if you attempt all questions like this
you will score more than 60 marks in subjective.

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Economics Mock Paper 1

do not write complete question, precise it like title

Q2. State the bases for IS-LM framework (equation and establish equilibrium) and comment whether it is a short run or long run analysis. State the basis for your answer. Do you think this approach is still applicable for policy formulation? (20)

Ans2. Introduction:

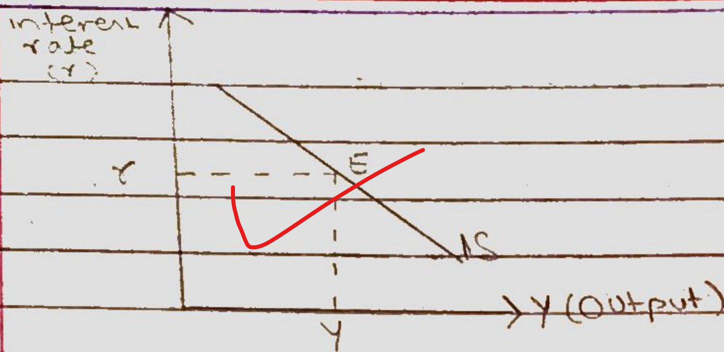
The IS-LM model combines the goods market, which determines the equilibrium level of output, with the money market which determines the equilibrium level of real money. This helps to assess the role that fiscal and monetary policies may have in explaining real output fluctuations.

IS - Curve:

The IS (Investment-Saving) Curve represents the relationship between the real interest rate and output in the goods market. The IS curve depicts the set of all levels of interest rates and output (GDP) at which total investments (I) equals to total savings (S).

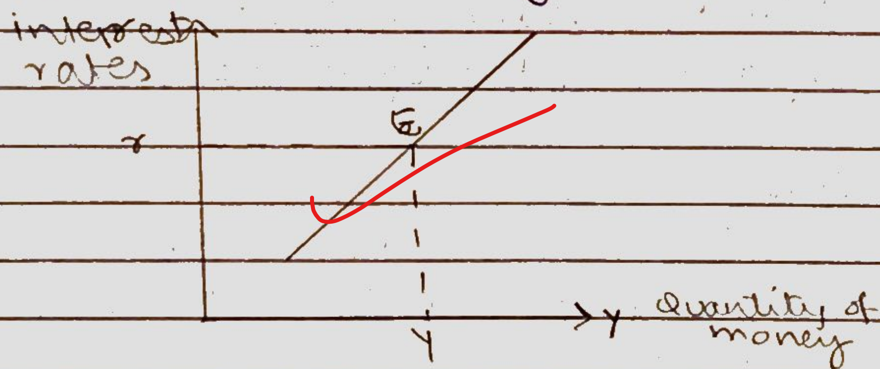
$$IS: I = S$$

At lower interest rates, investment is higher, which ~~total~~ translates into more total output. Hence, the IS curve slopes downwards and to the right. Graphical representation is on the following page.



LM- Curve:

The LM (Liquidity preference Money supply) curve represents the relationship between the real interest rate and output (or income) in the money market. The LM curve depicts the set of all levels of income (GDP) and interest rates at which money supply equals money demand.

