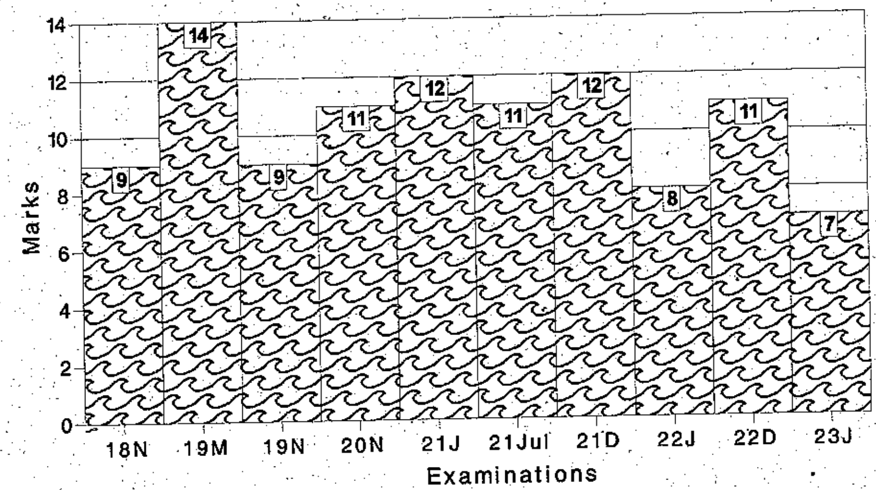
Business Economics

1 NATURE AND SCOPE OF BUSINESS ECONOMICS

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



PAST YEAR QUESTIONS AND ANSWERS

2006 - NOVEMBER

[1] 'Economics is the study of mankind in the ordinary business of life' was given by:
(a) Adam Smith
(b) Lord Robbins
(c) Alfred Marshall
(d) Samuelson (1 mark)

Answer:

(c) 'Economics is a study of mankind in the ordinary business of life' is the welfare definition given by Alfred Marshal.

[2] The branch of economic theory that deals with the problem of allocation of resources is :
(a) Microeconomics
(b) Macroeconomics
(c) Econometrics
(d) None of these (1 mark)

Answer:

(a) The study of microeconomics deals with how a producer allocates his resources and fixes the price of his product for the optimum utilization of resources.

[3] Capitalistic Economy uses _____ as principal means of allocating resources.
(a) demand
(b) supply
(c) price
(d) all of the above (1 mark)

Answer:

(c) A capitalistic economy is characterized by the absence of state intervention. This economy uses price mechanism (forces of demand and supply) to solve their basic economic problems. Demand and supply both depend upon price and therefore capitalistic economy uses price as principal means of allocating resources.

2007 - FEBRUARY

[4] A study of how an increase in the corporate income tax rate will affect the natural unemployment rate is an example of:
(a) Macroeconomics
(b) Descriptive Economics
(c) Microeconomics
(d) Normative Economics (1 mark)

Answer:

(a) Macroeconomics studies the economy as a whole. Therefore, increase in corporate income tax rate and its effect on unemployment is at the macro level.

[5] In which type of economy do consumers and producers make their choices based on the market forces of demand and supply?
(a) Open Economy
(b) Controlled Economy
(c) Command Economy
(d) Market Economy (1 mark)

Answer:

(d) In a capitalistic economy, producers make their choices based on market forces of demand and supply. The capitalist economy works under the price mechanism i.e. prices are determined by free interplay of demand and supply forces. A capitalist economy is also known as Market Economy.

2007 - MAY

[6] Under a free economy, prices are:
(a) Regulated
(b) Determined through a free interplay of demand and supply
(c) Partly regulated
(d) None of these (1 mark)

Answer:

(b) Under the free economy (capitalist economy) prices are determined by the price or the market mechanism i.e. there is no authority to determine prices but they are decided by forces of demand and supply.

[7] Which of the following falls under microeconomics?
(a) National income
(b) General price level
(c) Factor pricing
(d) National saving and investment (1 mark)

Answer:

(c) Microeconomics studies the economic behavior of individual economic units. Factor pricing is pricing of every factor, and hence is a micro concept.

2007 - AUGUST

[8] In a free-market economy, when consumers increase their purchase of a goods and the level of _____ exceeds ____ then prices tend to rise:
(a) demand, supply
(b) supply, demand
(c) prices, demand
(d) profits, supply (1 mark)

Answer:

(a) In a market (capitalist) economy prices are determined by market forces of demand and supply. When the demand for goods increases, the supply remaining the same, the prices of goods rise.

2007 - NOVEMBER

[9] Under the Inductive method, the logic proceeds from :
(a) General to particulars
(b) Particular to general
(c) Both (a) and (b)
(d) None (1 mark)

Answer:

(b) Under the inductive method, conclusions are drawn on the basis of collection and analysis of facts relevant to the inquiry. The logic proceeds from particular to general. The generalizations are based on the observations of individual examples.

[10] According to Robbins, 'means' are:
(a) Scarce (b) Unlimited
(c) Undefined (d) All of these (1 mark)

Answer:

(a) Robbins in his definition of scarcity explains that there are unlimited ends (wants) and limited means (resources). Resources are limited in nature and have alternative uses.

2008 - JUNE

[11] Economics is the study of :
(a) How society manages its unlimited resources
(b) How to reduce our wants until we are satisfied
(c) How society manages its scarce resources
(d) How to fully satisfy our unlimited wants. (1 mark)

Answer:

(c) Society has scarce resources and unlimited wants. Economics is the study of how to manage the scarce resources to fulfill the unlimited ends. Economics deals with how to make optimum utilization of scarce resources.

[12] A mixed economy means :
(a) Co-existence of small and large industries
(b) Promoting both agriculture and industries in the economy
(c) Co-existence of rich and poor
(d) Co-existence of public and private sectors (1 mark)

Answer:

(d) Mixed economy is characterized by the presence of both the private and the public sectors. Under this economy prices are determined both by planning authority and market forces.

2008 - DECEMBER

[13] Who defines Economics in terms of Dynamic Growth and Development?
(a) Robbins (b) Paul A Samuelson
(c) Adam Smith (d) None (1 mark)

Answer:

(b) Economics in terms of Dynamic Growth and Development was given by Paul A. Samuelson. Who states that "Economics is the study of how men and society choose, with or without the use of money to enjoy scarce productive resources which could have alternative uses, to produce various commodities over time and to distribute them for consumption now and in the future of amongst various people and groups of society.

[14] A Free Market- economy, solves its Central Problems through________.
(a) planning authority
(b) market mechanism
(c) both
(d) none (1 mark)

Answer:

(b) A free market economy also known as a capitalist economy, has no central planning authority to decide what, how and for whom to produce. Such an economy uses the impersonal market forces of demand and supply or the price mechanism to solve its central problems.

[15] Normative aspect of Economics is given by :

(a) Marshall (b) Robbins

(c) Adam Smith (d) Samuelson (1 mark)

Answer:

(a) Normative aspect is concerned with welfare propositions. Such an aspect of economics is prescriptive in nature and describes 'what should be the thing'. Example, the question like what should be the level of national income, how the fruits of national product be distributed among people. An aspect of economics given by 'Alfred Marshall'.

2009 - June

[16] Which one is not the characteristic of a capitalistic economy?

(a) Profit motive (b) Income inequality

(c) Free employment (d) Collective ownership (1 mark)

Answer:

(d) The characteristic of collective ownership does not belong to capitalistic economy. The characteristic of collective ownership is that of a socialistic economy where the entire control is of the Government.

[17] Mixed economy means

(a) All economic decisions are taken by the Central Authority

(b) All economic decisions are taken by private entrepreneurs

(c) Economic decisions are partly taken by the state and partly by private entrepreneurs

(d) None of these (1 mark)

Answer:

(c) A mixed economy is characterised by the presence of both private and public enterprises. In this economy, the government as well as private enterprises, exist and hence economic decisions are taken by the government and private enterprises both.

2009 - December

[18] Capitalistic Economy uses _____ as principal means of allocating resources.

(a) demand (b) supply

(c) price (d) all of the above (1 mark)

Answer:

Same as Answer 3

[19] Economic Problem arises when :

(a) Wants are unlimited

(b) Resources are limited

(c) Alternative uses of resources

(d) All of the above (1 mark)

Answer:

(d) Economic problem arises when wants are unlimited, resources are limited and resources have alternative uses. These reasons give rise to basic economic problems of "what to produce", "How to produce" and "For whom to produce".

2010 - June

[20] Micro economics is also known as_______.

(a) public economics (b) price theory

(c) income theory (d) demand theory (1 mark)

Answer:

(b) Micro Economics is also known as Price Theory. (Self Explanatory).

[21] A developed economy uses _____ technique in production.
(a) labour intensive (b) capital intensive
(c) home-based (d) traditional (1 mark)

Answer:

(b) Developed Economies have more of technology so they use capital intensive techniques in production to minimize the cost of production.

[22] Which one is the feature of Marshall's definition?
(a) Limited ends
(b) Scarce means
(c) Study of wealth as well as study of man
(d) Study of allocation of resources (1 mark)

Answer:

(c) Alfred Marshall clearly pointed out that economics is on the one side a study of wealth and on the other and more important side a part of study of man.

2010 - DECEMBER

[23] Which one in the following is not correct :
(a) There are limited wants
(b) Means are scarce
(c) Resources have alternative uses
(d) Economics is science (1 mark)

Answer:

(a) According to two fundamental facts, human beings have unlimited wants and the means of satisfying the wants are scarce.

[24] Micro Economics is concerned with:
(a) Consumer Behaviour
(b) Product pricing
(c) Factor Pricing
(d) All of the above (1 mark)

Answer:

(d) Micro-economics is concerned with:
(i) Product pricing
(ii) Consumer behaviour
(iii) Factor pricing
(iv) Economic conditions of a section of the people
(v) Study of firms
(vi) Location of an industry

2011 - JUNE

[25] Who gave the positive aspect of science?
(a) Alfred Marshall
(b) A.C. Pigou
(c) Adam Smith
(d) Robbins (1 mark)

Answer:

(d) A positive or pure science analyses cause and effect relationship between variables but it does not pass value judgments. This positive aspect of science was emphasized by Professor Robbins.

[26] A mixed economy means :
(a) Coexistence of both private and public sector
(b) Coexistence of poor and rich people
(c) Both (a) and (b)
(d) None (1 mark)

Answer:

(a) A mixed economy is an economy that includes the best features of both the controlled economy and the market economy. The most important feature of a mixed economy is the co-existence of both private and public enterprises.

[27] Which of these is a part of microeconomics?
(a) Factor pricing (b) National Income
(c) Balance of payment (d) None (1 mark)

Answer:

(a) Microeconomics is the study of the economic behaviour of an individual, firm or industry in the national economy. It is the study of a particular unit. Factor pricing relates to the pricing of individual factors and hence is a subject of microeconomics.

[28] Which of these is an example of macroeconomics :

(a) The problem of unemployment in India
(b) The rising price level in the country
(c) Increase in disparities of income
(d) All of the above (1 mark)

Answer:

(d) In macroeconomics we study the economic behaviour of large aggregates such as overall conditions of the economy, total production etc. Therefore, all these are a subject of macroeconomics.

2011 - DECEMBER

[29] In a capitalist economy the allocation of resources is performed by:

(a) Producers
(b) Government
(c) Planners
(d) Price mechanism (1 mark)

Answer:

(d) A capitalistic economy has no central planning authority to decide what, how and for whom to produce. Thus, the allocation of resources is performed by the market forces of demand and supply known as price mechanism.

[30] Which of the following statements is incorrect?

(a) Alfred Marshall propagated the wealth definition of Economics
(b) L. Robbins introduced the "Scarcity" definition of Economics
(c) Samuelson emphasized upon the "growth" aspect of Economics
(d) A.C Pigou believed in the "welfare" aspect of Economics (1 mark)

Answer:

(a) The 'wealth' definition of Economics was given by Adam Smith and JB Say:

"An inquiry into the nature and causes of the wealth of the nations" – Adam Smith.

"Science which deals with wealth" – JB Say.

[31] Inequalities of income do not perpetuate in__________.

(a) socialism (b) mixed economy
(c) capitalism (d) none (1 mark)

Answer:

(a) The relative equality of income is an important feature of a socialistic economy. Educational and other facilities are enjoyed more or less equally, thus the basic causes of inequalities are removed.

2012 - JUNE

[32] Which of the following are the features of a mixed economy?

(a) Planned economy
(b) Dual system of pricing exists
(c) Balanced regional development
(d) All of the above. (1 mark)

Answer:

(d) An economy that incorporates the features of capitalist and socialist both the economies is called a mixed economy. It has the following features –

(a) A mixed economy is a planned economy where the government has a clear and definite economic plan.
(b) In a mixed economy, the prices are determined both by price mechanism and central planning authority. Hence a dual system of pricing exists.
(c) There is a balanced regional development in a mixed economy as the public sector enterprises will be set up in backward areas for balanced development.

Hence, the answer will be all of these.

[33] Normative Economics is based on:
(a) Ethical Considerations (b) Facts and Generalisation
(c) What is? (d) All of the above. (1 mark)

Answer:

(a) Normative economics is concerned with welfare propositions. It states "what should be the things." It does not deal with facts but involves value judgments. The ethical aspect of economics is normative economics.

Example: What should be the wage rate level? This is a normative statement.

[34] The dual system of pricing exists in:
(a) Free market economy
(b) Socialistic economy
(c) Mixed economy
(d) None of the above (1 mark)

Answer:

(c) A mixed economy is a type of economy which combines the features of both capitalistic and socialistic economy. In this economy, the dual system of pricing exists i.e. prices of essential commodities are determined by the government while the prices of others commodities are fixed by the price mechanism (by the interaction of demand and supply)

[35] In the Inductive method, logic proceeds from:
(a) General to Particular (b) Particular to General
(c) Both (a) and (b) (d) None of these. (1 mark)

Answer:

(b) Under the inductive method, conclusions are drawn on the basis of collection and analysis of facts relevant to the inquiry. Here the logic proceeds from particular to general. This means generalizations are made based on facts collected.

[36] In a capitalist economy, allocation of resources is done by:
(a) Producers (b) Government
(c) Planners (d) Price mechanism (1 mark)

Answer:

(d) In a capitalist economy, there is no government intervention. In this economy, the resources are allocated based on the demand of the consumers. Producers will produce those goods which are in demand without thinking about the public welfare. Hence, this economy is guided by the price mechanism.

2012 - DECEMBER

[37] A Capitalist Economy follows the policy of:
(a) Laissez- faire
(b) Regulated markets
(c) Promoting public sector
(d) None of the above. (1 mark)

Answer:

(a) One of the guiding principles of the capitalistic economy is that the economic system should be **free from government interventions** and be driven by market forces. Laissez- faire means **allow to pass.** Thus, the capitalistic economy follows the policy of laissez- faire.

[38] 'Economics is the science of choice- making' implies:-
(a) No choice is to be made
(b) The choice to be made between alternative uses
(c) The choice to be made between means and ends
(d) None of the above (1 mark)

Answer:

(b) Robbins gave the following definition of economics —

"Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses".

Thus, economics is a science of choice which is to be made between alternative uses.

[39] Which of the following is a part of the subject matter of macro economics?
(a) Study of firms
(b) Aggregate profits of a firm
(c) Market demand for a product
(d) Net national product. (1 mark)

Answer:

(d) In macroeconomics, we study the economic behaviour of large aggregates such as overall conditions of the economy, total production etc. Out of the given options, only NNP studies the national income which is related to the entire economy.

[40] A capitalist economy is by and large ___________
(a) a closed economy
(b) a free market economy
(c) a centrally controlled economy
(d) an economy in which a government neither collects any taxes nor incurs any expenditure (1 mark)

Answer:

(b) A capitalist economy also known as free- market economy has no central planning authority to decide what, how and for whom to produce. Such an economy uses the impersonal force of the market demand and supply or the price mechanism to solve its central problems.

2013 - June

[41] Deductive and Inductive methods are complementary to each other. It is:
(a) Absolutely correct
(b) Absolutely incorrect
(c) Partially incorrect
(d) None of the above (1 mark)

Answer:

(a) Deductive and inductive methods are not mutually exclusive and are used side by side in any scientific inquiry. Conclusions drawn from the deductive method of reasoning are verified by the inductive method of observing concrete facts of life. Thus, it can be said that Deductive and inductive methods are **complementary** to each other is **absolutely correct**.

[42] A free- market economy's driving force is:
(a) Profit motive
(b) Welfare of the people
(c) Rising income and levels of living
(d) None of the above (1 mark)

Answer:

(a) A free market economy or a capitalist economy is one in which all the means of production are owned and controlled by private individuals for profit. Thus, **the profit motive** is the driving force of a free market economy.

[43] "Economics is neutral between ends". The statement is given by:
(a) L. Robbins (b) Mrs. Joan
(c) Alfred Marshall (d) A.C. Pigou (1 mark)

Answer:

(a) According to Prof. Lionel Robbins "economics is neutral between ends" Ends refer to wants. Human wants are unlimited. When one want is satisfied, other wants crop up.

[44] A system of economy in which all the means of production are owned and controlled by the private individuals for the purpose of profit is called:
(a) Socialist Economy (b) Capitalist Economy
(c) Mixed Economy (d) All of the above (1 mark)

Answer:

(b) **Capitalistic** economic system is one in which all the means of production are owned and controlled by private individuals for profit. In this system, the government does not interfere in the management of economic affairs.

2013 - DECEMBER

[45] Where does the price mechanism exist?
(a) Capitalist Economy
(b) Socialist Economy
(c) Both types of economies
(d) None of the above (1 mark)

Answer:

(a) A **capitalistic economy** has no central planning authority to decide what, how and for whom to produce. This economy uses the impersonal forces of the market demand and supply or price mechanism to solve its central problems.

[46] Economics which is concerned with welfare propositions is called
(a) Socialistic economics
(b) Capitalistic economics
(c) Positive economics
(d) Normative economics. (1 mark)

Answer:

(d) Normative aspect is concerned with welfare propositions. It involves value judgements. It is prescriptive in nature and describes 'what should be the things'. **E.g.** what should be the level of national income, what should be the wage rate.

Thus **Normative economics** is the correct option.

[47] In which among the following systems the 'right to property' exists
(a) Mixed economy
(b) Capitalist economy
(c) Socialist economy
(d) Traditional economy (1 mark)

Answer:

(b) Capitalism is an economic system in which all the means of production are owned and controlled by private individuals for profit. The right of private property means that productive factors such as land, factories, machinery, mines etc are under private ownership. The owners of these factors are free to use them in the manner they like.

Thus **option (B)** is correct.

[48] Positive science only explains
(a) What is?
(b) What ought to be?
(c) What is right or wrong
(d) None of the above (1 mark)

Answer:

(a) A positive or pure science analyses cause and effect relationship between variables but it does not pass value judgement. It states **what is** and not what ought to be.

Thus, **option (A)** is correct.

[49] Socialist Economy is also known as
(a) Mixed Economy
(b) Centrally Planned Economy
(c) Capitalist Economy
(d) None of the above (1 mark)

Answer:

(b) Socialist economy is also known as centrally planned economy because there is central authority to set and accomplish socio-economic goals.

2014 - JUNE

[50] Which of the following is not a feature of a capitalist economy?
(a) Right to private property
(b) Restrictions on consumers right to choose
(c) Profit motive
(d) Freedom of enterprise (1 mark)

Answer:

(b) The features of a capitalist economy are:
(1) The right of private property
(2) Freedom of enterprise
(3) Freedom to choice by the consumers
(4) Profit motive

(5) Competition
(6) Inequalities of income

Hence, **restrictions on consumers right to choose** is not a feature of a capitalistic economy.

[51] The term "Mixed Economy" denotes:
(a) Co-existence of both consumers and producers good's industries in the economy.
(b) Co-existence of both private and public sectors in the economy.
(c) Co-existence of both rural and urban sectors in the economy.
(d) Co-existence of both large and small industries in the economy. (1 mark)

Answer:

(b) The term "Mixed Economy" denotes **the co-existence of both private & public sectors in the economy**. In fact, in a mixed economy, there are three sectors of industries:
(a) Private sector
(b) Public sector
(c) Combined sector

2014 - December

[52] The most important function of an entrepreneur is to _____.
(a) innovate
(b) bear the sense of responsibility
(c) finance
(d) earn profit (1 mark)

Answer:

(a) An entrepreneur is one of the factors of production. He is the one who co-ordinates with other factors like land, labour, capital, etc. Various functions of entrepreneurs are decision-making, managerial function, organizational functions, etc. while the most important function of an entrepreneur is to innovate.

