled jobs.
- C. There is high demand for staff in busy urban areas.
- D. The number of working days per year is higher compared to other professions because there are few holidays.

Correct answer: B

Explanation: A large supply of labor for low-skill jobs drives down wages, even if the work is unpleasant.

MCQ 5. Market failures (externalities, public goods, asymmetric information)

Which of the following scenarios represents an effective solution designed to address an adverse selection problem?

- A. Insurance companies require deductibles from policyholders to reduce unnecessary medical claims and ensure cost-sharing.
- B. Universities implement comprehensive proctored examination systems to prevent academic dishonesty and maintain educational integrity.
- C. Insurance companies require thorough medical examinations before issuing health policies to assess pre-existing conditions.
- D. Employers offer performance-based bonus structures tied to measurable outcomes to incentivize productive behavior.

Correct answer: C

Explanation: Adverse selection arises from asymmetric information; requiring medical exams reveals hidden health information, reducing this asymmetry.

MCQ 6. Specialization and gains from trade

Two countries, Robinsonland and Crusoestan, both produce wine and cloth. The table below shows the amount of land and capital required to produce one unit of each good:

Good	Land per unit	Capital per unit
Wine	4	1
Cloth	1	4

Robinsonland has 100 units of land and 100 units of capital. Crusoestan has 30 units of land and 90 units of capital.

Which of the following is correct?

- A. Robinsonland has absolute advantage in both goods.
- B. Crusoestan has a comparative advantage in cloth.
- C. If they specialize and trade one unit of wine for four units of cloth, both countries will be at least as well off as under autarky.
- D. Production under autarky is better than production under free trade for both countries.

Correct answer: C

Explanation: Specialization based on comparative advantage and trading at mutually beneficial terms ensures both countries are at least as well off as under autarky. There are no absolute advantages provided that the technologies are the same (same resources → same production). No claim can be made about comparative advantages provided that the country production frontiers are kinked (at different parts, different resource constraints are binding) and in different parts of them different countries have higher opportunity costs of a good (and it may well be the case that in autarkies they have the same opportunity costs).

MCQ 7. Economic Fluctuations and crises

Two countries are experiencing economic downturns:

Economic Indicator	Country A		Country B	
	Before	After	Before	After
Real GDP (billions)	\$500	\$480	\$800	\$776
Unemployment Rate	5%	12%	4%	10%
Price Level	100	85	100	120

- A. Both countries are experiencing demand-side recessions.
- B. Country A is experiencing a demand-side recession, Country B a supply-side recession.
- C. Country A is experiencing a supply-side recession, Country B a demand-side recession.
- D. Both countries are experiencing supply-side recessions.

Correct answer: B

Explanation: Country A's falling GDP and price level suggest a demand-side recession; Country B's rising price level alongside falling output and rising unemployment indicate a supply-side shock.

MCQ 8. Institutions and Inequality

Consider two economies, A and B, with the following income distributions among five population quintiles (each 20% of the population):

Quintile	Economy A (% of total income)	Economy B (% of total income)
Q1	5%	2%
Q2	10%	8%
Q3	15%	12%
Q4	25%	28%
Q5	45%	50%

Which of the following statements is correct regarding the Gini coefficients of these two economies?

- A. Economy B has a lower Gini coefficient than Economy A because its top quintile earns more, which increases total income and reduces relative inequality.
- B. Economy A has a higher Gini coefficient than Economy B because its income distribution is more unequal across the lower three quintiles.
- C. Economy B has a higher Gini coefficient than Economy A, and this can be shown by calculating the area between the Lorenz curve and the line of perfect equality.
- D. The Gini coefficients of both economies are equal, because both have identical income shares for the top 40% of the population.

Correct answer: C

Explanation: Economy B allocates a smaller share of income to the bottom quintiles and more to the top, indicating greater inequality and a higher Gini coefficient, as shown by a larger area between the Lorenz curve and the line of equality.

MCQ 9. Monetary and fiscal policy

Which of the following is not a negative implication of having high levels of government debts?