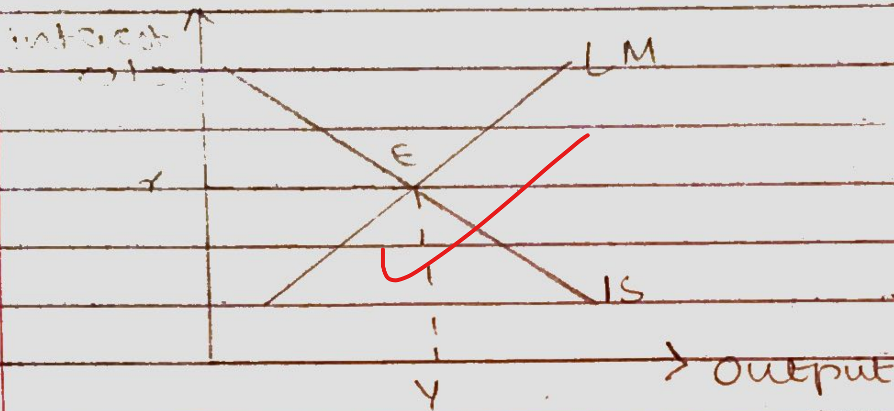


The LM curve slopes upwards because higher levels of income (GDP) induce increase demand to hold money balances for transactions, which requires higher interest rates to keep money supply and demand in equilibrium.

Equilibrium:

The intersection of the IS and LM curve shows the equilibrium point of interest

rates and output when money market and real economy are in balance.



The IS-LM graph examines the relationship between output, GDP and interest rates. The entire economy is boiled down to just two markets; and their respective demand and supply characteristics push the economy towards an equilibrium (E) point.

IS-LM Framework for short and long run analysis:
The IS-LM framework model can be utilised to analyse the short run and long run. It is important to note that short run and long run assumptions are based on classical economics.

In short run, the IS curve is assumed to be fixed, while the LM curve can shift due to changes in money demand or money supply. If the money supply increases in the economy, the LM curve will shift to the right, resulting in a lower real interest rate and a higher level of output.

Conversely, if money supply decreases, the LM curve will shift to the left, resulting in higher interest rates and lower level of output.

In the long run, both IS-LM curves can shift due to changes in the underlying determinants of investment, savings and demand for and supply of money. The intersection of IS-LM curves determines long-run equilibrium level of output (Y) and interest rate (r). If the underlying determinants of change in the economy, the IS-LM curve will shift resulting in a new long-run equilibrium.

Applicability of IS-LM framework for Policy Formulation:

The IS-LM model is still used as a tool for policy analysis, although it has been modified and extended over the years to incorporate other macroeconomic factors such as expectations, the role of government, and international trade. It is useful for policy makers because it provides the framework for understanding how changes in economic policy can affect the level of output and interest rate in the economy.

However, it is important to note that IS-LM model is a simplified representation of the economy and may not capture all the complexities and interactions in the real world. Therefore, it should be

used as a starting point for policy analysis, rather than the sole basis for policy descisions. Other macroeconomic models and empirical data should be considered in the policy formulation process.

Conclusion:

The IS-LM Framework continues to be used as it provides a simple and appropriate framework for analysing the effects of monetary and fiscal policy changes on the demand for output and on interest rates.

Q5. What are tariff and nontariff barriers to international trade? Why do countries sometimes restrict international trade? (20)

Ans. 5. Introduction

Tariff and non tariff barriers are protectionist measuries levied by a government on trade between ~~two~~ countries. These barriers to international trade can make trade more difficult and expensive. Such trade restrictions are often divided into tariff and non tariff barriers.

Tariff Barrier:

Tariff barriers to international trade are taxes or duties that are imposed on imported goods and services. A government may impose these taxes to raise revenues, protect domestic industries and protect national interests. There are

two types of tarrif barriers a government can impose: Ad valorem and specific tarrifs.

Ad Valorem Tariff Barrier:
These tariffs are based on percentage of the value of the imported goods. An example of this could be the 25% ad valorem tarriff imposed on steel by the United States in 2018.

Specific Tariff Barrier:
These tariffs are based on the quantity or volume of the imported goods. In 2019, European Union imposed a specific tariff of €176 per metric tonne on Chinese steel. This meant any steal imported from China to European Union was subject to €176 per metric tonne tax, regardless of its value.

Non Tarrif Barriers:
A non tarrif barrier is a restriction to international trade in any ~~for~~ form other than a tariff. Non-tarrif barriers include: quotas, embargoes, sanctions and voluntary exports restraints

Quotas:
Quotas are limits on the quantity of a particular good that can be imported. For example, the United States imposed the quota on imported steel as a measure

to protect domestic industries.