[53] Under Inductive method logic proceeds from:
(a) General to particular (b) Positive to normative
(c) Normative to positive (d) Particular to general (1 mark)

Answer:

(d) Under inductive method conclusions are drawn on the basis of collection and analysis of facts relevant to the inquiry. The logic in this case proceeds from the **particular to general**.

2015 - June

[54] The meaning of time element in economics is:
(a) Calendar time
(b) Clock time
(c) Operational time in which supply adjusts with the market demand
(d) None of the above (1 mark)

Answer:

(c) Operational time in which supply adjusts with the market demand.

[55] All wants of an individual are not of:
(a) Equal importance
(b) Immediate importance
(c) Fixed importance
(d) All of the above (1 mark)

Answer:

(a) All wants of individuals are not of **equal importance** as all cannot be fulfilled.

[56] _______ is another name of production possibility curve.
(a) Indifference Curve (b) ISO-Product Curve
(c) Transformation Curve (d) Diminishing Utility Curve (1 mark)

Answer:

(c) PPC is also known as Production Possibility Curve, Production Possibility Boundary, Transformation Line/Curve.

2015 - December

[57] Who is the author of "The Nature and Causes of Wealth of Nations"?
(a) Karl Marx (b) Adam Smith
(c) J B Say (d) A C Pigou (1 mark)

Answer:

(b) Science of wealth:
Although the activity of acquiring and increasing material wealth is as old as civilisation, a disciplined study of the wealth- producing activities commenced about 235 years back (in 1776) when **Adam Smith**, the father of Economics, published "The Nature and Causes of Wealth of Nations".

[58] Microeconomics does not study
(a) Consumer behaviour
(b) Factor pricing
(c) General price level
(d) Firms equilibrium. (1 mark)

Answer:

(c) Microeconomics is the study of particular firms, particular households, individual price, wage income, individual industries and particular commodities.
We mainly study the following:
(i) Product Pricing
(ii) Consumer Behaviour
(iii) Factor Pricing
(iv) Economic conditions of a section of the people
(v) Study of firms
(vi) Location of industry

[59] Find out the correct statement
(a) Higher the prices, lower the quality demanded of a product is a normative statement
(b) Micro and macro-economics are interdependent

(c) In a capitalist economy, the economic problems are solved by planning commission
(d) In deductive method logic proceeds from particular to the general (1 mark)

Answer:

(b) Micro and Macro Economics are interdependent on each other because they both play a vital and in most cases they play a complementary role Ex. National income cannot grow unless the production in individual firms and factories rises.

[60] Which of the following illustrate a decrease in unemployment using the PPF?
(a) A movement down along the PPF
(b) A rightward shift of the PPF
(c) A movement from a point on the PPF to a point inside the PPF
(d) A movement from a point inside the PPF to a point on the PPF (1 mark)

Answer:

(d) A movement of point inside PPF to on the PPF indicates the actual growth in an economy and wherever there is a decrease in unemployment, it shows that an economy is making progress towards growth by optimizing its full resources.

2016 - June

[61] Microeconomics is the study of:
(a) Individual parts of the economy
(b) The economy as a whole
(c) Choice making
(d) Development of the economy (1 mark)

Answer:

(a) The term microeconomics is derived from the Greek word mikros, meaning "small". In microeconomics we study the economic behaviour of an individual, firm or industry. It is thus a study of a particular unit rather than all the units combined.

2016 - December

[62] Freedom of choice is the advantage of

(a) Socialism (b) Capitalism
(c) Mixed Economy (d) Communism (1 mark)

Answer:

(b) Freedom of choice is the advantage of capitalism.

[63] The definition of economics given by Robbins does not deal with one of the following aspects. Indicate that aspect.

(a) Scarce means
(b) Limited ends
(c) Alternative uses
(d) Economics is a science (1 mark)

Answer:

(b) The definition of economics given by Robbins does not deal with limited ends as in the definition, he deals with unlimited ends.

[64] An economic system in which all means of production are owned and controlled by private individuals for profit is called:

(a) Mixed Economy
(b) Socialist Economy
(c) Capitalist Economy
(d) Developed Economy (1 mark)

Answer:

(c) A capitalist economy is an economy system in which all means of production are owned and controlled by private individuals for profit.

2017 - June

[65] In which of the following methods conclusions are drawn on the basis of collection and analysis of facts?

(a) Deductive method
(b) Scientific method

(c) Inductive method
(d) Experimental method. (1 mark)

Answer:

(c) Inductive Method: Under this method, conclusions are drawn on the basis of collection and analysis of facts relevant to the inquiry. The logic, in this case, proceeds from particular to general. The generalizations are based on observation of individual examples. Thus, **option (c)** is correct.

[66] Which Economic System is described by Schumpeter as 'capitalism in the oxygen tent'?

(a) Laissez-Faire Economy (b) Command Economy
(c) Mixed Economy (d) Agrarian Economy. (1 mark)

Answer:

(c) Mixed economy is described by Schumpeter as "Capitalism in the oxygen tent". According to him, it is only a trick of the capitalists to cheat the working class by offering them some temporary advantages like social security, upliftment of the depressed classes etc. Thus, option c is correct.

[67] The production Possibility Curve (PPC) is also known as:

(a) Indifference Curve
(b) Supply Curve
(c) Transformation Curve
(d) Demand Curve. (1 mark)

Answer:

(c) The production-possibility curve is also known as the transformation curve. It is a graph that shows the different rates of production of two goods that an individual or group can efficiently produce with limited productive resources.

[68] The Central problem in every economic society is:

(a) To ensure a minimum level of income for every individual.
(b) To allocate scarce resources in such a manner that society;s unlimited wants are satisfied in the best possible manner.
(c) To ensure that production occurs in the most efficient manner.
(d) To provide job to every job seeker. (1 mark)

Answer:

(b) Every economic system, be it capitalist, socialist or mixed, has to deal with this central problem of scarcity of resources relative to wants for them. The central economic problem is further divided into four basic economic problems.

These are:

(i) What to produce

(ii) How to produce

(iii) For whom to produce

What provisions (if any) are to be made for economic growth?

2018 - MAY

[69] Socialist Economy was propounded by:

(a) Karl Marx (b) Samuelson

(c) A.C. Pigou (d) Adam Smith (1 mark)

Answer:

(a) Karl Marx gave the theory of socialist economy.

[70] Concept of Business Economics was given by:

(a) Joel Dean (b) Alfred Marshall

(c) Adam Smith (d) L. Robbins (1 mark)

Answer:

(a) Concept of Business economics was given by Joel Dean.

[71] Features of the book wealth of nations:

(a) It was the first book written on economics

(b) It was created in 1776

(c) It was also known as 'wealth of nations'

(d) All of the above. (1 mark)

Answer:

(d) Adam Smith was the father of Economics. He wrote the book 'the Nature and Causes of Wealth of Nations' in 1776. This book was also known as 'Wealth of Nations'. He defined economics in 'An Inquiry into the Nature and Causes of wealth of nations'

[72] In India, Mixed Economy exists due to:

(a) coexistence of public sector and private sector

(b) individual forces of demand and supply

(c) orders by government

(d) None of these. (1 mark)

Answer:

(a) There are three types of economy. These are:

(a) Capitalist economy (private enterprises)

(b) Socialist economy (governed by government)

(c) Mixed economy (public and private enterprises)

Mixed economy means a co-relation or co-existence of public and private sector.

[73] Which economic system is described by Schumpeter as capitalism in the oxygen tent?

(a) Laissez-faire Economy

(b) Command Economy

(c) Mixed Economy

(d) Agrarian Economy (1 mark)

Answer:

(c) Mixed Economy is described by Schumpeter as 'capitalism in oxygen tent'. According to him it is only a trick of capitalism to cheat the working class by offering them some temporary advantages like social security, upliftment of depressed classes etc.

[74] Capitalistic Economy uses _____ as principal means of allocating resources:

(a) demand

(b) supply

(c) price

(d) all of the above. (1 mark)

Answer:

(c) Price is principal means of allocating resources in a capitalist economy while it is not so in a socialist economy. Price Mechanism is a characteristic is capitalist economy.

[75] Under inductive method logic proceeds from:
(a) General to particular
(b) Positive to narrative
(c) Normative to positive
(d) Particular to general (1 mark)

Answer:

(d) Inductive Method is based on facts and in this method logic proceeds from particular to general. While deductive method is based on assumptions and in this, logic proceeds from general to particular.

2018 - NOVEMBER

[76] Human wants are ______ in response to satisfy their wants?
(a) Unlimited
(b) Limited
(c) Scarce
(d) Multiple (1 mark)

Answer:

(a) 'Human beings have unlimited wants and the means to satisfy these unlimited wants are relatively scarce' form the subject matter of Economics.

[77] Price Mechanism is the main feature of which economy?
(a) Capitalistic Economy
(b) Mixed Economy
(c) Socialist Economy
(d) All of the above (1 mark)

Answer:

(a) Capitalism is self- regulating and works automatically through the price mechanism.

[78] Business Economics is also known as?
(a) Applied Economics
(b) Managerial Economics

(c) Micro Economics
(d) All of the above (1 mark)

Answer:

(b) Business economics, also referred to as managerial economics, generally refers to the integration of economic theory with business practice.

[79] A business economy involves the theory of Business economics with ____.
(a) Normative Economics
(b) Business practices
(c) Micro Economics
(d) Macro Economics (1 mark)

Answer:

(b) Business economy Involves theory of business with business practices. (application of theory)

[80] Which is not included in Economics?
(a) Family Structure
(b) Managerial Economics
(c) Micro Economics
(d) Macro Economics (1 mark)

Answer:

(a) Family structure in no sense effects economics, therefore, it is not included in economics.

[81] Business Economics involves the elements of:
(a) Micro Environment
(b) Macro Environment
(c) Both (a) and (b)
(d) None of the above (1 mark)

Answer:

(c) Business economics involves the economy as a whole and therefore, elements of macroeconomics and microeconomics are included in it.

[82] In which economy market and government both play an important role?
(a) Mixed economy
(b) Socialistic economy
(c) Capitalistic economy
(d) Business economy (1 mark)

Answer:

(a) The mixed economic system depends on market and government for allocation of resources. Infact every economy in the real world makes use of both market and government and therefore is mixed economy in its nature.

[83] Which factor is included in business Economics?
(a) Business Economics is an art
(b) Interdisciplinary in nature
(c) Normative in nature
(d) All of the above (1 mark)

Answer:

(d) Factors of business economics are
1. It is a science
2. It is normative in nature
3. It is Interdisciplinary in nature
4. It is pragmatic in approach

Therefore answer will be all of the above.

[84] Which out of these are the features of capitalism?
(i) Profit motive
(ii) Human welfare
(iii) Work through price mechanism
(a) (i) and (ii)
(b) (ii) and (iii)
(c) (i) and (iii)
(d) All of these. (1 mark)

Answer:

(c) Features of a capitalist economy
1. Profit motive
2. Work through the price mechanism
3. A high degree of operative efficiency

Therefore, human welfare is not a feature of capitalist economy.

2019 - MAY

[85] Business Economics is
(a) Normative in nature
(b) Interdisciplinary in nature
(c) Both
(d) None (1 mark)

Answer:

(c) The nature of business economics can be explained by the following points:
(i) Business Economics is a science
(ii) It is based on microeconomics and also incorporates the elements of macroeconomics.
(iii) It is normative in nature, i.e. it involves value judgements i.e. it, also deals with 'what should be'.
(iv) Interdisciplinary in nature i.e. it incorporates tools from other disciplines including Mathematics, Operational Research, Finance, Marketing, etc.

[86] Socialism ensures
(a) Rapid growth and balanced development
(b) Right to work
(c) Incentives for efficient economic decisions
(d) Both (a) and (b) (1 mark)

Answer :

(d) In a socialist economy, production and distribution of goods are aimed at maximising the welfare of the community as a whole.
It ensures rapid and balanced economic development as the central planning authority coordinates all resources in an efficient manner according to predetermined priorities.
It also ensures the right to work and a minimum standard of living to all people. However, no importance is given to personal efficiency and productivity.
Thus, **option (d)** is correct.

[87] Macroeconomics includes
(a) Product pricing
(b) Consumer behavior
(c) External value of money
(d) Location of industry (1 mark)

Answer :

(c) Macroeconomics is the study of the overall phenomena or the economy as a whole, rather than its individual parts. It includes:
(i) National income and national output
(ii) General price level and interest rates
(iii) Balance of trade and balance of payment
(iv) The overall level of savings and investment
(v) The level of employment and rate of economic growth
(vi) The external value of currency.

[88] Exploitation and inequality will be more in ______
(a) Socialism
(b) Capitalism
(c) Mixed
(d) All of the above (1 mark)

Answer :

(b) In a capitalist economy, all means of production are owned and controlled by private individuals for profit.
There is vast economic inequality and social injustice which reduces aggregate economic welfare of the society as a whole.
In a socialist economy, there is an equitable distribution of wealth and equal opportunities for maintaining economic and social justice.
In a mixed economy, there is co-existence of both the public and private sectors which prevents exploitation and inequality. Thus, among the three inequalities and exploitations are the characteristics of capitalism.

[89] **Shyam:** This year due to heavy rainfall my onion crop was damaged
Krishna : Climates affect crop yields. Some years are bad, others are good
Hari : Don't worry - Price increase will compensate for the fall in quantity supplied

Radhe: The Government ought to guarantee that our income will not fall.
In this conversation, the normative statement is made by
(a) Shyam
(b) Krishna
(c) Hari
(d) Radhe (1 mark)

Answer :

(d) A normative statement is one which involves value judgements and suggests what ought to be or what should be a particular course of action under given circumstances. Statements made by Shyam, Krishna and Hari are positive as they merely show cause and effect relationships and do not involve value judgement. However, Radhe's statement shows a particular course of action should be taken by stating that the government ought to guarantee that income will not fall.

[90] Which of the following is correct?
(a) 49% FDI is allowed in defence production
(b) 49% FDI is allowed in private sector banking
(c) 74% FDI is now allowed in multibrand retails
(d) 100% FDI is allowed in insurance (1 mark)

Answer :

(b) 49% FDI is allowed in private sector banking

[91] A capitalist economy consists of
(a) Central planning authority
(b) A mechanism to decide as to what, how and for whom to produce
(c) Both (a) and (b)
(d) None of the above (1 mark)

Answer :

(b) A capitalist economy does not have a central planning authority to decide what, how and for whom to produce. It uses the impersonal forces of market demand and supply or the price mechanism to solve its central problems.
Thus, **option (b)** is correct.

[92] As per the World Bank's International Debt Statistics 2017, India continues to be amongst the __________ countries.

(a) more debt
(b) less debt
(c) more vulnerable
(d) less vulnerable (1 mark)

Answer :

(d) As per country comparison based on "International Debt Statistics 2017" of the World Bank, India continues to be among the less vulnerable countries comparing well with other indebted developing countries.

[93] Applied economics includes

(a) Regression analysis and mathematical linear programming
(b) Capital budgeting
(c) Both (a) and (b)
(d) None (1 mark)

Answer:

(c) Business Economics has a close connection with Economic theory, Operation Research, Statistics, Mathematics, and the theory of Decision Making. It is essentially a component of applied economics as it includes the application of selected quantitative techniques such as linear programming, regression analysis, capital budgeting, cost analysis and breakeven analysis.

[94] Economic goods are considered as scarce resources because_____

(a) Inadequate quantity to satisfy the needs of the society
(b) Not possible to increase the quantity
(c) Limited hands to make goods
(d) Primary importance in satisfying social requirements (1 mark)

Answer:

(a) An economy exists because of two facts i.e. human wants are unlimited and the resources are scarce, i.e. there is an inadequate quantity to satisfy the needs of the entire society.

[95] Due to recession, employment rate and output ____________

(a) Rises ; rises
(b) Falls ; falls
(c) Rises ; falls
(d) Falls ; rises (1 mark)

Answer:

(b) During the contraction or recession phase of the business cycle, there is a fall in levels of investment and employment. The decrease in demand pulls down prices, investors confidence is at it's lowest. Employment rate falls and so is the output.

[96] Freedom of choice is the advantage of _________.

(a) Socialism
(b) Capitalist
(c) Mixed economy
(d) None of the above (1 mark)

Answer:

(b) In a Capitalist economy, consumers are benefitted due to competitive forces, a variety of good quality products, and affordable prices. This, not only ensures freedom of choice but also the maximum satisfaction to the consumers.

[97] ___________refers to the work area where surplus manpower is employed out of which some individuals have zero or almost zero marginal productivity, such that if they are removed the total level of output remains unchanged.

(a) Voluntary
(b) Disguised
(c) Structural
(d) Technological (1 mark)

Answer:

(b) Disguised unemployment: A kind of unemployment where more people are engaged in a work than required. Disguised refers to the work area where surplus manpower is employed out of which some individuals have zero or almost zero marginal productivity, such that if they are removed the total level of output remains unchanged.

[98] Socialist economy is _______

(a) Self- regulation
(b) Profit Oriented
(c) Command economy
(d) Allocation of resources as per market requirements (1 mark)

Answer:

(c) A socialist economy is also called as "Command Economy" or "Centrally Planned Economy". This economy will not provide incentives to hard work in the form of profit. Here, resources are allocated according to the commands of the central planning authority rather than market requirements.

2019 - November

[99] A study of have increase in the corporate tax rate will affect national unemployment rate is

(a) Macroeconomics
(b) Descriptive economics
(c) Microeconomics
(d) Normative economics (1 mark)

Answer:

(a) Macroeconomics is the study of the overall economic phenomena or the economy as a whole, rather than its individual parts. Therefore, a study of have increase in the corporate tax rate will affect national unemployment rate is of Macro environment.

[100] A capitalist economy uses ______ as a principal means of allocating resources.

(a) Demand
(b) Supply
(c) Efficiency
(d) Price (1 mark)

Answer:

(d) A capitalistic economy uses price as a principal means of allocating resources. It is the economy system in which all the resources are owned and controlled by private individuals for profit.

[101] In a market economy all assets are held by:

(a) Investors
(b) Privately
(c) Government
(d) Jointly by government (1 mark)

Answer:

(b) In market all assets are held by private owners as they fix their own prices and sell the goods at their own fixed price. So all the assets are held by private owners in the market.

[102] The branch of economic theory that deals with problem of allocating resources.

(a) Microeconomics
(b) Macroeconomics
(c) Econometrics
(d) None (1 mark)

Answer:

(a) The branch of economic theory that deals with problem of allocation of resources is MICRO ECONOMICS.
As microeconomics involves behaviour of different individuals and organisation within an economic system.

(i) Product pricing
(ii) Consumer behaviour
(iii) Factor pricing
(iv) The economic conditions of section of people
(v) Behaviour of firms
(vi) Location of industry.

[103] Larger production of ______ goods would lead to higher production in future.

(a) consumer goods
(b) capital goods
(c) agricultural goods
(d) public goods (1 mark)

Answer:

(b) Larger production of capital goods would lead to higher production in future. Since the resources are limited, every society has to decide which goods and services should be produced and how many units of each goods should be produced. Therefore, company should produce more of capital goods like machines, equipments, dam etc. as these goods makes the economy strong for the higher production in future.

[104] Which of the following is not within the scope of business economics?
(a) Capital budgeting
(b) Risk analysis
(c) Business cycle
(d) Accounting Standards (1 mark)

Answer:

(d) Business economics may be defined as the use of economic analysis to make business decision involving the best use of an organisations scarce resources. It involves linear programming, regression analysis, capital budgeting, break even analysis and cost analysis.
∴ Accounting Standards is not within the scope of business economics.

[105] Which is the first book of Economics named as _____
(a) The Wealth of Nations
(b) Economics
(c) Nations of Wealth
(d) Political Economy (1 mark)

Answer:

(a) The term Economics owes its origin to the Greek word 'Oikonomia' which means household'. Till 19th century, economics was known as 'Political Economy'. The book named 'An inquiry into the Nature and Causes of the Wealth of Nations' (1776) usually abbreviated as 'The Wealth of Nations' by Adam Smith is considered as the first modern work of Economics.

