Q-1. Solution: B.

Neutral rate = real trend rate + long-run expected inflation (target inflation rate)= 2% + 2% = 4%

The central bank's monetary policy is being contractionary when its policy rate is above 4%.

Q-2. Solution: C.

C is correct. Selling government bonds results in a reduction of bank reserves and reduces their ability to lend, causing a decline in money growth through the multiplier mechanism and hence leads to a contraction in the economy.

A is incorrect. Central bank selling of bonds is not expansionary.

B is incorrect. Central bank selling of bonds will reduce the money supply through its impact on bank reserves, which will result in a higher, not lower, interest rate.

Q-3. Solution: C.

While Brazil has an absolute advantage in the production of both flashlights and vegetables, Mexico has a comparative advantage in the production of vegetables. The opportunity cost of vegetables in Mexico is 1/3 per flashlight, while the opportunity cost of vegetables in Brazil is 1/2 per flashlight.

Q-4. Solution: A.

As a country opens up to trade, the benefit accrues to the abundant factor, which is labor in Country A.

Q-5. Solution: A.

The imposition of a tariff will most likely increase domestic government revenue. A tariff is a tax on imports collected by the importing country's government.