Embargoes

Embargoes are a government imposed restriction on the import or export of a certain goods with a specific country. These are often imposed for political or economic reasons. The United Nations imposed an arms embargo on North Korea ~~since~~ in 2006 in response to the country's nuclear weapon program. As a result there are significant trade restrictions between North Korea and rest of the world.

Sanctions:

Like ~~sanch~~ embargoes, sanctions are also imposed for similar motive. Sanctions limit complete trade activity with a specific country. An example of this is US sanctions on Iran since 1979 to isolate the country and exert pressure on the government to revise its extremist regime.

Reasons to Restrict International Trade:

Governments restrict international trade as a protectionist policy measure. Through this, domestic industries are protected from foreign competition. Reasons for restriction are mentioned below:

Protection of domestic industries:

Governments may impose tariff or non tariff barriers to protect domestic

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industry from foreign competition. This can help preserve jobs and support economic development in a domestic country.

Generation of Revenue:
Governments may impose tariffs on imported goods as a source of revenue. This can be an important source of funding for government programs and services. The Government of Pakistan often carries out this measure to reduce its Balance of Payment deficit.

Prevents Dumping:
Dumping is when a company exports its goods at a price below its cost. Trade barriers act as an anti dumping practice to protect local producers from fiercely competitive prices in the national market.

National Security:
Barriers are also employed by developed countries to protect certain industries that are deemed strategically important. Defense industries of a country often enjoy significant level of protection.

Protecting Consumers:
A government may levy barriers on products that it feels could endanger its population. For example, South Korea may place a tariff on imported meat from United

S | W
O | T

States if it feels the beef could be tainted with a disease.

Analysis must be SWOT.
strength ,weakness,opportunities
weakness

Critical Analysis:
It is important to note that trade restrictions can have both positive and negative impacts on an economy. Restricts on international trade can result in decreased efficiency and competitiveness. It disrupts specialisation that could take place from comparative advantage. Moreover, local industries relax their production quality making the products highly uncompetitive with no scope in international market.

Conclusion:
Free trade benefits consumers through increased choice ~~an~~ but global economy brings with it uncertainity, many governments impose barriers to protect their industries. There is a delecate balance between pursuit of efficiencies and government's need to ensure low unemployment.

Q6. Critically examine the marginal productivity theory of income distribution. (20)

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Ans. 6. Introduction
The marginal productivity theory of income distribution provides a general explanation of how price of a factor of production is determined. It suggests some broad principles regarding the

distribution of national income among the four factors of production. According to this theory, the income of an individual is determined by their marginal productivity, which is the value of the additional output that they contribute to the economy.

Critical Examination of Marginal Productivity Theory of Income distribution:
This theory is a subject of criticism due to its several defects. Main points of criticism are mentioned below:

a) Unrealistic Assumptions of Market
The theory assumes that there is perfect competition in the labour market. This means that all workers have the same skill and there is no discrimination based on factors like race and gender. However, discrimination and unequal opportunities do exist in real life.

b) Emphasis on demand side only:
The theory is one sided as it ignores supply side of the factor. Hence, it does not provide a complete and cohesive view point of productivity.

c) Role of power imbalances:
It also does not account for the role of power imbalances in the labour market such as unionization or the

influence of large corporations on wages of labour.

d) All factors are not homogeneous:
The consideration that all factors are homogeneous is also impractical as no labour, unit of land is similar. Every factor has varying efficiency in terms of production.

e) Static:
It is criticized and called a static theory as it ignores technical changes which can cause a shift in production function. Thus, it is considered to have an uncomplete ~~nature~~ due to its static nature.

f) Unrealistic Assumption of full employment
It considers that full employment prevails in the economy which is a rare phenomenon. As no country in reality enjoys full employment, the theory does not hold well in the real world.

g) Vague Concept of Marginal Productivity:
Many economists beleive the concept of marginal productivity is ~~wage~~ vague. Production is a result of co-operative effort of all factors of production. Hence, seperating a single factor out does not make complete sense.