[106] Which type of scarcity is referred to in economics
(a) Relative scarcity
(b) Absolute scarcity
(c) Both (a) and (b)
(d) None (1 mark)

Answer:

(a) The scarcity in economics referred as relative scarcity. As the resources are limited and these resources have alternative uses and wants of people are unlimited. Therefore, all wants cannot be satisfied.
As financial resources can be used for many purposes. If the resources were unlimited, people would be able to satisfy all their wants and there would be no economic problem. Alternatively if a resource has only single use, then all economic problem would not arise.

[107] Consumer sovereignty is which of the following characteristics?
(a) Capitalist economy
(b) Mixed economy
(c) Socialist economy
(d) Democracy (1 mark)

Answer:

(a) 'Consumer Sovereignty' is the characteristics of capitalist economy which states that consumer is the king under capitalism. Consumer sovereignty means that buyers ultimately determine which goods and services will be produced and in what quantities. Consumer have unbridled freedom to choose the goods and services which they would consume. In other words based on the purchases they make, consumers decide how the economy's limited resources are allocated.

2020 - November

[108] Who defines Economics in terms of Dynamic growth and development?
(a) Robbins
(b) Paul A Samuelson
(c) Adam Smith
(d) None (1 mark)

Answer:

(b) Economics in terms of Dynamic Growth and Development was given by Paul A. Samuelson. Who states that "Economics is the study of how men and society choose, with or without the use of money to enjoy scarce productive resources which could have alternative uses, to produce various commodities over time and to distribute them for consumption now and in the future of amongst various people and groups of society.

[109] ______ economics explain economic phenomenon according to their cause and effects.

(a) Normative
(b) Empirical
(c) Positive
(d) Applied (1 mark)

Answer:

(c) A positive or pure science analyses cause and effect relationship between variables but it does not pass value judgements.

[110] The study of behaviour of different individuals organisations within an economic system is known as:

(a) Micro Economics
(b) Macro Economics
(c) Welfare Economics
(d) None (1 mark)

Answer:

(a) Micro economics is the study of economic behaviour of an individual, firm or industry in the national economy it is the study of a particular unit.

[111] The nature of Business economics is:

(a) Positive in nature
(b) Pragmatic
(c) Pure science
(d) Independent (1 mark)

Answer:

(b) Micro - Economics is abstract and purely theoretical and analyses economic phenomena under unrealistic assumptions. In contrast, Business Economics is pragmatic in its approach as it tackles practical problems which the firms face in the real world.

[112] Economics is term of Dynamic Growth and development defined by :

(a) Alfred Marshall
(b) Adam Smith
(c) Robbins
(d) Paul A Samuelson (1 mark)

Answer:

(d) The term Dynamic Growth and development is defined by the famous author Mr. Paul A Samuelson.

[113] A socialistic economy is also called as:

(a) Profit oriented economy
(b) Self regulatory economy
(c) Centrally planned economy
(d) Unorganized economy (1 mark)

Answer:

(c) A socialist economy is also called as "Command Economy" or a "Centrally Planned Economy". Here, the resources are allocated according to the commands of a central planning authority and therefore, market forces have no role in the allocation of resources.

[114] In capitalistic economy _____ and ______will be more.

(a) Inequalities, exploitation
(b) Exploitation, equalities
(c) Equalities, Non exploitation
(d) Non exploitation, inequalities (1 mark)

Answer:

(a) Capitalism can also lead to inequality which may be seen as unfair. For example, a firm may develop monopoly power. Therefore, capitalists with access to private property can 'exploit' their monopoly power to make a much higher profit than other people in society inheritance.

[115] In which economy, cost benefit analysis is used to answer the fundamental questions of economy?
(a) Mixed economy
(b) Socialistic economy
(c) Capitalistic economy
(d) Regulatory economy (1 mark)

Answer:

(a) In a mixed economy, all the central problems of an economy is solved keeping in mind the cost of the factors of production with economic gains and social welfare.

[116] A system of economy in which all the means of production are owned controlled by the private individuals for the purpose of profits is called:
(a) Socialist economy
(b) Capitalist economy
(c) Mixed economy
(d) All of these (1 mark)

Answer:

(b) Capitalistic is an economic system in which all the means of production are owned and controlled by private individuals for profit. The government do not interfere in the management of economic affairs under this system.

[117] In which economic system production and distribution of goods and services aim at maximizing the welfare of community as a whole?
(a) Capitalistic economy
(b) Normative
(c) Mixed
(d) Socialist economy (1 mark)

Answer:

(d) In socialist economy, production and distribution, of goods are aimed at maximising the welfare of the community as a whole. It also ensures right to work and minimum standard of living to all people. However, no importance is given to personal efficiency and productivity.

[118] ______ are responsible for all economic problems.
(a) Unlimited wants
(b) Alternative resource
(c) Scarcity of resource
(d) Others (1 mark)

Answer:

(c) Scarcity of resources responsible of all economic problems because if sufficient economic resources are available than all problems will be automatically solve.

2021 - January

[119] Capitalist system offer incentives for:
(a) Efficient business decisions
(b) Efficient government decisions
(c) Efficient non-government decisions
(d) Efficient economic decisions (1 mark)

Answer:

(d) Efficient economic decisions
Capitalist system offers incentives for efficient economic decisions.

[120] Macro-economic is also called ______ economics:
(a) Applied
(b) Aggregate
(c) Micro
(d) Experimental (1 mark)

Answer:

(b) Aggregate
Macro economy is also called as Aggregate economy.

[121] The book "Wealth of Nations" was written by ______:
(a) Alfred Marshall
(b) Join Robinson
(c) Adam Smith
(d) Robert Malthus (1 mark)

Answer:

(c) Adam Smith

The book wealth of Nations was written by 'Adam Smith'.

[122] Rama : My corn harvest this year is poor.

Manoj : Don't worry. Price increase will compensate for the fall in quantity supplied.

Meera : Climate affects crop yield. Some years are bad, others are good.

Bharti : The Government ought to guarantee that our income will not fall. In this conversation, the normative statement is made by:

(a) Rama
(b) Manoj
(c) Meera
(d) Bharti (1 mark)

Answer:

(d) Bharti

The normative statement is made by Bharti which means what ought to be.

[123] In a mixed economy, there are _____ sectors of industries.

(a) Two
(b) Three
(c) Four
(d) Five (1 mark)

Answer:

(b) Three

In mixed economy there are three sectors of industries.

[124] An economy exists because of two basic facts., i.e. _______.

(a) Human wants are limited and re sources are unlimited
(b) Human wants are unlimited and resources are unlimited
(c) Human wants are unlimited and resources are scare
(d) Human wants are limited and resources are abundant (1 mark)

Answer:

(c) Human wants are unlimited and resources are scarce.

Two basic facts of economy are:-

(a) Human wants are unlimited
(b) Resources are scarce.

[125] An economy is called capitalist economy, when ______ is given.

(a) Right to private property
(b) Freedom of government interference
(c) Freedom of business choices
(d) Discrimination (1 mark)

Answer:

(a) Right to private property

An economy is called as capitalist economy when right to private property is given.

[126] Coexistence of public and private sector is the feature of ______.

(a) Capitalist Economy
(b) Mixed Economy
(c) Socialist Economy
(d) Federal Economy (1 mark)

Answer:

(b) Mixed economy

Coexistence of public and private sector is feature of mixed economy.

[127] Which one of the area comes under macro-economics?

(a) Product pricing
(b) Consumer behaviour
(c) The general price level and interest rates
(d) Economics conditions of a Section of people (1 mark)

Answer:

(c) The general price level of interest rates

The general price level of interest rate comes under macro economics.

[128] Laissez-Faire economy is also known as :

(a) Capitalist economy
(b) Socialist economy
(c) Mixed economy
(d) Communist economy (1 mark)

Answer:

(a) Capitalist economy

Laissez- faire economy is also called as capitalist economy.

[129] In economics, we use the term scarcity to mean :

(a) Absolute scarcity and lack of resources in less developed countries.
(b) Relative scarcity i.e. scarcity in relation to the wants of the society.
(c) Scarcity during times of business failure and natural calamities.
(d) Scarcity caused on account of excessive consumption by the rich (1 mark)

Answer:

(b) Relative scarcity, i.e., scarcity in relation to wants of the society.

In economics we use the term, scarcity to mean relative scarcity, which is the scarcity in relation to wants of the society.

[130] Micro economics is also known as:

(a) public economics
(b) price theory
(c) income theory
(d) demand theory (1 mark)

Answer:

(b) Price theory

Micro economics is also known as price theory (self explanatory)

2021 - JULY

[131] The Famous book abbreviated as "The Wealth of Nations", which is also considered as the first modern work of Economics, was written by:

(a) Frederic Engels (b) Karl Marx
(c) David Ricardo (d) Adam Smith (1 mark)

Answer:

(d) 'The Wealth of Nations' given by Adam Smith is considered as the first modern work of economics.

[132] The economic system in which production and distribution of goods are aimed at maximizing the welfare of the community as whole known as:

(a) Capitalism (b) Socialism
(c) Mixed economy (d) Communist economy
(1 mark)

Answer:

(b) In a socialistic economy, there will be better utilization of resource and it ensure maximum production. Equitable distribution of goods or wealth for all help to maintain economic and Social Welfare.

[133] The Central Economics Problem does not deal with which of the following economic problems?

(a) What to produce?
(b) How to produce?
(c) For whom to produce?
(d) Where to produce? (1 mark)

Answer:

(d) The Central economic problem is further divided into four basic economic problems. These are:

- What to produce?
- How to produce?
- For whom to produce?
- What provision are to be made for economic growth?

[134] Study of behaviour of different individual and organizations within an economic system is called:

(a) Industrial Economics (b) Macro Economics
(c) Micro Economics (d) Welfare Economics
(1 mark)

Answer:

(c) Micro economics is basically study of the behaviour of different individuals and organizations with in the economic system. In other words micro economics examines how the individuals units make decisions as to how efficiency allocate their scarce resources.

[135] The concept of socialist economy was propounded by __________.
(a) Karl Marx and Adam Smith
(b) Frederic Engels and Adam Smith
(c) Frederic Engels
(d) Karl Marx and Frederic Engels (1 mark)

Answer:

(d) The concept of socialist economy was propounded by Karl Marx and Frederic Engels. In this economy material means of production i.e. Factories mines, capital etc. are owned by the whole community represented by the state. A socialist economy is also called as "Command economy" or centrally Planned Economy".

[136] Which of the following is not a study of Macro economics?
(a) Consumer behaviour
(b) National Income
(c) General Price Level
(d) Level of Employment (1 mark)

Answer:

(a) Consumer behaviour is not a study of macro economics. Macro economics is the study of overall economic phenomena or economy as the whole, rather than its individual parts. In macro economics we study behaviour of large economic aggregates such as overall levels of output.

[137] Which one of the following is not the scope of business economics?
(a) Cost Standard (b) Cost Analysis
(c) Demand Analysis (d) Inventory Management
(1 mark)

Answer:

(a) Scope of Business Economics are:
- Demand analysis
- Cost analysis
- Inventory management
- Market structure and pricing policies
- Resource allocation
- Profit analysis
- Risk and uncertainty analysis

[138] Which of the following statement is correct?
(a) Mixed economy is not always a golden path between capitalism and socialism.
(b) Socialistic economy is not always a golden path between mixed and capitalism.
(c) Capitalism economy is not always a golden path between mixed and socialism.
(d) Mixed economy is always a golden path between capitalism and socialism. (1 mark)

Answer:

(a) Mixed economy is not always a 'golden path' between capitalism and socialism. It suffer substantial uncertainty mixed economy is characterised by excessive control by the state resulting is reduced intensive constrained growth of the private sector, poor implementation, lack of efficiency.

[139] The central economic problem of an economy arises due to:
(a) Scarcity of resources relatives to their wants
(b) Co-existence of private and public sector
(c) Govt. interference in economic activities
(d) Federal structure of constitution (1 mark)

Answer:

(a) Central economic problem of an economy arises due to scarcity of resources relatives to their wants.

[140] Business Economics is essentially a component of Applied Economics as it includes application of selected quantitatives techniques which technique is not included in it?
(a) Regression analysis
(b) Economic analysis
(c) Capital budgeting
(d) Linear programming (1 mark)

Answer:

(b) Business Economics is essentially a component of Applied Economics as it include, application of selected quantitative technique such as linear programming regression analysis, capital budgeting, break even analysis and cost analysis.

[141] Business economics is pragmatic in its approach because?
(a) It tackles practical problem which the firm faces in real world.
(b) It tackles practical problem which the firm faces due to WTO policies
(c) It tackles practical problem which the firms faces due to lack of directors.
(d) Business economics is abstracts and purely theoretical.
(1 mark)

Answer:
(a) Business economics is pragmatic in its approach because Micro Economics is abstract and purely theoretical and analysis economics phenomena under unrealistic assumption and it tackle practical problem which the firm faces in real world.

2021 - December

[142] Socialist Economy is also known as ______
(a) Private Economy
(b) Consumer Economy
(c) Centrally Planned Economy
(d) Mixed Economy
(1 mark)

Answer:
(c) A socialist economic system can also be called as command economy, centrally planned economy or controlled economy because the means of production and distribution are owned, controlled and regulated by the public, either through the state or through cooperatives.

[143] The term socialist economy was coined by
(a) Alfred Marshall
(b) Albert Einstein
(c) Joel Dean
(d) Karl Marx and Friedrich Engels
(1 mark)

Answer:
(d) By the late 19th century, after the work of Karl Marx and his collaborator Friedrich Engels, socialism had come to signify opposition to capitalism and advocacy for a post-capitalist system based on some form of social ownership of the means of production.

[144] Most important feature of capitalist economy is ________?
(a) State-run economy
(b) Competition
(c) Inefficient allocation of resources
(d) Socialism
(1 mark)

Answer:
(b) Competition: Competition is the most important feature of the capitalist economy. Competition brings out the best among buyers and sellers and results in efficient use of resources.

[145] Mr. Rohit invited a consultant for knowing staff requirement, consumer behaviour and product pricing. The approach consultant is looking–
(a) Micro Economics
(b) Applied Economics
(c) Macro Economics
(d) Econometrics
(1 mark)

Answer:
(a) Microeconomics is the study of what is likely to happen (tendencies) when individuals make choices in response to changes in incentives, prices, resources, and/or methods of production. These groups create the supply and demand for resources, using money and interest rates as a pricing mechanism for coordination.

[146] Which of the following is not included in Micro economics?
(a) Wages of workers in steel industry
(b) Location of a particular firm
(c) General pricing level in the market
(d) Price of a product
(1 mark)

Answer:

(c) General pricing level in the market is not included in microeconomics. Business Economics makes use of microeconomic analysis such as, demand analysis and forecasting, production and cost Analysis, inventory management, market structure and pricing policies, resource allocation, theory of capital and investment decisions, profit analysis and risk and uncertainty analysis.

[147] A mixed economy refers to ________

(a) all economic decisions are taken by the central authority
(b) all economic decisions are taken by private entrepreneurs
(c) co-existence of both private and public sector
(d) none of these. (1 mark)

Answer:

(c) A mixed economy refers to co-existence of both private and public sectors. The mixed economic system depends on both markets and governments for allocation of resources. In fact, every economy in the real world makes use of both markets and governments and therefore is mixed economy in its nature.

[148] Which of the following is not within the scope of Business Economics?

(a) Capital Budgeting
(b) Risk Analysis
(c) Business cycle
(d) Accounting Standards (1 mark)

Answer:

(d) Accounting standards is not within the scope of business economics. The scope of Business Economics is quite wide. It covers most of the practical problems a manager or a firm faces. There are two categories of business issues to which economic theories can be directly applied, namely:

1. Internal issues or operational issues (this can be solved using Micro Economics)
2. External issues or environmental issues (this can be solved using Macro Economics)

[149] Which are the areas that come under, Macro-economics?

(a) Demand for a firm's product
(b) General price level and interest rates
(c) Location of Industry
(d) Price of a product. (1 mark)

Answer:

(b) A few areas that come under Macro Economics are:

(i) National Income and National Output
(ii) The general price level and interest rates
(iii) Balance of trade and balance of payments
(iv) External value of currency
(v) The overall level of savings and investment; and
(vi) The level of employment and rate of economic growth.

[150] Economics is ________

(a) Driven by profit
(b) Driven by sentiments
(c) Driven by emotions
(d) Driven by Altruism (1 mark)

Answer:

(a) In turn, production tends to increase to satisfy the demand since producers are driven by profit. Hence, economics is driven by profits.

[151] Which of the following is demerit of capitalism:

(a) There is precedence of property rights over human rights
(b) It functions in domestic frame work
(c) High degree of operative efficiency
(d) None of these (1 mark)

Answer:

(a) Private property rights are central to a capitalist economy, its execution, and its legal defenses. Capitalism is built on the free exchange of goods and services between different parties, and nobody can rightfully trade property they do not own. Conversely, property rights provide a legal framework for prosecuting aggression against non-voluntary means of acquiring resources; there is no need for capitalist trade in a society where people could simply take from others what they want by force or the threat of force.

[152] Scarcity definition in economics in given by
(a) Lipsey
(b) Adam Smith
(c) J.B. say
(d) Robbins (1 mark)

Answer:

(d) The scarcity definition was given by Prof. Lionel Robbins in his book, 'An Essay on the Nature and Significance of Economic Science', published in 1932. He stated, "Economics as the science which studies human behaviour as a relationship between ends and scarce means, which have alternate uses."

[153] Normative economics can be explained through:
(a) fairness to tax
(b) incidence to tax
(c) effect of tax on incentive to work
(d) none of these. (1 mark)

Answer:

(a) Normative economics can be explained through fairness to tax. Normative economics (as opposed to positive economics) is a part of economics whose objective is fairness or what the outcome of the economy or goals of public policy ought to be. Economists commonly prefer to distinguish normative economics ("what ought to be" in economic matters) from positive economics ("what is").

2022 - JUNE

[154] Socialist Economy is also known as _______.
(a) Private Economy
(b) Consumer Economy
(c) Command Economy
(d) Mixed Economy (1 mark)

Answer:

(c) Socialist economy is also known as "command economy" or "centrally planned economy".

[155] Predominance of bureaucracy under which system?
(a) Mixed Economy
(b) Socialist Economy
(c) Capital Economy
(d) None of the above (1 mark)

Answer:

(b) Socialist economy involves the predominance of bureaucracy and resulting inefficiency and delays.

[156] Find the correct statement:
(a) Mixed economy is not a golden path between socialist & capitalist economy
(b) Socialist economy is not a golden path between mixed & capitalist economy
(c) Capitalist economy is not a golden path between socialist economy & mixed economy
(d) None of the above (1 mark)

Answer:

(a) Mixed economy is not always a golden path between socialist and capitalist economy. Sometimes, it is very difficult to maintain a proper balance between public and private sectors.

[157] Micro economics is also known as:
(a) public economics
(b) price theory
(c) income theory
(d) demand theory (1 mark)

Answer:

(b) Price theory
Micro economics is also known as price theory (self explanatory)

[158] Normative science refers to:
(a) What to Produce
(b) How to Produce
(c) Whom to Produce
(d) What should be (1 mark)

Answer:

(d) Normative science is prescriptive in nature. It involves value judgements. It is prescriptive in nature and suggests 'what should be' a particular course of action in different circumstances.

[159] Business is Pragmatic in approach:
(a) True
(b) False
(c) None of the above
(d) Uncertain (1 mark)

Answer:

(a) Business economics is pragmatic in its approach as it tackles practical problems which the firms face in the real world.

[160] Central problems of economics -
(a) Scarcity of resources
(b) Poverty
(c) Unemployment
(d) All of the above (1 mark)

Answer:

(a) The Central problem of economy is the scarcity of resources. The resources are limited, society has to decide the central problem of scarcity of resources.

[161] Business economics being_____in approach tackles practical problems.
(a) Interdisciplinary
(b) Normative
(c) Positive
(d) Pragmatic (1 mark)

Answer:

(d) Business economics being pragmatic in approach, tackles practical problems and deals with them on practical and theory basis.

2022 - DECEMBER

[162] __________ economic system is self-regulating and run by invisible hands.
(a) Mixed
(b) Socialistic
(c) Capitalistic
(d) Planned (1 mark)

Answer:

(c) Capitalism is self-regulating economy and works automatically through price mechanism. The "invisible hands" is a metaphor for how, in a free market economy self-interested individuals operate through a system of mutual interdependence.

[163] Indian economy is classified as:
(a) Mixed economy
(b) Capitalist economy
(c) Socialist economy
(d) Free market economy (1 mark)

Answer:

(a) India has a mixed economy, therefore, public as well as private entities, co-exist.

