

# Practice Test: Economic Fundamentals & Policies

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## Concept 1: Business Cycle

The business cycle shows the ups and downs of economic activity over time — **expansion, peak, contraction (recession), and trough (recovery)**. During recessions, GDP falls and unemployment rises; during expansions, GDP and employment grow.

### Question 1:

Explain what happens to inflation and unemployment when the economy moves from expansion to recession.

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## Concept 2: Fiscal Policy

Fiscal policy is how the government uses **spending and taxation** to influence the economy.

- **Expansionary fiscal policy:** increases spending or lowers taxes to boost demand.
- **Contractionary fiscal policy:** cuts spending or raises taxes to slow inflation.

### Question 2:

Give one example of an expansionary fiscal policy Canada might use during a recession and explain its effect on employment.

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## Concept 3: Monetary Policy

The **Bank of Canada** controls the money supply and interest rates.

- Lower interest rates → encourage borrowing/spending.
- Higher interest rates → reduce borrowing and inflation.

### Question 3:

If the Bank of Canada raises interest rates, what happens to consumer spending and business investment? Why?

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## Concept 4: Exchange Rates

When the **Canadian dollar appreciates**, imports become cheaper, exports more expensive. When it **depreciates**, imports cost more, exports become cheaper for foreign buyers.

### Question 4:

Explain how a weaker Canadian dollar affects Canadian exporters and importers.

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## Concept 5: Comparative Advantage

A country has a **comparative advantage** when it produces a good at a lower **opportunity cost** than another. Trade allows countries to specialize and benefit.

### Question 5:

Canada can produce wheat more efficiently than Japan, while Japan produces electronics efficiently. Explain why both countries benefit from trading with each other.

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## Concept 6: Aggregate Demand (AD)

**Aggregate demand** is the total demand for all goods and services in an economy. It increases with higher consumer spending, investment, or government spending.

### Question 6:

List two factors that can cause the AD curve to shift right and describe the effects on GDP and unemployment.

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## Concept 7: Inflation

**Inflation** means a general rise in prices. Mild inflation signals growth; high inflation erodes purchasing power and reduces real income.

### Question 7:

If inflation rises faster than wages, what happens to consumers' real income?

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## Concept 8: Protectionism

**Protectionism** uses tariffs, quotas, or bans to protect domestic industries from foreign competition. It can help local businesses but raise consumer prices.

**Question 8:**

Explain one advantage and one disadvantage of protectionist policies.

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**Concept 9: Balance of Payments**

The **balance of payments** tracks all transactions between a country and the rest of the world. It includes the **current account** (trade) and **capital account** (investments).

**Question 9:**

Give one example of an inflow and one example of an outflow in Canada's capital account.

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**Concept 10: Tight Money Policy**

A **tight money policy** reduces the money supply to control inflation. It raises interest rates, lowers borrowing, and slows spending.

**Question 10:**

Explain how a tight money policy affects business investment and consumer demand.

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## Concepts from Labour Force Section

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### Concept 11: Labour Force

The **labour force** includes everyone who is either employed or actively looking for work.

**Formula:**

Labour Force = Employed + Unemployed (seeking work)

**Question 11:**

If 8 million people are employed and 2 million are unemployed but looking for work, what is the size of the labour force?

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### Concept 12: Total Employable Population

The **total employable population** includes everyone of working age, whether they are working, job-hunting, or not participating (students, retirees, homemakers).

**Question 12:**

If a country has 20 million people of working age and 14 million are in the labour force, what percentage of working-age people are **not** in the labour force?

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### Concept 13: Labour Force Participation Rate (LFPR)

The **LFPR** measures what percentage of the working-age population is in the labour force.

**Formula:**

$$\text{LFPR} = \left( \frac{\text{Labour Force}}{\text{Total Employable Population}} \right) \times 100$$
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**Question 13:**

If a country has a labour force of 18 million and a working-age population of 24 million, calculate the **labour force participation rate**.

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## Answer Key

1. Inflation falls; unemployment rises.
2. Increase public spending → more jobs and demand.
3. Spending and investment fall; borrowing becomes expensive.
4. Exports become cheaper; imports become costlier.
5. Each country specializes → gains from trade.
6. Higher government or consumer spending → GDP up, unemployment down.
7. Real income decreases.
8. Advantage: protects jobs; Disadvantage: higher prices.
9. Inflow: foreign investment; Outflow: Canadian investment abroad.
10. Investment and spending fall.
11. 10 million.
12. 30% not in labour force.
13.  $(18 \div 24) \times 100 = 75\%$ .