h) Labour is not perfectly mobile:
Considering that labour would easily move from one occupation to another is not a realistic assumption. Hence, the theory contradicts real life phenomenons.

i) Theory of Exploitation:
If units of factors are paid according to marginal productivity and the enterprise is subject to law of diminishing returns; it will result in the exploitation of labour.

j) Difficult to Measure MPP:
It is considered impossible to measure this theory. This is because if labour is increased to measure their marginal productivity, then other factors would have to be increased too.

k) Short-run is ignored:
The theory only holds good in the long run while ignores the short run. In reality: the problems of short run are more important. As stated by keynes: "in the long run we are all dead". Hence, short run cannot be ignored.

l) Role of non-market factors:
Family structures, social networks and other non-market factors are ignored by this theory in determining the

distribution of income.

Conclusion:
The marginal productivity theory of income distribution ~~is~~ does not explain wages or income. On the contrary, it simply explains how labour is hired by the firm once they know its price (income). It explains how many workers an employer can hire at a certain wage not the wage level itself.

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Q8. Distinguish between:
a) Comparative advantage and Absolute Advantage:

Factors	Absolute ~~Comparative~~ Advantage	Comparative ~~Absolute~~ Advantage
Definition	Country's inherit ability to produce specific goods efficiently at a lower marginal cost compared to other countries.	Country's capability to produce the specific good at lower marginal cost and opportunities compared to other countries.
Trade Benefits	It may not always be mutually beneficial for both countries involved in trade transaction	Countries in transaction are mutually benefitted due to each other.

Factors	Absolute Advantage	Comparative Adv
Cost of Production	Refers to lowering the cost of production of a specific good in comparison to competitors.	Refers to lowering of opportunity cost of a specific good in comparison to competitors.
Resource Allocation	May not be highly effective in allocation as it does not consider opportunity cost of production	More effective in resource allocation, domestic production and import of specific goods.
Benefits to Economies	Not very effective as focuses on maximization of production with the same available resources.	More effective in helping countries take descisions related to resource allocation, import and export of goods.

b) Consumer Surplus v/s Producer Surplus:

Factors	Consumer Surplus	Producer Surplus
Definition	It is the difference between the lowest price a producer is willing to accept and the market price	It is the difference between the highest price a consumer is willing to pay and the market price.
Impact of Price	When price decreases consumer surplus increases (to a certain point) but below equilibrium	When price decreases producer surplus increases
Welfare	Measure of consumer welfare from consuming a good or service	Measure of producer welfare from ~~selling~~ producing a good or service
How to Calculate	Consumer surplus = maximum price willing to spend - actual cost.	Producer surplus = total revenue - total cost

c) Progressive and Regressive Tax

Factors	Progressive Tax	Regressive Tax
1 Meaning.	A taxing mechanism where tax rate rises with rise in taxable amount	A tax system where tax rate falls with rise in taxable amount
Benefical from	Low income groups	High income groups
Rate of tax	Marginal tax rate exceeds average tax rate	Average tax rate exceeds marginal tax rate.
Types of tax	Direct tax only (income tax)	Direct and indirect tax (e.g. value added tax)
Assessment of tax	Imposed on income or profit on the basis of increasing rate schedule	Charged as a percentage of the asset purchased or owned by the payer.

d) Real GNP and Nominal GNP

Factors	Real GNP	Nominal GNP
Definition	Money value of final goods and services produced by a country in an economic year valued at base year price	Money value of final goods and services produced by a country in an economic year valued as current year price
Calculation	~~GNP = C + I + G +~~ ~~IF~~ GNP = $\frac{\text{nominal GNP}}{\text{GNP deflator}}$	GNP = C + I + G + IF
Indicates	A true indicator to measure economic growth	Doesnot reflect actual growth of economy.
Determinants	Only affected by change in output level	Affected by change in price and output level
Inflation impact	Economic output this is adjusted for inflation	Economic output that is not adjusted for inflation