[164] The basic problem of scarcity gives rise to:
(a) technological problems
(b) social problems
(c) cultural problems
(d) economic problems (1 mark)

Answer:

(d) The basic problem of scarcity gives rise to economic problems. The basic problems of an economy are that resources available are scarce and our wants are unlimited. Hence, choice is made to allocate resources to alternative uses is such a way that maximum satisfaction can be achieved.

[165] Which of the following is NOT a basic problem of all economy?
(a) Whether to produce more of consumer goods or capital goods
(b) Whether to lay emphasis or labour intensive techniques or no capital intensive techniques
(c) Whether to produce for rich people or for poor people
(d) Whether to accept foreign direct investment in the economy. (1 mark)

Answer:
(d) The basic problems of all economy are:
1. What to produce-whether to produce more of consumer goods or capital goods.
2. How to produce-whether to employ more of labour intensive or capital intensive techniques
3. For whom to produce - How the goods and services should be distributed among the members of society, i.e., decision about shares of different people in the national cake of goods and services.
4. What provision should be made for economic growth - How much saving and investment would be made for future progress.

[166] ________ involves the predominance of bureaucracy and resulting in inefficiencies and delays.
(a) Socialistic economy
(b) Capitalist economy
(c) Mixed economy
(d) Free market economy (1 mark)

Answer:
(a) Socialist economy involves the predominance of bureaucracy resulting in inefficiencies and delays.

[167] Capitalist system offers incentives for:
(a) Efficient business decisions
(b) Efficient government decisions
(c) Efficient non-governmental decisions
(d) Efficient economic decisions (1 mark)

Answer:
(d) One of the merits of capitalist system is that it offers incentives for efficient economic decisions and their implementation.

[168] 'Analysis of impact of COVID-19 on the Indian Economy' is a part of:
(a) Macro economics (b) Micro economics
(c) Economics slicing (d) Normative economics (1 mark)

Answer:
(a) Macroeconomics focuses on the performance of economies-changes in economic output, inflation, interest and foreign exchange rates, and the balance of payments. Poverty reduction, social equity, and sustainable growth are only possible with sound monetary and fiscal policies.
The Covid-19 pandemic has caused direct impacts on income due to premature deaths, workplace absenteeism and reduction in productivity and has created a negative supply shock, with manufacturing productive activity slowing down due to global supply chain disruptions and closures of factories. These consequence have impacted the Indian economy on a macro level.

[169] The 'communist manifesto' related to socialist economy propounded by Karl Marx and Frederic Engels was published in:
(a) 1950
(b) 1848
(c) 1849
(d) 1951 (1 mark)

Answer:
(b) Karl Marx in 1848 and Frederic Engels published the 'Communist Manifesto' related to socialist economy.

[170] 'Consumer sovereignty' is a feature of:
(a) Capitalist
(b) Socialist
(c) Mixed
(d) Command (1 mark)

Answer:

(a) 'Consumer Sovereignty' is the characteristics of capitalist economy which states of that consumer is the king under capitalism. Consumer sovereignty means that buyers ultimately determine which goods and services will be produced and in what quantities. Consumer have unbridled freedom to choose the goods and services which they would consume. In other words, based on the purchases they makes. Consumers decide how they economy's limited resources are allocated.

[171] Which one of the following is not a central problem of an economy?

(a) What to produce? (b) How to produce?
(c) When to produce? (d) For whom to produce? (1 mark)

Answer:

(c) Every economic system, be it capitalist, socialist or mixed, has to deal with this Central problem of scarcity of resources relative to the wants for them. This is generally called 'the Central economic problem'. These economic problem are further divided into four basic economic problem. These are:

- What to produce?
- How to produce?
- For whom to produce?
- What provision (if any) are to be made for economic growth?

[172] The price of hot dogs increases by 22% and the quantity demanded falls by 25%. This indicates that demand for hot dogs is:

(a) Elastic (b) Inelastic
(c) Unitarily elastic (d) Perfectly elastic (1 mark)

Answer:

(a) Price elasticity of demand expresses the responsiveness of quality of a good to a charge in its price, given the consumer's income, his taste and prices of all other goods.

Price elasticity = Ep = % change in quantity demand % change in price

$Ep = \frac{25}{22} = 1.13636$

i.e. = elastic

2023 - June

[173] Which of the following is the central problem of economy?

(a) Scarcity of resources (b) Unemployment
(c) Poverty (d) Inflation (1 mark)

Answer:

(a) **Scarcity of Resources**

The Central Problem of Economy is scarcity of resources and unlimited wants.

[174] Economics is classified into:

(a) Normative and Positive
(b) Micro and Macro
(c) Internal and External
(d) None of the above (1 mark)

Answer:

(b) **Micro and Macro**

Economics as a whole is classified into Micro and Macro Economics.

[175] Under which of the following economy the consumer have limited freedom of choice?

(a) Socialist (b) Mixed
(c) Capitalist (d) Restricted (1 mark)

Answer:

(a) **Socialist**

Since, Socialist Economy is planned and enrolled economy so consumer have limited freedom of choice.

[176] Which of the following is not the Subject matter of Micro Economies?

(a) Consumer Behaviour (b) Foreign Exchange Rate
(c) Behaviour of Firms (d) Location of Industry (1 mark)

Answer:

(b) **Foreign Exchange Rate**

Foreign Exchange Rate is based on Macro Economics.

[177] Which of the following is one of the merits of socialism?
(a) Importance given to productivity
(b) Importance given to personal efficiency
(c) Rapid Growth and Balanced Economic Development
(d) Incentive for Economic Decision (1 mark)

Answer:

(c) **Rapid Growth and Balanced Economic Development**
Socialist Economy is concerned with social welfare and equitable distribution of income which leads to rapid growth and balanced economic development.

[178] Capitalist Economy solve their economic problems through which of the following?
(a) Central Planning Authority
(b) Price Mechanism
(c) Administered Prices
(d) Voting by Consumers (1 mark)

Answer:

(b) **Price Mechanism**
Price Mechanism helps in allocation of resources under Capitalist Economy.

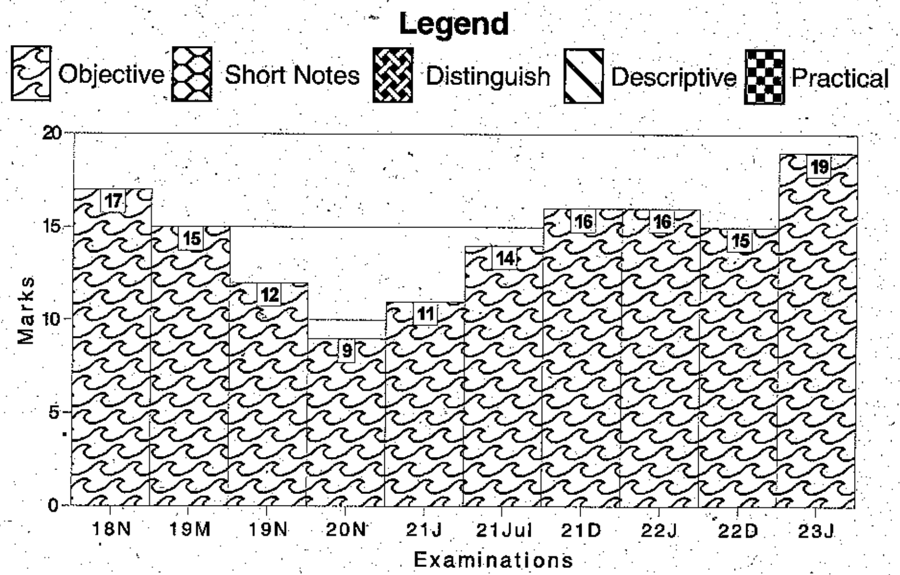
[179] An Economic system in which all means of production are owned and controlled by Private Individuals is called as?
(a) Free Economy
(b) Capitalist Economy
(c) Normative Economy
(d) Both (a) and (b) (1 mark)

Answer:

(d) An economy is called capitalist or a free market economy or laissez faire economy in which all means of production are owned and controlled by private individuals for profit, since private property is the mainstay of capitalism and profit motive is it observing force.

2 THEORY OF DEMAND AND SUPPLY

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



SELF STUDY NOTES

Unit 1: Law of Demand and Elasticity of Demand

Demand and Law of Demand

Desire to have a commodity backed by purchasing power at a particular price in a particular period of time is known as Demand.
Demand per commodity refers to amount of the commodity which consumers are willing and able to purchase at a particular price in a particular period of time.

Types of Demand:

1. **Individual and Market Demand:**
   The quantity of a commodity that an individual consumer is willing to purchase at given price during given period of time is known as Individual demand.
   Total quantity of commodity that all the consumers are willing to buy at given price during a given period of time.
2. **Ex-ante and Ex-post Demand:**
   Ex-ante demand refers to the amount of goods the consumers want/willing/planned to buy during a particular time period.
   Ex-post demand refers to the amount of the goods that the consumers actually purchased during a specified period.
   Ex-ante demand can be less, more or equal to ex-post demand.
3. **Joint Demand:**
   It refers to the demand for two or more goods which are used jointly or demanded together.
   Example: Car and petrol, pen and ink, mobile and Sim card.
4. **Derived Demand:**
   The demand for a commodity that arises because of the demand for some other commodity.
   Example: Steel, bricks and Cements are derived from the houses or other buildings. All the factors of production are derived demand.

5. **Composite Demand:**
   Demand for goods that have multiple uses is called multiple or composite demand.
   Example: Electricity and Milk.

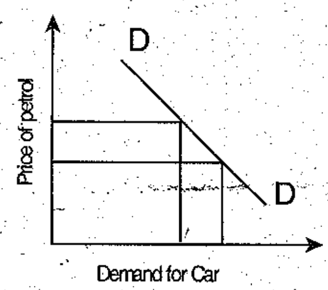
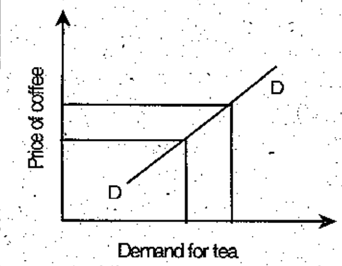
Factors affecting Demand

1. **Price of the commodity:**
   When the price of the commodity increases the demand decreases and when the price of the commodity decreases the demand increases. Price and demand are inversely related. This type of demand is known as price demand.

   P ↑ Increases D ↓ Decreases

   P ↓ Decreases D ↑ Increases

2. **Price of related goods (also known as cross demand)**
   Related goods can be classified into two kinds.

1. (a)	Complimentary goods	(b)	Substitute goods
•	Goods that are used together to satisfy a given want.		Goods that satisfy the same type of demand and can be used in place of one another.
	eg: car and petrol, gas and gas stove.		**eg: tea and coffee, coke and pepsi.**
•	There is an inverse relationship between demand for a good and the price of its components.  		There is a direct relationship between the demand for the product and the price of its substitutes. 

3. **Consumers taste and Preferences:**
Taste and preferences depend on social customs and the habits of the people, fashion and the general lifestyle of the people etc. if taste and preferences are strong for the product, demand increases and if taste and preferences are weak and unfavourable for the product, demand decreases.
4. **Consumer Expectation regarding price in future**
If consumer expects increase in price in future, demand increases in present. If consumer expects decrease in the price in future, demand decreases in present.
5. **Consumer credit facility**
If credit facility to consumers is available, demand increases. If credit facility to consumers is not available, demand decreases.
Ex: Car loans are easily available in India that's why there are so many cars in India.
6. **Income of the consumer**
The relation between the income of the consumer and the demand can be understood taking three types of commodities
    (a) **Normal goods:** Goods for those the demand increases with the increase in income of the consumer and decrease with the decrease in income of the consumer.
    Example: Furniture, Television and clothes.
    (b) **Inferior goods:** Goods for those the demand falls with an increase in the income of the consumer and rises with the decrease in the income of the consumer. There is an inverse relationship between the income of the consumer and the demand for inferior goods.
    Example: Maize and Bajara

    (c) **Inexpensive goods of necessities:** Goods for those the demand increases with increase in income upto a certain level and, thereafter, it remains constant irrespective of the level of income.
    Example: Salt and Match box

Factors affecting Market demand

7. **Size and Composition of population:** The population size of a country determines the number of consumers. With an increase in the size of the population, the demand for the commodity will increase.
The composition of a population refers to the various aspects of the population like the number of children adults, males, females, etc. If the number of teenagers increases, the demand for those goods that teenagers tend to buy increases.
Example: Jeans, cricket bat will tend to increase.
8. **Government Policy:** If the Government increases indirect taxes, it leads to an increase in price, and as a result, the demand decreases.
If the government incurred more expenditure on the construction of roads, bridges, etc., the demand for construction goods will increase.
9. **Distribution of Income:**
Case I:
If income is distributed evenly, there will be more demand for essential goods.
Case II:
If income is distributed unevenly, then there will be more demand for luxury goods.

Demand Function

The functional relationship between the demand for a product and its factors is known as demand function.

Law of Demand

It states that other things remaining constant, the quantity demanded of the commodity increases when its price fall and decreases when its price rises. Law of Demand explains the inverse relationship between price and quantity demanded.

Assumption of Law of Demand

1. Price of related goods are kept constant.
2. Price of the commodity are kept constant.
3. Consumers' taste and preference are kept constant.
4. Consumers' expectations regarding price in the future are kept constant.
5. Consumer credit facility.
6. Income of the consumers are kept constant.
7. Size and composition of the population are kept constant.
8. Government Policies are kept constant.
9. Distribution of Income is kept constant.

Exception to the Law of Demand:

1. Articles of Snob appeal (Conspicuous Consumption)

The Law of Demand does not apply to the commodities which serve as a status symbol, increases social prestige, and is a source of display and richness. Example: rich women would like to buy a diamond at a higher price to show their richness.

2. Giffen goods

(i) Giffen goods are those inferior goods on which consumers spend a large part of their income.

(ii) Demand for which falls with the fall in their prices.
Example: Maize and Jawar.

(c) Expectations regarding future price:

- If the price of a commodity is rising today and it is likely to rise more in the future then people demand more at their existing higher price and store it up.
- Similarly, when the consumer anticipates a large fall in the price of the commodity in the future, they will postpone their purchase even if price falls today.

(d) Quality price relationship:

- Sometimes consumers take price as an index of quality in such cases more of the goods may be demanded at a higher price. This is known as the Veblen effect.
  Example: Like Lux Premium, there is not much difference between Lux Premium and Lux International but a huge difference in price. But people think that Lux International is better as it has a higher price.

(e) Change in fashion:

When a commodity goes out of fashion, consumers will not demand even when its price is reduced.

(f) Emergency:

Law of Demand may not hold good during emergencies like wars, famines, droughts, etc.

(g) Habitual goods:

If the price of habitual goods increases, demand does not decrease.
Example: Cigarettes, Wines.

Demand Schedule

It is a tabular statement that shows different quantities of commodities demanded at different prices during a given period.

It is of two types:-

(a) Individual demand schedule:

It is the table that shows various quantities of the commodities demanded at different prices by a household/single consumer during a given period.

(b) Market demand schedule:

It is the table which shows various quantities of commodities demanded at different prices by all the households in a market during a given period.

Individual demand schedule:

Price	Quantity demanded by Mr. A
10	5
20	4
30	3
40	2
50	1

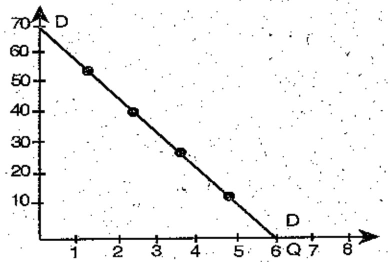
Market Demand Schedule:

Price	Quantity Demanded by Mr. A	Quantity Demanded by Mr. B	Quantity Demanded by Mr. C	Total
10	8	7	6	21
20	7	6	5	18
30	6	4	3	13
40	3	2	1	6
50	2	1	1	4

Demand Curve

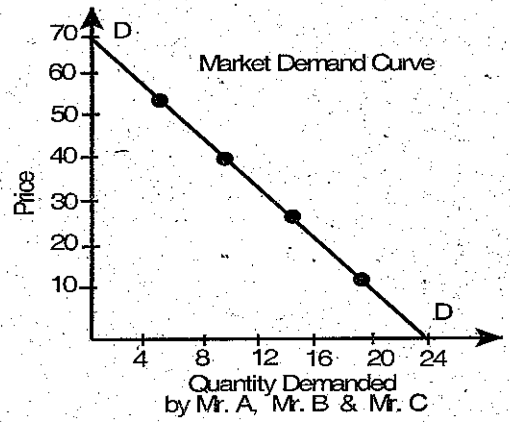
It is a graphical representation of different quantities demanded at different price levels.

1. **Individual Demand Curve:**
   A graphical representation of different quantities demanded at the different price levels by a single consumer.



Market Demand Curve:

A graphical representation of different quantities demanded at different price levels by all the consumers in a market.



Reasons for Negatively Sloping Demand Curve

1. **Income Effect:**
   - A change in demand on account of change in real income resulting in a change in the price of the commodity is known as income effect.
   - When the price of the commodity falls which results in an increase in purchasing power and the consumer can buy more and feel "BETTER OFF".
   - On the other hand with an increase in price, purchasing power decrease and consumer reduces the demand and feel "WORSE OFF"
2. **The Law of Diminishing Marginal Utility**
   - The law of diminishing marginal utility states that with an increase in the units of a commodity consumed, every additional unit of the commodity gives lesser satisfaction.
   - Marginal utility falls with an increase in consumption.
   - A consumer will maximise his satisfaction when MU_n = Price i.e. equilibrium condition.
   - If seller wants to sell more he has to reduce the price of the commodity.

3. **Substitution effect:**
   - The substitution effect refers to the change in demand for a good as a result of a change in the relative price of the good in terms of other goods.

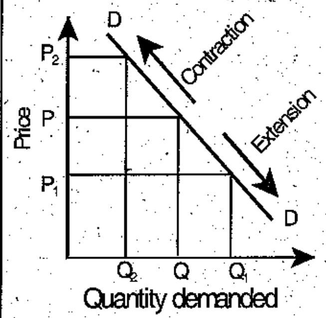
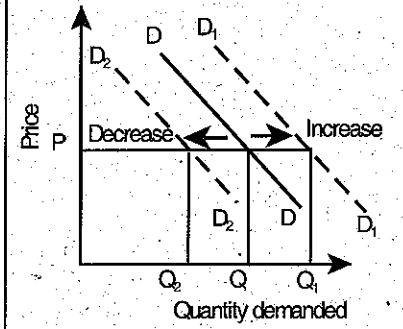
     Example: When the price of a good rises, it becomes more expensive in terms of other goods in the market. As a result, consumers move away towards its substitutes.
   - When the price of the commodity falls and prices of the substitute remains unchanged, it becomes relatively cheaper in comparison to its substitutes. As a consequence demand for a commodity will increase.
   - **Example:** If the price of tea falls and the price of coffee remains the same then the demand for tea increases and the consumers will shift their demand from coffee to tea.

     Price effect = Income effect + Substitution effect

4. **Increase in the number of consumers**
   - When the price of the commodity falls, the number of consumers increases which increases the demand for the commodity.
   - It happen because at a very high price only a few people can afford to buy that commodity and when the price falls people with less income will also be able to purchase that commodity.

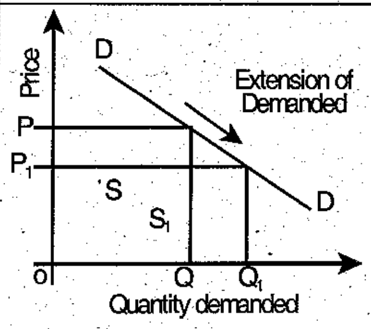
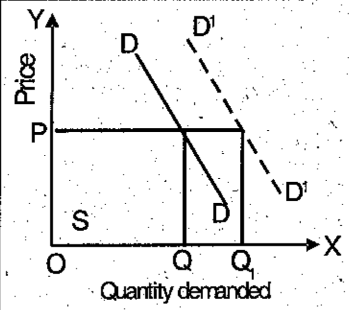
5. **Several uses of a commodity**
   - When the price of commodities e.g. electricity and milk are very high, they will be used for more important purposes only.
   - And, thereafter small quantity will be in demand but when the price falls, these commodities will be put to less important uses also leading to an increase in demand.
   - Example: Electricity will be used mainly for lightning purposes if price is high, and the electricity will be used for cooking and other purposes also when its price falls.