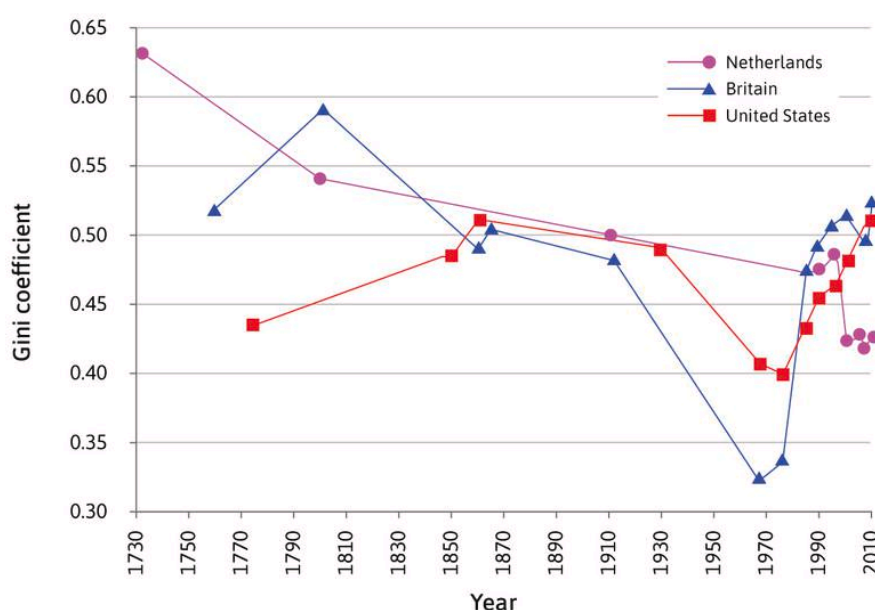
- A. It may lead to crowding out of private investments.
- B. Higher rates of taxation to cover the expenditures.
- C. Decreased ability of the government to respond to emergencies.
- D. All of them are negative implications of having a high level of government debts.

Correct answer: D

Explanation: All listed options are widely recognized as potential negative consequences of high government debt, including crowding out, higher taxes, and reduced fiscal flexibility.

MCQ 10. Institutions and Inequality

You are given the following graph of Gini coefficients over the past three centuries for three capitalist economies: Britain, the US, and the Netherlands.



The information in the figure suggests that:

- A. Capitalist economies tend to have similar degrees of equality.
- B. Of these three countries, the Netherlands was the most equal country over the past three centuries.
- C. In the most recent decade where data is available, the US and British economies are at their most unequal level since the 1750s.
- D. Over time, capitalist economies can become less as well as more equal.

Correct answer: D

Explanation: The graph shows that Gini coefficients have both risen and fallen over time, indicating that inequality in capitalist economies can both worsen and improve.

MCQ 11. Consumer's choice

The following information is the data on a survey of demand elasticity for low calorie fruit and vegetables (the price elasticity is reported as an absolute value).

Price per 100g	Typical spending per week	Price elasticity of demand
\$0.36	\$3.44	0.830

The total expenditure of the consumer is \$80 per week. Suppose now that the price of low-calorie fruit and vegetables increases by 10%. Based on this information, we can conclude that:

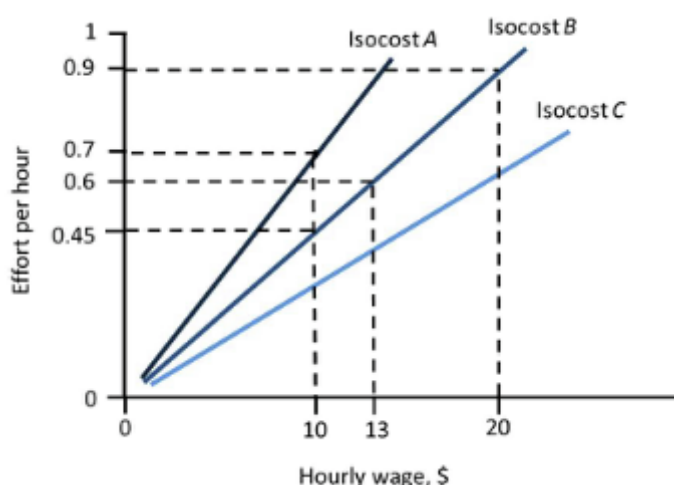
- A. The demand for low-calorie fruit and vegetables rises by 8.3%.
- B. The quantity the consumer consumes before the price change is 344g per week.
- C. The quantity the consumer consumes after the price change is 876.25g per week.
- D. The consumer's expenditure on low-calorie fruit and vegetables increases by \$0.08.

Correct answer: C

Explanation: $\$3.44 / \$0.36 \text{ per } 100\text{g} \approx 9.5556 \text{ units (or } 955.56\text{g)}$. After the price increases by 10%, the quantity consumed should fall approximately by 8.30%:
 $955.56 \times (1 - 0.083) \approx 876.25$.

MCQ 12. Firm's behavior

The figure depicts the isocost lines of a firm. Which of the following statements is correct?



- A. The cost of production is constant along an isocost line.
- B. Isocost A has the lowest cost per unit of effort of the three isocosts.
- C. The units of effort per dollar of wage cost for isocost B are 0.45.
- D. For the hourly wage of \$12, the effort per hour is 0.8 on isocost A.

