

# Chapter 29

---

Page 610

**Which of the following statements are true and which are false? Explain your answer.**

- a. To reduce import spending, a government may try to reduce national income.  
True
- b. The balance of payments measures the value of all of the transactions within a country over a year. FALSE it measures transactions between a country and the rest of the world
- c. A depreciation of the exchange rate should improve the current account position of a country in the medium term. TRUE due to cheaper exports and more expensive imports
- d. A depreciation of the exchange rate may lead to demand-pull inflation if there is substantial capacity in the economy. FALSE if there is capacity firms can produce more without demand pull inflation

Page 611

**Which policy would be most likely to reduce a balance of payments current account deficit?**

- a. Reducing the external value of the currency TRUE
- b. Reducing tariff levels FALSE; would increase imports
- c. Cutting subsidies to domestic industries; FALSE; would reduce exports
- d. Cutting income tax rates. FALSE; would increase spending including spending on imports

**Why is a balance of payments deficit a potential problem for an economy with a fixed exchange rate?**

Answer is C. The standard of living will fall. With more spending on imports than earning from exports demand in the economy will fall.

**Which of the following would most help a country achieve a surplus on the current account of the balance of payments?**

Answer is B: depreciating currency, low inflation and high productivity,

Page 616

With reference to the diagram in Figure 29.25 which shows a tariff imposed on the world price:

- How much does domestic output increase?
- How much does the quantity demanded decrease?
- What is the new level of imports?
- How much revenue does the government earn?

Answer:

Domestic output increases 50 m

Quantity demanded decreases 40m

New level of imports 120 m

Revenue for government £5 per unit \* 120m = £600 m

Page 618

**Which of the following statements are true and which are false?**

- A tariff is a restriction on the quantity of imports into a country. FALSE
- All countries in the world belong to the WTO. FALSE
- Members of the EU have free trade amongst themselves, but agree their own trade policies against non-members. TRUE

## End of chapter put into practice questions

Page 624

**Show the effect of a tariff on consumer surplus.**

Figure 29.4; the increase in producer surplus is the reduction in consumer surplus

**Show the effect of a subsidy on the total consumption of a product.**

See figure 29.7

**Show the possible impact of protectionism on aggregate demand**

Protectionism in the short term might reduce imports and increase aggregate demand

**What is an example of an expenditure-reducing policy?**

- Lower interest rates FALSE
- Increased import tariffs. FALSE
- A revaluation upwards of the exchange rate FALSE
- Higher income tax rates. TRUE

**Which of the following increases protection against imports? Explain your answer.**

- a. Higher domestic inflation FALSE
- b. An appreciation of the exchange rate FALSE
- c. A reduction in import quotas. Yes TRUE, this limits imports further
- d. A reduction in subsidies to domestic producers. FALSE

**What is an example of an expenditure-switching protectionist policy?**

- a. Less government spending. FALSE
- b. Increased import tariffs. FALSE
- c. A devaluation upwards of the exchange rate. TRUE
- d. Higher income tax rates. FALSE