Difference between Movement along the Demand Curve and Shift in Demand Curve.

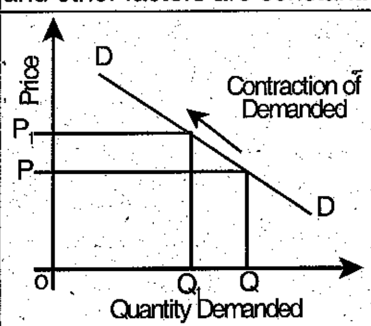
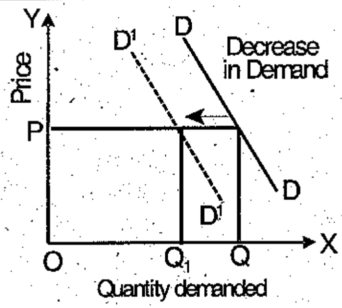
	Movement along the Demand Curve	Shift in Demand Curve
1.	When the amount demanded of a commodity changes as a result of change in its own price and factors remain constant it is known as movement along the demand curve.	When the amount demanded of a commodity changes because of change in all factors other than the own price of the commodity it is known as shift in demand.
2.	It is also known as change in quantity demanded.	It is also known as change in demand.
3.	It is of two types: (a) Extension of Demand (b) Contraction of Demand  	It is of two types: (a) Increase in demand (b) Decrease in demand 

Difference between Extension of Demand and Increase in Demand

	Extension of Demand	Increase in Demand
1.	It refers to the rise in quantity demanded of a good as a result of fall in its price.	It refers to the situation when consumer buys a larger amount of commodity at the same price due to change in other factors.

2.	Price of the commodity decreases and other factors are constant.	Other factors changes and the price of the commodity remains constant.
		
3.	There is a downward movement along the demand curve.	There is a rightward shift in demand curve.

Difference between contraction of Demand and Decrease in Demand

	Contraction of Demand	Decrease in Demand
1.	It refers to a fall in quantity demanded of a good as a result of rise in its price.	It refers to a situation when a consumer buy a smaller amount of the commodity at the same price due to change in other factors.
2.	Price of the commodity increases and other factors are constant.	Other factor changes and price of the commodity remains the same.
		

Elasticity of Demand

Meaning of Elasticity of Demand

It refers to the degree of responsiveness of quantity demanded of a commodity to a change in any of its determinants.

Three main types of elasticities are:

1. Price elasticity
2. Income elasticity
3. Cross elasticity

(a) Price Elasticity:

It refers to the degree of responsiveness of a quantity demanded of a commodity to a change in price.

Symbolically:

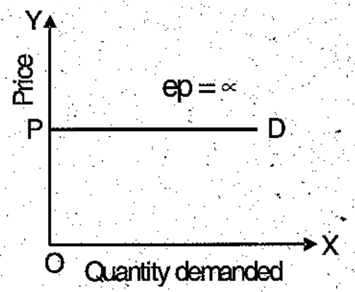
$$ep = \frac{\text{Percentage change in quantity demanded}}{\text{Percentage change in price}}$$

Degree/Classification of Price elasticity

1. Perfectly elastic demand. $ep = \infty$
2. Perfectly inelastic demand. $ep = 0$
3. Unitary elastic demand. $ep = 1$
4. Greater than one/more elastic demand. $ep > 1$
5. Less than one/less elastic demand. $ep < 1$

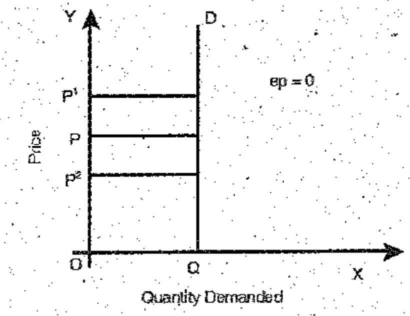
Perfectly Elastic Demand

When consumers are prepared to purchase all that they can get at a particular price but nothing at all at a slightly higher price. The demand curve is parallel to x-axis.



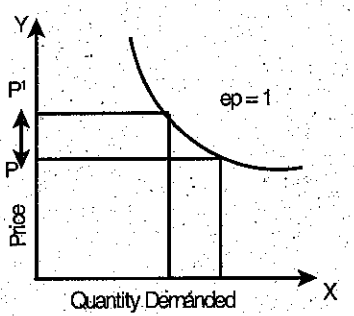
Perfectly Inelastic Demand:

When quantity demanded of a commodity does not respond to change in its price then the elasticity of demand is equal to zero. The demand curve is parallel to y-axis.



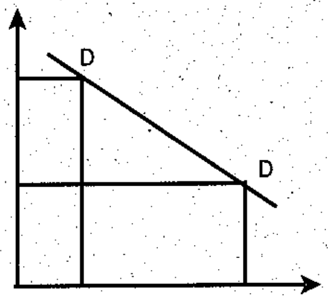
Unitary Elastic Demand:

When the percentage change in the price of a commodity causes an equivalent percentage change in quantity demanded. The demand curve is Rectangular hyperbola.



Greater than One/More Elastic Demand:

When the percentage change in quantity demanded of a commodity exceeds the percentage change in its price.



PAST YEAR QUESTIONS AND ANSWERS

2018 - MAY

[1] "High priced goods consumed by status seeking rich people to satisfy their need for conspicuous goods" is:

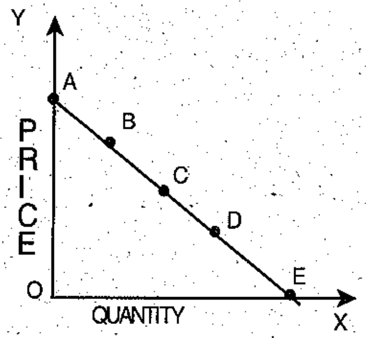
(a) Veblen effect (b) Bandwagon effect

(c) Snob effect (d) Demonstration effect (1 mark)

Answer:

(a) Veblen effect was given by Veblen. Hence, it is called Veblen effect, also known as prestige goods effect. It is related to conspicuous consumption. Veblen effect takes place as some consumers measure the utility by its price i.e. if price rises them they think that the commodity has got more utility. Veblen effect is the behavior practiced by rich people to satisfy their needs for conspicuous goods.

[2]



(a) elasticity at point A = ∞, at B = > 1, at C = 1, at D = < 1 and at E = 0

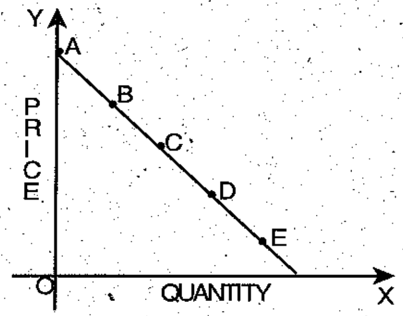
(b) elasticity at A=0, at B = < 1, at C = 1, at D = > 1 and at E = ∞

(c) elasticity at A = 0, at B > 1, at C = 1, at D = < 1 and at E = 0

(d) None of these. (1 mark)

Answer:

(a)



(a) When change in demand is greater than price change then e > 1
(b) When change in demand is less than the price change then e < 1
(c) When change in demand is same as the change in price then it is e =1
(d) When there is no change in demand as change in price then e = 0
(e) When price changes slightly but demand change is higher then e = ∞

Here, C shows e = 1 by which we can prove that
C ⇒ e = 1, A ⇒ e = ∞, B ⇒ e ≥ 1
D ⇒ e < 1, E ⇒ e = 0

[3] Cardinal approach is related to:

(a) Indifference curve (b) Equi marginal utility

(c) Law of diminishing returns (d) None of these. (1 mark)

Answer:

(b) Marginal Utility theory is given by Alfred Marshall. He assumes that the marginal utility theory is related to cardinal approach which means we can measure the utility in terms of money. Marshall says, "Money is the measuring rod of utility".

[4] An Increase in demand can result from:

(a) A decline in the market price
(b) An increase in income
(c) A reduction in the price of substitutes
(d) An increase in the price of complements. (1 mark)

Answer:

(b) Price and demand are inversely related as the price rises demand falls and *vice-versa*. But income and demand are directly related. Rise in income increases the quantity demanded and fall in income decreases the quantity demanded.

[5] Cross elasticity of perfect substitutes is

(a) Zero (b) Negative

(c) One (d) Infinity (1 mark)

Answer:

(d) Cross elasticity of perfect substitutes is infinity as the rise in the price of one good will cause a rise in the demand of its substitutes. **Example:** If the price of the tea rises, the demand for coffee rises as these two are perfect substitutes.
Cross elasticity of complementary goods leads to zero.

[6] Supply is a ______ concept.

(a) flow
(b) stock
(c) flow and stock, both
(d) qualitative (1 mark)

Answer:

(a) Supply refers to 'quantity of a good or service that consumers are willing and able to purchase during a given period of time. Supply is a flow concept as quantity supplied is so much per unit of time per day, per week or per year. It is regularly going on supply which means not only those goods which are sold but also those which are in stock.

[7] For what type of goods does demand fall with a rise in income levels of households?

(a) Inferior goods (b) Substitutes
(c) Luxuries (d) Necessities (1 mark)

Answer:

(a) Inferior goods are the type of goods which are not of good quality and no one wants to consume these but circumstances force them to consume these. If income rises of households then demand for inferior goods go down or elasticity for these goods becomes negative.

[8] Which economist said that money is the measuring rod of utility?

(a) A.C Pigou (b) Marshall
(c) Adam Smith (d) Robbins (1 mark)

Answer:

(b) Marginal Utility theory is given by Alfred Marshall. He assumes that the marginal utility theory is related to cardinal approach which means we can measure the utility in terms of money. Marshall says, "Money is the measuring rod of utility".

[9] Elasticity between two points:

(a) point elasticity (b) Arc elasticity
(c) Cross elasticity (d) None. (1 mark)

Answer:

(b) When price elasticity is to be found between two prices or two points on the demand curve then it is not possible to know what price and quantity should be taken as the base. So, we use Arc elasticity method to know the base price and quantity.

[10] An indifference curve is L shaped, then two goods will be:

(a) Perfect substitute goods
(b) Substitute goods
(c) Perfect complementary goods
(d) Complementary goods (1 mark)

Answer:

(c) When two goods are **perfect complementary goods** (e.g. printer and cartridge), the indifference curve will consist of two straight lines with a right angle between them which is convex to the origin, or in other words, it will be L shaped.

[11] The concept of consumer's surplus is derived from:

(a) The law of diminishing marginal utility.
(b) The law of equal-marginal utility
(c) The law of diminishing returns
(d) Engel's law (1 mark)

Answer:

(a) Consumer surplus is a surplus which a consumer would be willing to pay rather than go without a commodity over that which he actually does pay. Concept of consumer surplus is given by Marshall and it is derived from = what a consumer is willing to pay - what he actually pays.

[12] When supply curve shifts to the right there is:

(a) an increase (b) expansion
(c) contraction (d) decrease (1 mark)

Answer:

(a) When the supply curve shifts to the right due to a change in one or more factors other than the own price of the commodity. When supply curve shifts to right, we say that there is an increase in supply and when supply curve shift to left we say that there is a decrease in supply.

[13] Short- run price is also called by the name of:

(a) Market price
(b) Showroom price
(c) Maximum retail price
(d) None of these. (1 mark)

Answer:

(a) Short-run price is also known as the **market price** and it is determined by the temporary equilibrium between the forces of demand and supply.

[14] When supply price increase in the short run, the profit of the producer ______.

(a) increases
(b) decreases
(c) remains constant
(d) decreases marginally (1 mark)

Answer:

(a) Supply and price are directly related as the supply increase, price increases and as the price decreases, supply decreases. So, increase in supply-price will increase the profits of the producer.

2018 - November

[15] When Price of a commodity increases what will be the effect on quantity demanded?

(a) Increases
(b) Decreases
(c) No change
(d) None of these (1 mark)

Answer:

(b) As per the law of demand, other things being equal, if the price of a commodity falls, the quantity demanded of it will rise and if the price of a commodity rises, its quantity demanded will fall.

[16] According to the law of supply, change in supply is related to?

(a) Price of goods
(b) Price of related goods
(c) Factors of production
(d) None of the above (1 mark)

Answer:

(a) According to the law of supply, change in supply is related to the price of goods. As other things remaining constant, the quantity of a good (produced and offered for sale) will increase if the price rises.

[17] In case of inferior goods, with a rise in the income of consumers, demand for Giffen goods will ....?

(a) Increases
(b) Decreases
(c) No change
(d) None of the above (1 mark)

Answer:

(b) In general cases, as consumer income rises, they will prefer high quality goods and, therefore, demand for Giffen goods will decrease.

[18] In case of necessaries, consumer surplus is?

(a) Infinite
(b) Zero
(c) Equals to one
(d) More than one (1 mark)

Answer:

(a) In case of necessaries, the marginal utilities of the first few units are infinitely large. In such cases the consumer surplus is always infinite.

[19] When the price of a commodity rises from 200 to ₹ 300 and Quantity supply increases from 2000 to 5000 units, find the elasticity of supply?

(a) 3.0
(b) 2.5
(c) 0.3
(d) 3.5 (1 mark)

Answer:

(a) $\frac{\Delta q}{q} \times \frac{p}{\Delta p} \Rightarrow \frac{3,000}{2,000} \times \frac{200}{100}$

$= 3.0.$

[20] From the following data given below answer question 20 and 21-

Units	TU	MU
1	200	
2	–	180
3	480	–

Total utility derived from 2nd unit?
(a) 380
(b) 20
(c) 100
(d) 280 (1 mark)

Answer:

(a) TU = $\sum$ MU
therefore, 380

[21] Marginal utility of 3rd unit is?
(a) 200
(b) 280
(c) 100
(d) 50 (1 mark)

Answer:

(c) $MU = TU_n - TU_{n-1}$
Therefore, = 480 – 380 = 100

[22] Which Equation is correct–
(a) $\frac{MUx}{MUy} = \frac{Px}{Py}$
(b) $\frac{MUx}{MUy} > \frac{Px}{Py}$
(c) $\frac{MUx}{MUy} < \frac{Px}{Py}$
(d) $\frac{MUx}{MUy} \neq \frac{Px}{Py}$ (1 mark)

Answer:

(a) The law of utility states that consumer will be in equilibrium when $\frac{MUx}{MUy} = \frac{P_x}{P_y}$

[23] The scope of the indifference curve shows consumer equilibrium at the point where $MRS_{(xy)}$ ______ $\frac{Px}{Py}$ (Price line)
(a) Less than
(b) More than
(c) Equal to
(d) None of the above (1 mark)

Answer:

(c) Consumer will be in equilibrium only when $MRS_{(xy)}$ is equal to $\frac{P_x}{P_y}$ (price line).

[24] Which of the following is not the property of the indifference curve?
(a) IC is convex to the origin
(b) IC scopes downwards from left to right
(c) Two IC can touch each other
(d) IC cannot touch either of the axes (1 mark)

Answer:

(c) Properties of Indifference curve are:
1. Indifference curves slope downward to the right
2. Indifference curves are always convex to the origin.
3. Indifference curves can never intersect each other
4. A higher Indifference curve represents higher level of satisfaction
5. Indifference curve will not touch either axes.

[25] In case of Normal goods, rise in price leads to ____?
(a) Fall in demand
(b) Rise in demand
(c) No change
(d) Initially rise then ultimately fall (1 mark)

Answer:

(a) In general cases, when the price of the commodities rise, the purchasing power of customer will fall and therefore demand will fall.

[26] Method of demand forecasting does not include?
(a) Mathematical method
(b) Barometric method
(c) Expert opinion method
(d) Statistical method (1 mark)

Answer:

(a) Method of demand forecasting are:
1. Survey of buyers' intentions
2. Collection opinion method
3. Expert opinion method
4. Statistical method
5. Controlled experiments
6. Barometric method.

Therefore, mathematical method is not a method of forecasting.

[27] If the price of the commodity increases, what will be the effect on the Quantity demanded?
(a) Decreases
(b) Increases
(c) No change
(d) Cant say (1 mark)

Answer:

(a) As per the law of demand, other things remaining constant when the price of commodity increases quantity demanded decreases and *vice versa.*

[28] An IC shows ________ MRS between the commodity?
(a) Increasing
(b) Decreasing
(c) Constant
(d) Zero (1 mark)

Answer:

(b) MRS is falling because as the consumer has more and more units of food, he is prepared to give up less and less units of the commodity.

[29] Forecasting of demand is the Art and Science of predicting?
(a) Actual demand for a product at the same future date
(b) Probable demand in future
(c) Total demand in future
(d) None of these. (1 mark)

Answer:

(b) Forecasting, in general, refers to knowing or measuring the status or nature of an event or variable before it occurs. Forecasting of demand is the art and science of predicting the probable demand for a product or a service.

[30] Addition made to total utility refers to?
(a) Total utility
(b) Average utility
(c) Marginal utility
(d) All of the above. (1 mark)

Answer:

(c) Marginal utility is the addition made to total utility by the consumption of an additional unit of a commodity.

[31] The elasticity of supply is zero means?
(a) Perfectly inelastic
(b) Perfectly elastic
(c) Imperfectly elastic
(d) All of the above. (1 mark)

Answer:

(a) The elasticity of supply:

$e > 1 \Rightarrow$ elastic supply
$e < 1 \Rightarrow$ inelastic supply
$e = 0 \Rightarrow$ Perfectly inelastic supply
$e = \infty \Rightarrow$ Perfectly elastic supply
$e = 1 \Rightarrow$ Unit elastic

Therefore, the elasticity of supply is zero means, it is perfectly inelastic supply.

2019 - MAY

[32] The Consumer is in equilibrium when the following condition is satisfied:

(a) Budget line is tangent to the Ic curve

(b) $\frac{MU_X}{P_X} = \frac{MU_Y}{P_Y} = \frac{MU_Z}{P_Z}$

(c) Both (a) and (b)

(d) None of the above (1 mark)

Answer :

(c) Condition for consumer attaining equilibrium is the point where the budget line is tangent to the indifference curve and $\frac{MU_x}{P_x} = \frac{MU_y}{P_y}$

Hence, **option (c)** is correct.

[33] Which of the following statement is correct?

(a) Supply is inversely related to its cost of production

(b) Price and quantity demand of a good have a direct relationship

(c) Taxes and subsidy has no impact on the supply of the product

(d) Seasonal changes have no impact on the supply of the commodity (1 mark)

Answer :

(a) In economics, supply refers to quantity of product available in market for sale at a specified price at a given point of time.

Supply of a product has an inverse relation with cost of production. **Example** A seller would supply less quantity of product in market when the cost of production exceeds the market-price of the product. In such case, the seller would wait for a rise in the price of the product.

[34] When the supply of a product is perfectly inelastic then the curve will be

(a) Parallel to Y-axis

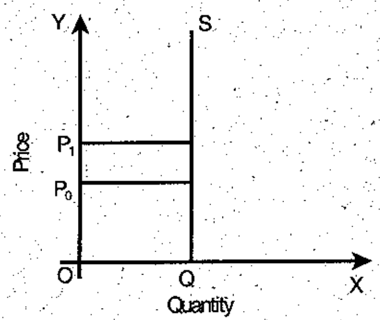
(b) Parallel to X-axis

(c) At the angle of 45^0

(d) Sloping upwards (1 mark)

Answer :

(a) If due to a change in the price, the quantity supplied of goods remain unchanged, such goods are said to have inelastic supply i.e. there supply cannot be changed. This is shown by the vertical supply curve i.e. curve parallel to Y-axis.



[35] In the case of ________, there is an inverse relationship between income and demand for a product.

(a) Substitute goods

(b) Complementary goods

(c) Giffen Goods

(d) None of the above (1 mark)

Answer :

(c) Giffen goods are the products for which demand increases as the price increases and falls when the price decreases. These is a special case of inferior goods which people buy less when their income rises. Hence, an inverse relationship is established between income and demand of the product.

[36] If maize has - 0.30 as income elasticity of demand, then maize will be considered as________.

(a) Necessity

(b) Inferior good

(c) Superior good

(d) None (1 mark)

Answer :

(b) Since the income elasticity of maize is — .30 < 0, it is an inferior commodity in the eyes of the household. The demand for inferior goods falls as income rises. Also as the elasticity is less than one, it shows that the goods is either relatively less important in the consumer's eye or it is a necessity.