Correct answer: B

Explanation: Isocost A is the steepest, meaning it gives the highest effort per dollar spent—thus, it represents the lowest cost per unit of effort. Note that answer A is incorrect because these isocosts reflect only labor cost, not all production cost (see Unit 9 of The Economy 1.0).

MCQ 13. Non-competitive markets (monopoly, oligopoly, monopolistic competition)

There are five students who are looking to buy one second-hand textbook each. Their willingness-to-pay are £5, £6, £8, £12, and £15, respectively. Based on this information, which of the following statements is correct?

- A. The student with a willingness-to-pay of £15 is the richest.
- B. Their willingness-to-pay indicates an upward-sloping demand curve.
- C. To sell three books, the maximum price that can be charged is £8.
- D. If a seller is one of many identical sellers and his reservation price is £8, then he is guaranteed to sell his textbook.

Correct answer: C

Explanation: To sell three books, the price must not exceed the willingness-to-pay of the third highest student (£8); any higher price would reduce quantity demanded.

MCQ 14. Macroeconomic data: measuring income, inflation and unemployment

You are given the following information for a country: Participation rate = 75%, Unemployment rate = 10%, Employment rate = 67.5% and Number of employed = 27 million. Based on this information, which of the following is correct?

- A. The working age population is 30 million.
- B. The size of the labour force is 40 million.
- C. The number of unemployed is 3 million.
- D. The unemployment rate is 12%.

Correct answer: C

Explanation: If 27 million are employed and the employment is 90% of the labor force (1 – unemployment rate of 10%), then labor force = $27 / 0.9 = 30$ million → unemployed = 3 million.

Jury's comment: Provided there was a typo in the online version, all answers get full credit.

MCQ 15. Money and the role of banks

Which of the following statements is correct?

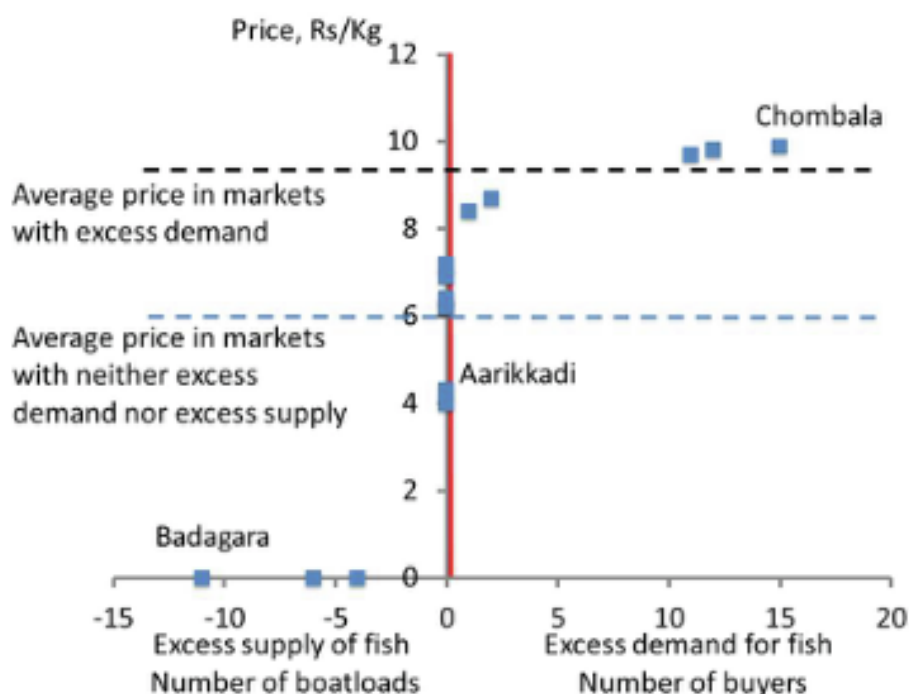
- A. The supply of base money entirely depends on how many transactions commercial banks have to make.
- B. The central bank intervenes in the money market by committing to lend whatever quantity of base money is demanded at the current bank lending rate.
- C. The central bank sets the policy rate in order to maximise its profits.
- D. When savers buy bonds they are lending money in the money market.

Correct answer: D

Explanation: Buying bonds is equivalent to lending money to the issuer (government or firm), thus representing lending in the money or capital markets.

MCQ 16. Competitive markets (demand and supply, elasticities, equilibrium)

The graph depicts the prices in the Kerala wholesale fish markets on 14 January 1997. Based on the graph, which of the following statements is correct?