[37] If price decreases from ₹ 80 to ₹ 60 and elasticity of demand is 1.25 then ___________.

(a) demand increase by 25%
(b) demand decrease by 25%
(c) remains constant
(d) None of the above (1 mark)

Answer:

(d) $\text{Price Elasticity} = \dfrac{\text{Percentage change in quantity demanded}}{\text{Percentage change in price}}$

given, ⇒ Elasticity = 1.25

$\% \text{ change in price} = \dfrac{60-80}{80}\ 25\%$

$1.25 = \dfrac{\%\text{change in Quantity}}{25\%}$

Increase in Demand = -31.25%

Hence, **option (d)** is correct.

[38] Which of the following is / are the conditions of theory of consumer surplus if the price is same for all the units he purchased?

(a) The consumer gains extra utility or surplus
(b) Consumer surplus for the last commodity is zero
(c) Both
(d) None (1 mark)

Answer:

(c) The concept of consumer surplus is based on the law of diminishing marginal utility. If a consumer gets extra of something, its marginal unity starts decreasing. Keeping the price same for all the commodities, a consumer gets extra utility for the units consumed by him except the one at the margin i.e. the last unit. The extra utility obtained by the consumer is known as consumer surplus.

[39] Which of the following is not the property of an indifference curve?

(a) Slopes downwards to the right
(b) Always convex to the origin
(c) Intersects each other
(d) Will not touch either of the axes. (1 mark)

Answer:

(c) The following are the properties of an indifference curves:

1. It slopes downwards to the right
2. It is convex to the origin
3. Two ICs never intersect each other
4. Higher IC represents a higher level of satisfaction
5. IC never touches either axes

Thus **option (c)** is not the property of an indifference curve.

[40] Which of the following is correct ?

(a) Elasticity on the lower segment of demand curve is greater than unity
(b) Elasticity on the upper segment of demand curve is lesser than unity
(c) Elasticity at the middle of the demand curve is equal to unity
(d) Elasticity decreases as one moves from the lower part of the demand curve to upper part (1 mark)

Answer:

(c) Point elasticity at any point can be measured by the following formula

$\dfrac{RT}{Rt} = \dfrac{\text{lower segment}}{\text{upper segment}}$

- Elasticity on lower segment of demand curve is less than 1
- Elasticity at the middle of the demand curve is equal to unity
- Elasticity on the upper segment of the demand curve is more than 1
- Elasticity increases on one moves from the lower part of the demand curve to upper part.

[41] Which of the following will affect the demand for non-durable goods?

(a) Disposable Income
(b) Price
(c) Demography
(d) All of the above (1 mark)

Answer:

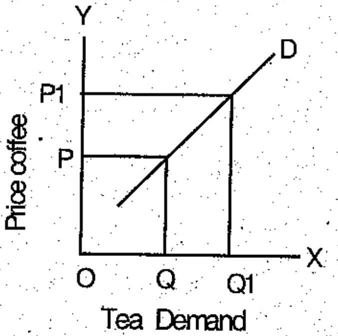
(d) Factors affecting the demand for non-durable consumer goods are
1. Disposable income
2. Price
3. Demography

Thus, **option (d)** is the correct answer.

[42] When the price of tea decreases, people reduce the consumption of coffee. Then the goods are
(a) Complementaries
(b) Substitutes
(c) Inferior goods
(d) Normal goods (1 mark)

Answer:

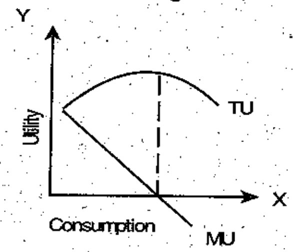
(b) Substitute goods are those goods which can be interchangeably used. **Example**, tea and coffee, ink pen and ball pen. If the price of a product falls the people will try it and thus, the demand for the other product will fall.



[43] Which of the following relation is true with MU?
(a) When MU is positive, Total utility rises at a diminishing rate
(b) When marginal utility is zero, total utility is maximum
(c) When marginal utility is negative, total utility is diminishing
(d) All of the above (1 mark)

Answer:

(d) The relationship between marginal utility (MU) and Total Utility (TU) is as follows:
1. When MU decreases TU increases at a decreasing rate
2. When MU is zero, TU is maximum
3. When MU becomes negative, TU declines.



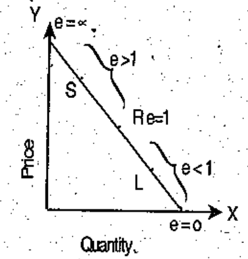
[44] The price elasticity of demand at the midpoint of the straight - line demand curve under point method is ________.
(a) 0
(b) 1
(c) >1
(d) <1 (1 mark)

Answer:

(b) Given a straight line demand curve, point elasticity can be calculated through.

$$\frac{RT}{Rt} = \frac{\text{lower segment}}{\text{upper segment}}$$

Elasticity at various points:

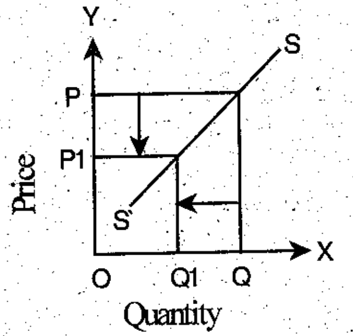


Thus, price elasticity of demand at mid point under point method is 1.

[45] Contraction of supply implies ________.
(a) Decrease in cost of production
(b) Decrease in price of the good concerned
(c) Decrease in price of related good
(d) Increase in price of the good concerned (1 mark)

Answer:

(b) Contraction in supply is the result of decrease in price of the goods concerned.



[46] Perishable commodities will have ________.
(a) Perfectly elastic curve
(b) Perfectly inelastic curve
(c) Elastic
(d) Inelastic (1 mark)

Answer:

(b) The supply curve of perishables goods is perfectly inelastic. Perishable goods cannot be stored for a long time, if stored, the same will be wasted, thus, its supply is limited and cannot be changed in short run.

2019 - NOVEMBER

[47] Supply is a ______ concept.
(a) Flow
(b) Stock
(c) Both (a) and (b)
(d) None of the above (1 mark)

Answer:

(a) Supply refers to what a firm offer for sale in the market, not necessarily to what they succeed in selling. What is offered may not get sold.
Supply is a flow concept. The quantity supplied is 'so much' per unit of time, per day, per week, or per year.

[48] Total utility is also known as
(a) Total satiety
(b) Aggregate satiety
(c) Full satiety
(d) Half satiety (1 mark)

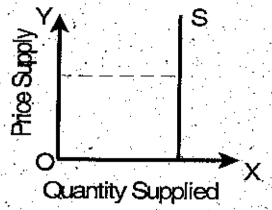
Answer:

(a) Total utility is measurable and additive total utility may be defined as the sum of utility derived from different units of a commodity consumed by a consumer.
Total utility is the sum of total marginal utilities derived from the consumption of different units i.e.
$TU = Mu_1 + Mu_2 + ... + Mu_n$
∴ We can say that total utility is also known as total satiety.

[49] A vertical supply curve parallel to y axis implies the elasticity of supply is
(a) Zero
(b) Infinity
(c) Equal to one
(d) Greater than zero but less than infinity (1 mark)

Answer:

(a) A Vertical supply curve parallel to y-axis implies that elasticity of supply is Zero.



[50] Budget line is also called
- (a) Price line
- (b) Iso cost line
- (c) Iso-quant
- (d) None

(1 mark)

Answer:

(a) Budget line shows all those combinations of two goods which the consumer can buy spending his given money incomes on the two goods at their given prices. All those combinations which are within the reach of the consumer. Will lie on the budget line.

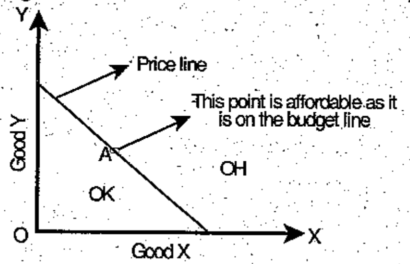
$\therefore \quad P_x O_x + P_y Q_y \leq B$

Where Budget line is also called price line.

$\therefore \quad P_x Q_x \Rightarrow$ Price and Quantity of good X

$P_y Q_y \Rightarrow$ Price and Quantity of good Y

B is the Budget



Points K and H are not affordable because of budget constraints.

[51] The Quantity supplied of a goods or services is the amount that____
- (a) As actually bought during a given time period at given price.
- (b) Producers wish, they could sell at higher price
- (c) Producers plan to sell during a given time period at given price.
- (d) People are willing to buy during a green their period at a given price.

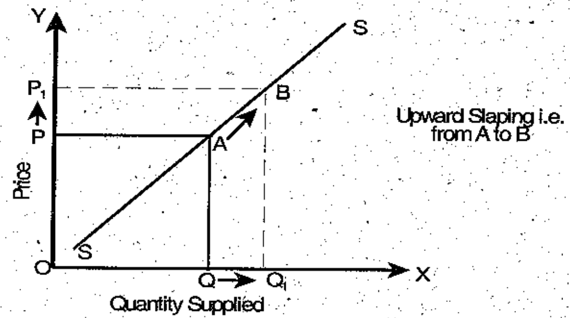
(1 mark)

Answer:

(c) The quantity supplied of a good or services is the amount that producers plan to sell during a given time period at given price.

The quantity supplied of a good also depends upon government's industrial and foreign policies, goals of the firm, infrastructural facilities etc.

Law of supply states that other things remaining constant, the quantity of a good produced and offered for sale will increase as the price of the good rises and decreases as the price falls.



Supply Curve

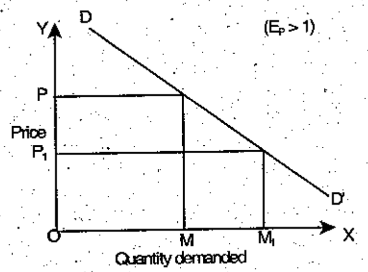
[52] Luxury goods have income elasticity
- (a) Negative and less than 1
- (b) Positive and greater than 1
- (c) Zero
- (d) None

(1 mark)

Answer:

(b) Luxury goods have income elasticity is positive and greater than one. i.e. ($E_P > 1$)

Demand for luxury goods arise beyond a certain level of consumers income and keep on rising as income increases.
Eg.: Car, TV etc.
Elasticity greater than one when the percentage change in quantity demanded is greater than percentage change in price.



Elasticity is greater than one

[53] Percentage change quantity supplied is divided by ______ to obtain elasticity of supply
(a) Percentage decrease in price
(b) Percentage change in price
(c) Both (a) and (b)
(d) None (1 mark)

Answer:

(b) Percentage change in quantity supplied is divided by percentage change in price to obtain elasticity of supply.

$$E_s = \frac{\text{Percentage change in Quantity Supplied}}{\text{Percentage change in Price}}$$

[54] If the price of the product is ₹ 20 per unit and if the price decreases by 5% as a result of which quantity demanded increases by 10% find MR_{11} { old quantity is 10 units}
(a) 9
(b) 19
(c) 10
(d) 12 (1 mark)

Answer:

(a)

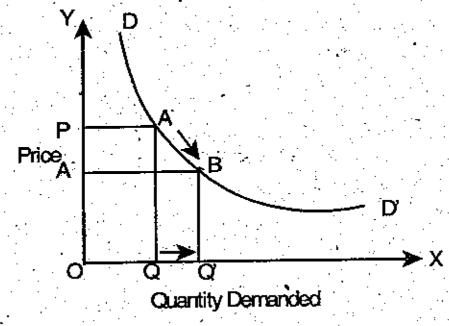
Price (P) (₹)	Quantity units	Total Revenue TR = P × Q
20	10	200
19	11	209

$\therefore$ $MR_n = TR_n - TR_{n-1}$
$MR_{11} = TR_1 - TR_{11-1}$
$MR_{11} = 209 - 200$
$MR_{11} = 9$

[55] Law of demand relates to:
(a) Price only
(b) Price and quantity demanded of a good
(c) Quantity demanded only
(d) Supply (1 mark)

Answer:

(b) Law of demand relates to price and quantity demanded of a good.
As "Prof. Alfred Marsall" defined Law of Demand as –
The greater the amount to be sold, the smaller must be the price at which it is offered in order that it may find purchasers or in other words the amount demanded increases with a fall in price and diminishes with a rise in price.



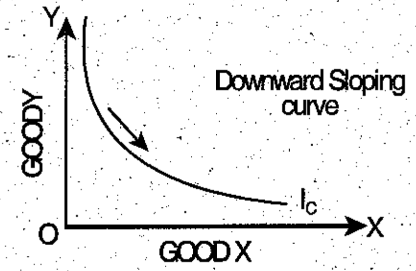
Demand Curve for Commodity X

[56] An in difference curve slopes down towards right since more of one commodity and of another commodity result in
(a) Same level of satisfaction
(b) Maximum satisfaction
(c) Greater satisfaction
(d) Less satisfaction (1 mark)

Answer:

(a) Indifference curve slopes down towards right since more of one commodity and of another commodity result in same level of satisfaction.

The downward slope of indifference curve states that two commodities can be substituted for each other and when the amount of one good in the combination is increased, the amount of the other good is reduced. This is essential if the level of satisfaction is to remain the same on an indifference curve.



Indifference Curve

[57] Elasticity for habitual goods is
(a) Perfectly elastic
(b) Elastic
(c) Perfectly inelastic
(d) Inelastic (1 mark)

Answer:

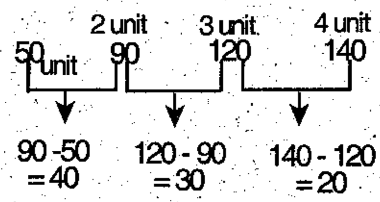
(d) Elasticity for habitual goods is inelastic. Elasticity is less than one when the percentage change in quantity demanded is less than the percentage change in price. In such case demand is said to be inelastic.

$$E_P = \frac{\text{Percentage Change Quantity Demanded}}{\text{Percentage Change in Price}}$$

[58] Diminishing marginal returns for the first four units of variable inputs is exhibited by the total product sequences.
(a) 50,100,150,200
(b) 50,50,50,50
(c) 50,110,150,260
(d) 50,90,120,140 (1 mark)

Answer:

(d) 50 , 90 , 120, 140



As $MP_n = TP_n - TP_{n-1}$

2020 - NOVEMBER

[59] Demand forecasting by means of asking customer what they are going to buy comes under:
(a) Survey of buyers intentions
(b) Statistical method
(c) Grass roots method
(d) Expert opinion method (1 mark)

Answer:

(a) Survey of buyer's intention - a forecasting technique in which known purchasers of a product are asked to predict their requirements for a given future period.

[60] When the price of petrol decreases, people reduce the consumption of diesel then the goods are:

(a) Mixed

(b) Complementary

(c) Superior

(d) Substitutes (1 mark)

Answer:

(d) Substitute goods are two alternative goods that could be used for the some purpose. When the price of petrol decreases, people reduce the consumption of diesel.

[61] When price of apple is ₹ 120 per kg. Ram buys one kg. of apples at that price. Now if other things remains the same but the price of apples falls to ₹ 90 per kg. Now Ram buys 2 kg of apples. It is called as:

(a) Contraction of demand

(b) Expansion of demand

(c) Market demand

(d) Demand schedule (1 mark)

Answer:

(b) Expansion in demand refers to a rise in the quantity demanded due to a fall in the price of commodity, other factors remaining constant it leads to a downward movement along the some demand curve.

[62] To know the base price and quantity, which method of elasticity is used?

(a) Arc Elasticity

(b) Cross Elasticity

(c) Point Elasticity

(d) Zero Elasticity (1 mark)

Answer:

(a) In Arc elasticity, it can be calculated by using the formula:

$$E_p = \frac{q_1 - q_2}{q_1 + q_2} \times \frac{p_1 + p_2}{p_1 - p_2}$$

This is because elasticities found by using original price and quantity figures as base will be different from the one derived by using new price and quantity figures.

[63] The price elasticity of demand for X is 1 and the average quantity demand of X is 90 units. If the price of X decreases from ₹ 300 to ₹ 180 per unit, calculate the new quantity demand of X is:

(a) 126 units

(b) 36 units

(c) 144 units

(d) 120 units (1 mark)

Answer:

(a) It can be calculated by using formula:

$$e = \frac{Q_1 - Q_0}{Q_0} \times \frac{P_0}{P_1 - P_0} \Rightarrow 1 = \frac{Q_1 - 90}{90} \times \frac{300}{300 - 180} \Rightarrow Q_1 = 126 \text{ units}$$

[64] If the quantity supply changes substantially in response to small changes in price of the good then it is:

(a) Relatively greater elastic supply

(b) Relatively less elastic supply

(c) Unitary elastic

(d) Perfect elastic (1 mark)

Answer:

(a) If elasticity of supply is greater than one i.e., when the quantity supplied of a good changes substantially in response to a small change in the price of the good we say that supply is relatively elastic.

[65] If Indifference curve is L shaped, means two goods will be:

(a) Perfect complementary goods

(b) Perfect substitute goods

(c) Perfect inferior goods

(d) Perfect superior goods (1 mark)

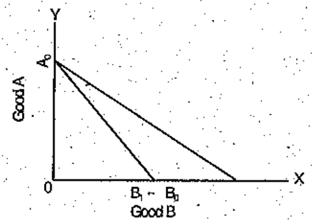
Answer:

(a) When two goods are perfect complements, they are represented by a 'L' shaped indifference curve.

[66] Let us assume that in OY axis we have good A and on OX axis good B. If the price of good B increases by ₹ 1 but the price of good A remains constant and income also remains unchanged, the budget line will shift:
(a) Right on OY axis
(b) Right on OX axis
(c) Left on OY axis
(d) Left on OX axis (1 mark)

Answer:

(d)



Left on ox axis

In this diagram, we can clearly see that good B has shifted leftward towards ox-axis.

[67] Purushotham wanted to buy laptop by paying ₹ 60,000 but the actual price is ₹ 55,000 then the consumer surplus is:
(a) ₹ 60,000
(b) ₹ 55,000
(c) ₹ 5,000
(d) ₹ 6,500 (1 mark)

Answer:

(c) Consumer's surplus = What a consumer is ready to pay – What he actually pays

∴ Consumer's Surplus = 60,000 – 55,000
= ₹ 5,000

2021 - JANUARY

[68] Effective demand depends on.
(a) Price
(b) Cost
(c) Desire
(d) Product. (1 mark)

Answer:

(a) Price

Effective demand depends upon various factors but according to the given question it mainly depends upon price.

[69] Why does demand curve slopes downwards?
(a) Law of diminishing marginal cost
(b) Arrival of old consumers
(c) Cost effect
(d) Different users. (1 mark)

Answer:

(b) Arrival of old consumers

Generally, demand curve slopes downward from left to right. It is due to many reasons such as law of diminishing marginal utility, price effect, substitution effect arrival of old consumers and many uses of a commodity.

[70] What is not a determinant of demand?
(a) Consumer's expectations
(b) Consumer's tastes and preferences
(c) Income of the consumers
(d) Prices of unrelated goods. (1 mark)

Answer:

(d) Prices of unrelated goods

Demand depends upon various determinants such as price, income, taste and preferences, price of related commodity, climatic factors etc.

[71] What are exceptions to Law of Demand?
(a) Law of Diminishing Marginal Utility
(b) Substitution effect
(c) Conspicuous goods
(d) Different uses. (1 mark)

Answer:

(c) Conspicuous goods
Generally law of demand slopes downward but sometimes it slopes upward which is known as an exception to the law of demand. The various reasons are Giffen goods conspicuous goods, during emergencies etc.

[72] Identify the factor which generally keeps the price elasticity of a good law:
(a) Variety of uses for that good
(b) Very low price of a commodity
(c) Close substitutes for that good
(d) High proportion of the consumer's income spent on it. (1 mark)

Answer:

(b) Very low price of a commodity
Price elasticity of a good is low if the price of a commodity is very low i.e. it is inelastic.

[73] In the case of inferior goods, the income elasticity of demand is:
(a) Positive
(b) Zero
(c) Negative
(d) Infinite (1 mark)

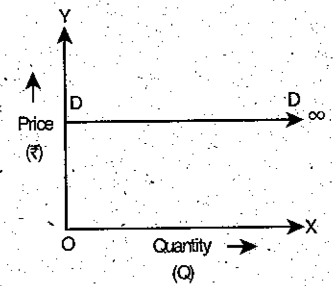
Answer:

(c) Negative
In the case of inferior goods, the income elasticity of demand is Negative which means that due to the increase in income the quantity consumed (inferior goods) decreases.

[74] What is numerical measure of elasticity for "Perfectly Elastic"
(a) Zero
(b) Infinity
(c) Greater than one and less than infinity
(d) Less than one (1 mark)

Answer:

(b) Infinity
The numerical value of elasticity of perfect elastic = (∞)



[75] The price of 1 kg. of tea is ₹ 30 demand at this price is 5 kg. If price of coffee rises from 25 to 35 per kg. the quantity demanded of tea rises from 5kg. to 8 kg. Find out cross elasticity of tea?
(a) –1.5
(b) 1.5
(c) 3
(d) 1 (1 mark)

Answer:

(b) 1.5

Demand	Price
5 kg.	₹ 30
8 kg.	₹ 35

$$\text{Cross Elasticity} = \frac{\triangle qx}{\triangle py} \times \frac{py}{qx} \quad \begin{matrix} x = \text{tea} \\ y = \text{Coffee} \end{matrix}$$

$$= \frac{5-8}{-10} \times \frac{25}{5} = \frac{+3}{+10} \times \frac{25}{5} = +1.5$$

[76] Supply is _______ concept.
(a) Flow
(b) Stock
(c) Flow and Stock
(d) None of the above. (1 mark)

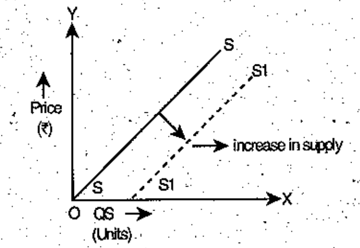
Answer:

(a) Flow
Supply is a flow concept. The quantity supplied is so much per unit of time, per day, per week or per year.

[77] When supply curves moves to right, it means:
(a) Supply increases
(b) Supply decreases
(c) Supply remains constant
(d) Supply expands (1 mark)

Answer:

(a) Supply Increases
When supply curves moves to right it means increase in supply.



[78] The second glass of lemonade gives lesser satisfaction to a thirsty boy. This is a clear case of:
(a) Law of demand
(b) Law of diminishing returns
(c) Law of diminishing marginal utility
(d) Law of supply. (1 mark)

Answer:

(c) Law of diminishing marginal utility
The second glass of lemonade gives lesser satisfaction to a thirsty boy. This is a clear case of diminishing marginal utility.

2021 - JULY

[79] The quantity demanded of coffee increases by 2% when the price of tea increases by 8%, the cross elasticity of demand between two product are:
(a) – 0.30
(b) + 0.30
(c) + 0.25
(d) – 0.25 (1 mark)

Answer:

(c) Cross elasticity = $\frac{\text{Percentage change in quantity demanded}}{\text{Percentage change in Price}}$

$= \frac{2\%}{8\%} = 0.25$

$= 0.25$

Hence, option **(c)** is correct.

[80] Goods which are inferior, with no close substitutes easily available and which occupy a substantial place in consumer's budget are called ______ goods.
(a) Giffen
(b) Conspicuous
(c) Speculative
(d) Prestige (1 mark)

Answer:

(a) Such goods which exhibits direct price-demand relationship are called Giffen goods. Giffen goods are those inferior goods whose demand increase as this price increase. Those goods which are inferior, with no close substitutes easily available and which occupy a substantial place in consumer's budget.

[81] Suppose the demand for automobile decreases due to increase in price of petrol both the goods are:
(a) Normal
(b) Substitute
(c) Perishable
(d) Complementary (1 mark)

Answer:

(d) Complementary goods are those goods which are consumed together or simultaneously for example automobile and Petrol. When two commodities are complements, a fall in the price of one will cause the demand for the other to rise.

[82] Marshall defined the concept of consumer surplus as the _______.
(a) Area covered in between the average revenue and marginal revenue curve
(b) Difference between maximum amount a person is willing to pay far a goods and the amount he actually pays
(c) Area inside the budget line
(d) Difference between the minimum amount a person is willing to pay for a good and its market price (1 mark)

Answer:

(b) Marshall defined the concept of consumer's Surplus as the difference between what a consumer is ready to pay and what he actually pays.

[83] Of the following who developed the Delphi technique of Demand forecasting?
(a) Olaf Helmer
(b) David Richardson
(c) Michael Porter
(d) J.M. Keynes (1 mark)

Answer:

(a) Delphi technique, developed by Olaf Helmer at the Rand Corporation of the USA, provides a useful way to obtain informed judgement from diverse expert by avoiding the disadvantages of conventional panel meeting.

[84] Indifference curve analysis is based on which approach?
(a) Nominal
(b) Cardinal
(c) Marginal
(d) Ordinal (1 mark)

Answer:

(d) Indifference curve analysis is based on ordinal approach. The indifference curve analysis assume that utility is only ordinally expressible. The consumer is capable of ranking all conceivable combination of goods according to the satisfaction.

[85] Read the following table and answer question no (32 – 33)

Quantity consumed	Total utility
0	0
1	300
2	500
3	650
4	750
5	830
6	890
7	930
8	960

What is Marginal utility when consumption increases from 4 units to 5 units?
(a) 130
(b) 80
(c) 160
(d) 100 (1 mark)

Answer:

(b) Marginal utility $= Tu_n - Tu_{n-1}$
$= Tu_5 - TU_4$
$= 830 - 750$
$= ₹\ 80$

Hence, **(b)** is correct.

[86] What is Marginal utility when consumption increases from 7 units to 8 units?
(a) 60
(b) 100
(c) 40
(d) 30 (1 mark)

Answer:

(d) Marginal utility $= Tu_n - Tu_{n-1}$
$= Tu_8 - Tu_{(8-1)}$
$= Tu_8 - Tu_7$
$= 960 - 930$
$= 30$

Hence, option **(d)** is correct.

[87] The price of a commodity decreases from ₹ 200 to ₹ 120 per unit. If the price elasticity of Demand for this commodity is 2 and the original quantity demanded is 60 units calculate the new quantity demanded.
(a) 48 units
(b) 100 units
(c) 120 units
(d) 108 units (1 mark)

Answer:

(d) Original quantity demanded = 60 units
elasticity = 2 times
original price = ₹200
new prices = ₹120

$$\text{Price elasticity} = \frac{\Delta Q}{\Delta P} \times \frac{P}{Q}$$

$$2 = \frac{\Delta Q}{80} \times \frac{200}{60}$$

$$\Delta Q = 48$$

New quantity = original quantity + ΔQ
= 60 units + 48 units
= 108 units.

[88] A group of people decreases or altogether stop consumption of a common product due to which of the following effect?
(a) Veblen effect
(b) Demonstration effect
(c) Bandwagon effect
(d) Snob effect. (1 mark)

Answer:

(d) When a product becomes common among all, some people decreases or altogether stop its consumption, this is called snob effect.

[89] Highly price goods are consumed by Status seeking rich people to satisfy their need for conspicuous consumption. This is called:
(a) Veblen effect
(b) Demonstration effect
(c) Snob effect
(d) Bandwagon effect (1 mark)

Answer:

(a) Veblen effect was given by Veblen. Hence, it is called Veblen effect, also known as prestige goods effect. Veblen effect takes place as some consumers measure the utility by its price i.e. if price rises them they think that commodity has got more utility. Veblen effect is the behavior practiced by rich people to satisfy their need for conspicuous goods.

[90] For which of the following product elasticity of demand is highly elastic?
(a) Salt
(b) Jewellery
(c) Life saving medicines
(d) Water. (1 mark)

Answer:

(b) Jewellery have elasticity of demand is highly elastic because due to increase in price of jewellery more will be demand on the other hand necessaries goods like salt, water, medicines have in elastic in nature.

[91] The indifferences curve for two perfect complementary goods is ________.

(a) Z shaped
(b) L shaped
(c) U shaped
(d) Straight line (1 mark)

Answer:

(b) When two goods are perfect complementary goods (e.g pointer and cartridge), the indifference curve will be consist of two straight lines with a right angle bent which is convex to the origin or in other words it will be L shaped.

[92] Assume that wheat have (-) 0.4 as income elasticity by this we can say:

(a) wheat is normal good
(b) wheat is an inferior good
(c) wheat is a superior good
(d) wheat is a luxurious good (1 mark)

Answer:

(b) Since the income elasticity of wheat is - 0.4 < 0, it is an inferior goods. The demand for inferior goods falls as income rises. Also the elasticity is less than one it shows the goods is either relatively less important in the consumer eye or it is a necessity.

2021 - DECEMBER

[93] Equation of supply is given as Q = 20p – 200.
If price is ₹ 30, then find the elasticity.

(a) + 1.5
(b) – 0.5
(c) + 0.66
(d) – 0.66 (1 mark)

Answer:

(a) Elasticity of demand measures how the quantity demanded of a commodity will change in response to the changes in its price. Elasticity of a good depends on the factors like nature of the good, availability of substitutes, income level, share in the expenditure etc.

Hence,

$$Es = \frac{dq}{dp} \times \frac{p}{q}$$

Since, $\frac{dq}{dp} = 20$,

p = 30,

q = 20 × 30 - 200

q = 400

$$\therefore \quad Es = \frac{20 \times 30}{400} = 1.5$$

[94] Who coined the term 'Demonstration effect'?

(a) Adam Smith
(b) Veblen
(c) James Duesenbury
(d) Alfred Marshall (1 mark)

Answer:

(c) James Duesenberry (1949) gave the name "demonstration effect" to this phenomenon, arguing that it promoted unhappiness with current levels of consumption, which impacted savings rates and consequently opportunities for macroeconomic growth.

[95] MRS from X to Y can be defined as ________

(a) Change in Y to change in X
(b) p_x / p_y
(c) p_y / p_x
(d) Change in X to change in Y (1 mark)

Answer:

(b) MRS is calculated between two goods placed on an indifference curve, displaying a frontier of utility for each combination of "good X" and "good Y." The slope of this curve represents quantities of good X and good Y that you would be happy substituting for one another.

[96] In case of _____ goods, the demand will rise to the fall of price only if substitution effect outweighs the income effect.

(a) Inferior goods
(b) Necessaries
(c) Giffen goods
(d) Luxury goods. (1 mark)

Answer:

(a) The increase in demand on account of an increase in real income is known as income effect. When the price of a commodity falls, the consumer can buy the same quantity of the commodity with lesser money or he can buy more of the same commodity with the same amount of money. In other words, as a result of fall in the price of the commodity, consumer's real income or purchasing power increases. A part or whole of the resulting increase in real income can now be used to buy more of the commodity in question, given that the good is normal. Therefore, the demand for that commodity (whose price has fallen) increases. However, there is one exception. In the case of inferior goods, the income effect works in the opposite direction to the substitution effect. In the case of inferior goods, the expansion in demand due to a price fall will take place only if the substitution effect outweighs the income effect.

[97] The value of demand elasticity can be taken from _____

(a) -1 to $+1$
(b) -1 to ∞
(c) 0 to ∞
(d) -1 to 0 (1 mark)

Answer:

(a) The elasticity of demand for a given good or service is calculated by dividing the percentage change in quantity demanded by the percentage change in price. If the elasticity quotient is greater than or equal to one, the demand is considered to be elastic.

[98] Consumer surplus is derived from which concept?

(a) Law of Diminishing Marginal Utility
(b) Law of consumer surplus
(c) Law of indifference curve
(d) Maximization of Profits (1 mark)

Answer:

(a) Consumer surplus is derived from the law of Diminishing Marginal utility. Consumer surplus is based on the economic theory of marginal utility, which is the additional satisfaction a consumer gains from one more unit of a good or service. Consumer surplus always increases as the price of a good falls and decreases as the price of a good rises.

[99] Law of Diminishing Marginal Utility is derived from ______.

(a) indifference curve
(b) consumer surplus
(c) maximization of profits
(d) expansion of firm (1 mark)

Answer:

(b) The law of diminishing marginal utility states that all else equal, as consumption increases, the marginal utility derived from each additional unit declines. Marginal utility is the incremental increase in utility that results from the consumption of one additional unit i.e., consumer surplus.

[100] Hicks and Allen believed that utility _________

(a) can be measured in ordinal numbers
(b) can be measured in cardinal numbers
(c) can be measured
(d) cannot be measured (1 mark)

Answer:

(a) Hicks and Allen believed that utility can be measured in ordinal numbers. The ordinal analysis of demand is based on indifference curve which represent the consumer's preferences graphically. An indifference curve is a curve which represents all those combinations of two goods which give same satisfaction to the consumer.

[101] At the point of satiation, TU is _____ and MU is ______.

(a) Maximum, zero
(b) Minimum, minimum
(c) Zero, Maximum
(d) Maximum, Maximum. (1 mark)

Answer

(a) When Marginal Utility is Zero, Total Utility is the maximum and it is the point of maximum satisfaction. i.e., point of satiety.

[102] Demand refers to ______

(a) Need for a commodity
(b) Use for a commodity
(c) Unlimited wants
(d) It is a desire backed by purchasing power, ability and willingness to pay. (1 mark)

Answer

(d) The effective demand for a thing depends on (i) desire (ii) means to purchase and (iii) willingness to use those means for that purchase. Unless desire is backed by purchasing power or ability to pay and willingness to pay, it does not constitute demand. Effective demand alone would figure in economic analysis and business decisions.

[103] Budget Line will be affected by __________

(a) change in demand
(b) change in income
(c) change in supply
(d) change in equilibrium (1 mark)

Answer:

(b) The budget constraint can be explained by the budget line or price line. In simple words, a budget line shows all those combinations of two goods which the consumer can buy spending his given money income on the two goods at their given prices. All those combinations which are within the reach of the consumer (assuming that he spends all his money income) will lie on the budget line.

[104] Utility can be measured in _____

(a) Units
(b) Utils
(c) Points
(d) Numbers (1 mark)

Answer:

(b) According to the neoclassical economists, utility is a cardinal concept i.e., utility is a measurable and quantifiable entity. It implies that utility can be measured in cardinal numbers and may be assigned a cardinal number like 1, 2, 3 etc. Marshall and some other economists used a psychological unit of measurement of utility called utils. According to Marshall, utility is the numerical score in terms of 'utils' representing the satisfaction that a consumer obtains from the consumption of a particular good. (Utils refer to the hypothetical measuring unit of utility).

[105] Which of the following is the property of IC?

(a) IC is concave to the origin
(b) ICs intersect each other
(c) IC slopes upward to the left
(d) IC does not touch either x-axis or y-axis (1 mark)

Answer:

(d) The four properties of indifference curves are:

1. indifference curves can never cross
2. the farther out an indifference curve lies, the higher the utility it indicates
3. indifference curves always slope downwards, and
4. indifference curves are convex.

[106] The dealings of Aeroplanes as given below are _______

Price (in ₹ lakhs)	Quantity Demanded (No. of Aeroplanes)
250	52
252	52
259	52
268	52
272	52

This represents ________
(a) Perfectly inelastic demand
(b) Perfectly Elastic demand
(c) Unit Elastic
(d) Relative Inelastic. (1 mark)

Answer:

(a) Perfectly inelastic demand

[107] During lockdown due to covid 19 a consumer finds the vegetable vendors selling vegetables in the streets have raised the prices of vegetables than usual prices. She will buy ______ vegetable than / as her usual demand showing the demand of vegetable is _______
(a) Same; Elastic demand
(b) Same; Inelastic demand
(c) Less; Elastic demand
(d) More; Inelastic demand (1 mark)

Answer:

(b) During lockdown due to covid 19 a consumer finds the vegetable vendors selling vegetables in the streets have raised the prices of vegetables than usual prices. She will buy **same** vegetable than/as her usual demand showing the demand of vegetables is **Inelastic demand.**

[108] For giffen goods the angle curve is:
(a) Vertical
(b) Horizontal
(c) Negatively slopped
(d) Positively slopped (1 mark)

Answer:

(c) For Giffen goods the angle curve is negatively slopped. A Giffen good is a low income, non-luxury product that defies standard economic and consumer demand theory. Demand for Giffen goods rises when the price rises and falls when the price falls. In econometrics, this results in an upward-sloping demand curve, contrary to the fundamental **laws of demand** which create a downward sloping demand curve.

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[109] Elasticity measured at a given point on supply curve:
(a) Point elasticity
(b) Arc elasticity
(c) Cross elasticity
(d) None of the above (1 mark)

Answer:

(a) The point elasticity of demand is the price elasticity of demand at a particular point on the demand curve. The change in price elasticity when is infinitesimal (very negligible) we use point elasticity.

[110] Change in price is larger than proportionate to change in demand ______which type of elasticity?
(a) Elastic
(b) Infinite
(c) Zero
(d) Inelastic (1 mark)

Answer:

(d) Demand is inelastic when change in price is larger than proportionate he change in demand.

Elasticity < 1

Demand curve of elasticity less then one.

[111] Veblen effect slopes toward:
(a) Downward to
(b) Upward
(c) Negative
(d) Positive (1 mark)

Answer:
(b) The demand curve for a veblen good is upward sloping, contrary to a normal demand curve, which is downward sloping.
When price of a veblen good goes up, demand goes up.

[112] Advertising elasticity of demand is always:
(a) Positive
(b) Negative
(c) Constant
(d) All of the above (1 mark)

Answer:
(a) Advertisement elasticity of demand is most of the time positive.
Advertisement elasticity is typically positive.
Advertisement elasticity varies between zero and infinity.

[113] The graph of perfect complimentary goods is:
(a) Straight line
(b) L shaped
(c) U shaped
(d) None of the above (1 mark)

Answer:
(b) When goods are perfect compliments, consumers consume them in fixed proportions. The indifference curve will consist of straight lines with a right angle bent, convex to origin.
Hence, if will be 'L' shaped.

[114] Which of the following is not a exception of law of demand?
(a) Giffen goods
(b) Conspicuous goods
(c) White goods
(d) None of the above (1 mark)

Answer:
(c) White goods are heavily priced slow moving goods.
Ex- Computers, radios, washing machines etc.
Every other good example giffen goods, conspicuous goods and speculative goods are exceptions to law of demand.

[115] When price increases fewer units are sold which tends to lower the revenue?
(a) Income effect
(b) Price effect
(c) Quantity effect
(d) Substitution effect (1 mark)

Answer:
(c) Quantity effect, after a price increase, fewer units are sold, which tends to lower the revenue.
If the quantity effect, which sends to reduce total revenue, is the stronger, total revenue reduces.

[116] The price of sugar falls from ₹ 10,000 to ₹ 8,000 & Quantity decrease from 2500 to 2000 find elasticity of supply .
(a) 0 (b) 1
(c) -1 (d) 2 (1 mark)

Answer:
(b) $E(s) = \frac{\Delta Q}{Q} \times \frac{P}{\Delta P} = \frac{2,000}{10,000} \times \frac{2,500}{500} = 1$

[117] The law of demand states that the quantity purchased______.
(a) Varies Inversely with price.
(b) Varies directly proportional with price
(c) Varies similarly with price
(d) None of the above (1 mark)

Answer:
(a) Varies inversely with price
Reason: The law of demand states that the quantity purchased varies inversely with price. In other words, the higher the price, the lower the quantity demanded. This occurs because of diminishing marginal utility.

[118] If the quantity demanded of mutton increases by 5 % when the price of chicken increase by 25% the price elasticity of demand is -
(a) 0.2
(b) -1
(c) 0
(d) 0.8 (1 mark)

Answer:

(a) Cross Price elasticity is $\Rightarrow \frac{\text{Demand of Good X (\%)}}{\text{Price of Good Y (\%)}} = \frac{5\%}{25\%} = 0.2$

[119] A vertical supply curve parallel to y axis implies that the elasticity of supply is -
(a) Zero
(b) Infinity
(c) More than one
(d) Less than one (1 mark)

Answer:

(a) A vertical supply curve parallel to y axis implies that the elasticity of supply is inelastic (highly) and is zero.
∴ No change in demand when price changes

[120] If customer is a habitual customer then elasticity is -
(a) Relative elastic
(b) Negative
(c) Zero
(d) Inelastic (1 mark)

Answer:

(d) If a customer has habitual use of a commodity, no matter how much its price changes, the demand for the commodity will be inelastic. If buyer have preference demand will be inelastic.

[121] Consumer surplus what he is willing to pay less-
(a) What he actually pays
(b) The price of the goods
(c) Money spent on goods
(d) All of the above (1 mark)

Answer:

(a) Consumer Surplus:
= What the consumer is willing to pay - What he actually pays.