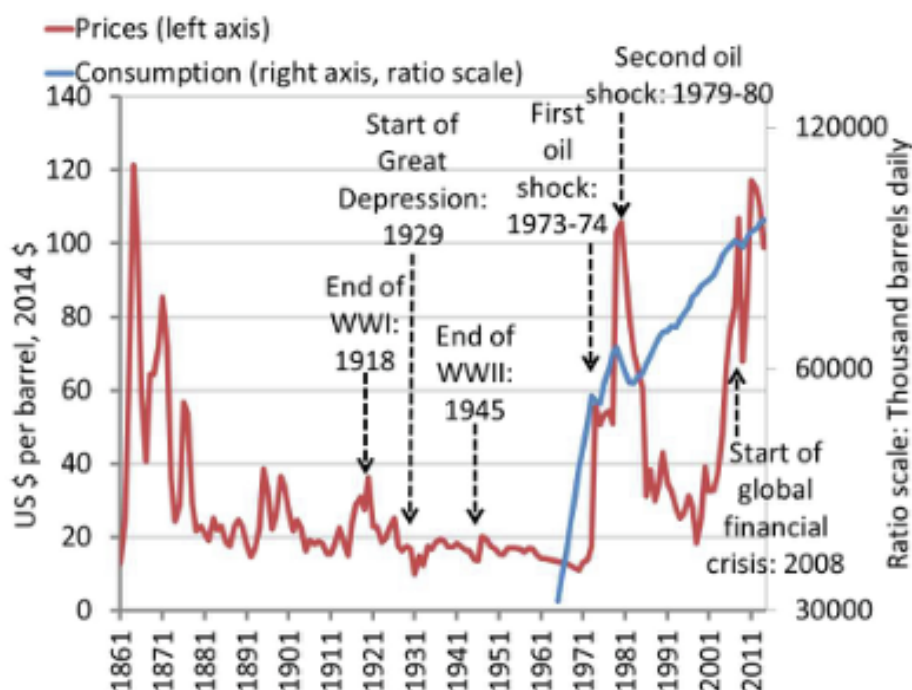
- A. In markets with excess demand, there is a positive correlation between excess demand and price.
- B. In markets with no excess demand or supply, the Law of One Price holds.
- C. In markets with excess supply, there is a negative correlation between excess supply and price.
- D. The data demonstrates that the price adjusts to clear the market.

Correct answer: A

Explanation: The graph shows that as excess demand increases, prices also rise—indicating a positive correlation between excess demand and price in these markets.

MCQ 17. Competitive markets (demand and supply, elasticities, equilibrium)

The figure shows the world oil price in constant prices for years 1865–2014 and the global oil consumption for 1965–2014. Based on this information, which of the following statements is correct?



- A. The nominal price of oil was the highest back in the 1860s.
- B. The hike in the oil price in 1979 was caused by a rightward shift in the demand curve.
- C. The sudden fall in the oil price in 2008 was caused by a leftward shift in the demand curve.
- D. The sharp swings in the oil price over short periods of time suggest inelastic demand and supply curves in the long-run.

Correct answer: C

Explanation: The global financial crisis in 2008 reduced demand for oil sharply, causing a leftward shift in the demand curve and a steep drop in price.

MCQ 18. Market failures (externalities, public goods, asymmetric information)

Which of the following is a non-excludable public good?

- A. A student's personal bicycle.
- B. Seats in a cinema.
- C. None of the other
- D. Karate sessions at a private gym.

Correct answer: C

Explanation: All the options listed (bike, cinema seat, gym session) are excludable and rivalrous, so none qualify as non-excludable public goods.

MCQ 19. Monetary and fiscal policy

In an economy with unutilised resources, the government stimulates aggregate demand by increasing its spending. The effect on output and employment will be greater if:

- A. The economy has a high propensity to import.
- B. The spending is financed by additional taxation.
- C. Its trading partners undertake a similar policy.
- D. The central bank simultaneously tightens monetary policy.

Correct answer: C

Explanation: If trading partners also increase spending, their increased demand boosts exports, amplifying the effect of domestic fiscal expansion on output and employment.

MCQ 20. Macroeconomic data: measuring income, inflation and unemployment

Last year, an economy had 1m registered unemployed and a labour force of 20m. Official statistics forecast a level of unemployment of 0.8m by the year's end while the size of the labour force remains unchanged. If this happens then the unemployment rate will have:

- A. Risen by 0.2m.
- B. Fallen from 5% to 4%.
- C. Fallen by 0.2m.
- D. Fallen by 0.2 per cent.

Correct answer: B

Explanation: Unemployment rate falls from $1\text{m} / 20\text{m} = 5\%$ to $0.8\text{m} / 20\text{m} = 4\%$.