[122] If advertisement is increased by 25% & demand is only increased by 5%. Find advertisement elasticity.
(a) -1
(b) 1
(c) 0.2
(d) -0.2 (1 mark)

Answer:

(c) Advertisement elasticity $\Rightarrow \frac{\text{Increase in Demand}}{\text{Advertisement Exp.}} \Rightarrow \frac{5\%}{25\%} = 0.02$

[123] When demand decrease due to price increase it is?
(a) Change in demand
(b) Increase in demand
(c) Contraction in demand
(d) Decrease in demand (1 mark)

Answer:

(c) When demand decreases due to price increase it is contraction of demand.

[124] An indifference curve is L shaped, then two goods will be .
(a) Perfect substitute goods
(b) Substitute goods
(c) Perfect complementary goods
(d) Complementary goods (1 mark)

Answer:

(c) When two goods are perfect complimentary goods, indifference curve will be L shaped.

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[125] When the elasticity of supply is infinite, the curve will be:
(a) Parallel to X-axis
(b) Parallel to Y-axis
(c) Upward sloping
(d) Downward sloping (1 mark)

Answer:

(a) When elasticity of supply is:
(i) Perfectly elastic ($E_S = \infty$) : Curve is parallel to x - axis
(ii) Perfectly inelastic ($E_S = 0$) : Curve is parallel to y - axis
(iii) Unit elastic ($E_S = 1$) : Curve is upward sloping and cuts the origin
(iv) Less elastic ($0 < E_S < 1$) : Curve is more slopier and cuts x-axis
(v) Greaver elastic ($1 < (E_S < \infty$) : Curve is more flatter and cuts y-axis

[126] Ram and sons are going for heavy advertisement campaign to enhance their sales. When analysed it was realised that the expenditure on advertisement by the company has gone up from ₹ 2,00,000 to 3,00,000 and the sales of this product increased from 10 lakh units to 20 lakh units. What is the advertising elasticity of demand?
(a) -1 (b) 4
(c) 2 (d) 3 (1 mark)

Answer:

(c) Advertisement elasticity = $\frac{\text{Increase in demand}}{\text{advertisement Exp.}}$

$$= \frac{\Delta Qd}{Qd} \times \frac{A}{\Delta A}$$

$$= \frac{10,00,000}{10,00,000} \times \frac{2,00,000}{1,00,000} = 2$$

[127] If the quantity demanded of mutton increases by 5% when the price of chicken increases by 20%, the cross price elasticity of demand between mutton and chicken is:
(a) 0.25
(b) -4
(c) 4
(d) -0.25 (1 mark)

Answer:

(a) $E_d = \frac{\text{\% change in quantity demanded}}{\text{\% change in price}}$

$$= \frac{\Delta Qd}{Q} \times \frac{p}{\Delta p} = \frac{5\%}{20\%} = 0.25$$

[128] The household income rises by 20% in a year consequently the demand of TV sets rises by 30% what is income elasticity of demand?
(a) 1.5 (b) 0.5
(c) 0.4 (d) 5 (1 mark)

Answer:

(a) Income elasticity = $\frac{\text{\% change in demanded}}{\text{\% change in income}}$

$$= \frac{30}{20} = 1.5$$

[129] Which of the following methods calculates elasticity of demand by using formula?
$\frac{\text{lower segment of demand curve}}{\text{upper segment of demand curve}}$
(a) They are elasticity method
(b) Cross elasticity method
(c) The income elasticity method
(d) The point elasticity method (1 mark)

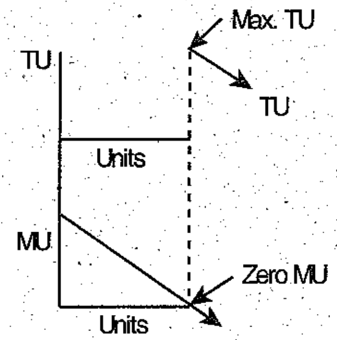
Answer: (d)

(d) Point elasticity of demand = $\frac{\text{Lower segment of demand curve}}{\text{Upper segment of demand curve}}$

[130] When marginal utility is zero then total utility is:
(a) Maximum
(b) Lower
(c) Negative
(d) Increasing (1 mark)

Answer:

(a) Relationship between TU and MU:
(i) TU rises as long as MU is positive, but at a diminishing rate because MU is diminishing
(ii) MU diminishes throughout
(iii) When MU = O, TU is maximum it is the satiation point
(iv) When MU is negative, TU is diminishing
(v) MU is the rate of change of total utility or it is the slope of TU curve
(vi) MU can be positive, zero or negative.



[131] The extent to which the demand for a consumers' good is decreased owing to the fact that others are also consuming the same commodity refers to:
(a) Bandwagon effect
(b) Snob effect
(c) Veblen effect
(d) None of the above (1 mark)

Answer:

(b) By Snob effect, we refer to two extent to which the demand for a consumer's good is decreased owing to the fact that others are also consuming the same commodity.

[132] Suppose the income elasticity of air conditioners is +1.8, which kind of good is an air conditioner?
(a) Conspicuous goods
(b) Normal good
(c) Inferior good
(d) Superior good (1 mark)

Answer:

(b) Income elasticity will be positive in case of a normal goods. As Air conditioner is a luxury goods and there is no precise definition of a luxury, but one might expect the income elasticity to be greater than +1.

[133] Change in demand due to increase in real income of a consumer is called:
(a) Income effect
(b) Substitution effect
(c) Marginal effect
(d) Price effect (1 mark)

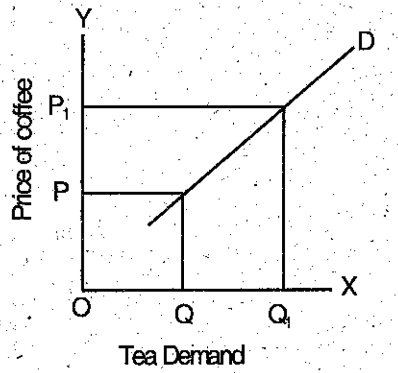
Answer:

(a) The increase in demand on account of an increase in real income is known as income effect.

[134] If the price of good X increases, demand of good Y also increases, the two goods are:
(a) substitutes
(b) complementary goods
(c) normal goods
(d) giffen goods (1 mark)

Answer:

(a) Substitute goods are those goods which can be interchangeably used. **Example,** tea and coffee, ink pen and ball pen. If the price of a product falls the people will try it and thus, the demand for the other product will fall.



[135] The Delphi technique of demand forecasting is also called:
(a) Expert opinion method
(b) Collective opinion method
(c) Controlled experiments
(d) Barometric method (1 mark)

Answer:

(a) The Delphi technique which is also known as Expert Opinion method is developed by Olaf Helmer at the Rand Corporation of the USA, provides a useful way to obtain informed judgements from diverse experts by avoiding the disadvantages of conventional panel meeting. Under his method, instead of depending upon the opinions of buyers and salesman, firm solicit the opinion of specialists or experts through a series of carefully designed questionnaires. Experts are asked to provide forecasts and reasons for their forecasts.

[136] Which of the following is not a statistical method of forecasting?
(a) Survey of buyers' intentions
(b) Regression Analysis
(c) Freehand projection method
(d) Least square method (1 mark)

Answer:

(a) Statistical method have proved to be very useful in forecasting demand. Forecasting using statistical methods are considered as superior methods because they are more scientific, reliable and free from subjectivity.

Import statistical methods of forecasting are:

(i) Trend projection method, which is also known as classical method, its popular techniques are:
  (a) Graphical Method, is also known as **Free hand.**
  (b) Fitting trend equation is also known as **Least Square Method**
(ii) Regression Analysis this is the most popular method of forecasting.

[137] An indifference curve represents those combination of two commodities which give consumer:
(a) Equal satisfaction
(b) Greater satisfaction
(c) Less satisfaction
(d) No satisfaction (1 mark)

Answer:

(a) An indifference curve of two commodities represent those combination which given consumer **Equal Satisfaction.**

[138] "Which of the following is NOT meant by liberalisation?
(a) Decontrol
(b) Disinvestment of PSU's
(c) Freedom to do business
(d) Deregulation (1 mark)

Answer:

(c) In an economy liberlisation aims for running a business without any barriers like without having any control, without any regulations. There is no hindrance for doing any business.

[139] Which of the following is not an assumption of marginal utility analysis?

(a) Consumer rationality
(b) Cardinal measurability of utility
(c) Ordinal measurability of utility
(d) Continuity in consumption (1 mark)

Answer:

(c) Ordinal measurability of utility means that utility can be ranked, which can be possible only in indifference curve analysis and not marginal utility analysis.

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[140] If demand of Bajra decreases due to decrease in its price, then Bajra is a:

(a) Superior Good
(b) Inferior Good
(c) Necessity Good
(d) Luxury Good (1 mark)

Answer:

(b) **Inferior Goods**

If the price of Bajra decreases, there will be increase in real income of consumers that will lead to decrease in demand for Bajra. Hence, it is inferior good.

[141] There is decrease in price of LED TV after budget announcement from ₹ 60,000 to ₹ 50,000. As a result to which demand for it has increases from 1500 units to 2000 units. Elasticity of demand for LED TV will be:

(a) 1.27 (b) 1.57
(c) 0.63 (d) 0.67 (1 mark)

Answer:

(b) **1.57**

P_0 = ₹ 60,000, P_1 = ₹ 50,000, $\Delta P = 50,000 - 60,000 = -10,000$
$Q_0 = 1500$ units, $Q_1 = 2000$ units, $\Delta Q = 2,000 - 1,500 = 500$ units

$$\text{Elasticity of Demand} = \frac{\Delta Q}{\Delta P} \times \frac{P_1 + P_2}{Q_1 + Q_2} = \frac{500}{-10,000} \times \frac{1,10,000}{3,500}$$

$$= -1.57 = 1.57$$

[142] Price effect is described as which of followings?

(a) Income Effect + Veblen Effect
(b) Substitution Effect + Veblen Effect
(c) Income Effect + Substitution Effect
(d) Veblen Effect + Demonstration Effect (1 mark)

Answer:

(c) **Income Effect + Substitution Effect**

Price Effect = Income Effect + Substitution Effect

[143] Increase in price of pulses leads to increase in demand of green vegetables:

(a) Substitute Goods
(b) Normal Goods
(c) Complimentary Goods
(d) None of the above (1 mark)

Answer:

(a) **Substitute Goods**

There is an increase in price of pulses which leads to increase in demand for vegetables. As the price of one good and demand for another good shows direct relation, so they are substitutes.

[144] When two goods are unrelated, then cross elasticity of demand will be:

(a) 0 (b) ∞
(c) 1 (d) (-)1 (1 mark)

Answer:

(a) **0**

When two goods are unrelated to each other, the cross elasticity of demand is zero.

[145] Rightward shift of demand curve of coffee represents:
(a) Decrease in Demand
(b) Increase in Demand
(c) Contraction
(d) Expansion (1 mark)

Answer:

(b) **Increase in Demand**
As, there is rightward shift of demand curve, there are factors other than price (non-price factors) or conditions of demand which might increase the demand of a particular good or service.

[146] If the price of a gel pen increases from ₹ 40 to ₹ 50 and in response to this the quantity demand decreases from 25 units to 20 units. The coefficient of price elasticity will be:
(a) 1.25
(b) –1.25
(c) 0.8
(d) –0.8 (1 mark)

Answer:

(d) **(–) 0.8**
P_0 = ₹ 40, P_1 = ₹ 50, QD_0 = 25 units, QD_1 = 20 units
ΔP = ₹ 10 , $\Delta QD = -5$

$$Ep = \frac{\Delta QD}{\Delta P} \times \frac{P_0}{Q_0} = \frac{-5}{10} \times \frac{40}{25} = -0.8$$

[147] Suppose there is an increase in income by 15%, which increases demand by 307, the income elasticity of demand will be:
(a) 0.67
(b) 0.5
(c) 2
(d) 1 (1 mark)

Answer:

(c) **2**
$\Delta D = 30\%$, $\Delta I = 15\%$

$$Ey = \frac{\Delta D}{\Delta I} = \frac{30\%}{15\%} = 2$$

[148] If indifference curve is 'L' shaped then two goods will be called as:
(a) Perfect Superior Goods
(b) Perfect Inferior Goods
(c) Perfect Quality Goods
(d) Perfect Complementary Goods (1 mark)

Answer:

(d) **Perfect complementary goods**
If the indifference curve has 'L'-shaped, it means that marginal rate of substitution (MRS) is undefined because an individuals preference donot allow any substitution between goods.
Eg: Right shoe and left shoe.

[149] Who coined the term 'Demonstration Effect'?
(a) James Duesenberry (b) Thorstein Veblen
(c) Hicks and Allen (d) Alfred Marshall (1 mark)

Answer:

(a) **James Duesenberry**
Demonstration effect, a term coined by James Duesenberry refers to desire of goods to evaluate consumption behaviour of others.

[150] Increase or Decrease in supply means:
(a) Shifts in supply curve
(b) Rightward or leftward shift
(c) Expansion malantration
(d) Both (a) and (b) (1 mark)

Answer:

(d) **Both (a) and (b)**
Increase or decrease in supply is due to shifts in supply curve i.e. rightward or leftward shift which occurs due to changes in non-price factors.

[151] Which of the following is not an exception to law of Demand?
(a) Speculative Goods (b) Giffen Goods
(c) Necessity Goods (d) Normal Goods (1 mark)

Answer:

(d) **Normal Goods**
Normal Goods are in agreement with Law of Demand . So, they are not exception to Law of Demand.

[152] Movement along the same Demand curue represents.
(a) Change in Demand
(b) Change in Quantity Demand
(c) Increase in Demand
(d) Decrease in Demand (1 mark)

Answer:

(b) **Change in Quantity Demand**
Movement of along source demand curve is due to changes in price which leads to change in quantity demanded.

[153] Increase in price of pulses leads to increase in demand of green vegetable:
(a) Substitutes (b) Complimentary Goods
(c) Normal Goods (d) None of the above (1 mark)

Answer:

(a) **Substitutes**
Increase in price of pulses leads to decrease in demand of pulses and increase in demand of green vegetables.

[154] When number of tourists increase at a place for which room rent of hostel also increases. Then electricity of supply of room will be:
(a) Zero (b) < 1
(c) >1 (d) = 1 (1 mark)

Answer:

(b) **< 1**
There is increase in number of tourists and even though there is increase in hotel room prices, the supplier cannot be able to expand the supply with same proportionate. So, the elasticity of supply will be less than one that is inelastic supply.

[155] When oranges has (-)0.58 Increase elasticity, the commodity orange is called as:
(a) Orange is a Necessity Good
(b) Orange is a inferior Good
(c) Orange is a Substitute Good
(d) None (1 mark)

Answer:

(b) **Orange is a Inferior Good**
If Income elasticity has negative value, then good is said to be Inferior Good.

[156] Which of the following method is used to calculate Elasticity of Demand, when price and quantity demand are large?
(a) Zero Elasticity (b) Cross Elasticity
(c) Point Elasticity (d) Are Elasticity (1 mark)

Answer:

(d) **Are Elasticity**
Are Elasticity is used to calculate elasticity of demand when price and quantity demand, has large changes.

[157] Suppose that total utility is 100 at 10 units of consumption of a commodity. If consumer increases the consumption by one more unit and owing to that total utility increases to 108. The marginal utility of last units consumed will be:
(a) 8 (b) 100
(c) 108 (d) 101 (1 mark)

Answer:

(a) **8**
$TU_{10} = 100, TU_{11} = 108.$
$MUn = TU_n - TU_{n-1}$
$MU_{11} = TU_{11} - TU_{10} = 108 - 100 = 8$

[158] Due to introduction of 5G mobiles in market, the price of such mobiles have increased by 20% and there by supply increased by 40%, the elasticity of supply will be which of the following?
(a) 0.5 (b) (-)0.5
(c) -2 (d) 2 (1 mark)

Answer:

(d) **2**

$\% .\triangle QS = 40\%, \%.\triangle P = 20\%$

$$Es = \frac{\%\triangle QS}{\%\triangle P} = \frac{40\%}{20\%} = 2$$

PRACTICE QUESTIONS OF MCQ

[1] Demand for a commodity refers to:
(a) A desire for the commodity
(b) Need for the commodity
(c) Quantity demanded of that commodity
(d) Quantity of the commodity demanded at a certain price during any particular period of time.

[2] Suppose the price of movies seen at a theatre rises from ₹ 120 per person to ₹ 200 per person. The theatre manager observed that the rise in prices has lead to a fall in attendance at a given movie from 300 persons to 200 persons. What is the price elasticity of demand for the movie? (Arc elasticity)
(a) 0.5
(b) 0.8
(c) 1.00
(d) None of these.

[3] In case of an inferior good, the income elasticity of demand is :
(a) Positive
(b) Zero
(c) Negative
(d) Infinite

[4] For what type of goods does demand fall with a rise in income levels of households?
(a) Inferior goods
(b) Substitutes
(c) Luxuries
(d) Necessities

[5] In case of Inferior goods like bajra, a fall in its price tends to :
(a) Make the demand remain constant
(b) Reduce the demand
(c) Increase the demand
(d) Change the demand in an abnormal way

[6] Movement along the same demand curve shows:
(a) Expansion of demand
(b) Expansion of supply
(c) Expansion and contraction of demand
(d) Increase and decrease of demand

[7] The price of hot-dogs increases by 22% and the quantity demanded falls by 25% this indicates that demand for hot dogs is :
(a) Elastic
(b) Inelastic
(c) Unitary elastic
(d) Perfectly elastic

[8] The quantity demanded does not respond to price change and so the elasticity is :
(a) Zero
(b) One
(c) Infinite
(d) None

[9] What is an Engels curve?
(a) Another name of the demand curve
(b) A curve showing both demand & supply curves
(c) Curve named after Lord Engels
(d) All

[10] Which factor generally keeps the price-elasticity of demand for a good low:
(a) Variety of uses for that goods
(b) Its low price
(c) Close substitutes for that goods
(d) A high proportion of the consumer's income spent on it

[11] In case of a straight- line demand curve meeting the two axes, the price elasticity of demand at the mid-point of the line would be :
(a) 0
(b) 1
(c) 1.5
(d) 2

[12] An increase in demand can result from:
(a) A decline in the market price
(b) An increase in income
(c) A reduction in the price of substitutes
(d) An increase in the price of complements

[13] Compute income elasticity if demand increases by 5% and income by 1%.
(a) 5
(b) 1/5
(c) 0
(d) None

[14] For a commodity with a unitary elastic demand curve if the price of the commodity rises, then the consumer's total expenditure on this commodity would :
(a) Increase (b) Decrease
(c) Remains constant (d) Either increase or decrease

[15] What is the value of elasticity of demand if the demand for the goods is perfectly elastic?
(a) 0 (b) 1
(c) Infinity (d) Less than 0

[16] What is the original price of a commodity when price elasticity is 0.71 and demand changes form 20 units to 15 units and the new price is ₹ 10? [Point elasticity]
(a) ₹ 15.4 (b) ₹ 18
(c) ₹ 20 (d) ₹ 8

[17] If the price of a complementary good rises :
(a) Demand curve shifts to the left
(b) Demand curve shifts to the right
(c) Demand curve moves downwards
(d) Demand curve moves upwards

[18] Cross elasticity of demand in Monopoly market is:
(a) Elastic (b) Zero
(c) Infinite (d) One

[19] What is income elasticity of demand, when income changes by 20% and demand changes by 40%
(a) 1/2 (b) 2
(c) 0.33 (d) None

[20] If demand is parallel to the X- axis, what will be the nature of elasticity?
(a) Perfectly elastic (b) Inelastic
(c) Elastic (d) Highly elastic

[21] Giffen Paradox is an exception of
(a) Demand (b) Supply
(c) Production (d) Utility

[22] Law of demand is a__________
(a) quantitative statement (b) qualitative statement
(c) Both (a) & (b) (d) Hypothetical

[23] The demand for which type of goods do not decrease with the increase in its price
(a) Comforts (b) Luxury
(c) Necessities (d) Capital goods

[24] Increase in Price from ₹ 4 to ₹ 6 then decrease in demand from 15 units to 10 units. What is the price elasticity? (Point elasticity)
(a) 0.66 (b) 5
(c) –1.5 (d) 2

[25] Expansion & contraction of the demand curve occurs due to:
(a) Change in the price of commodity
(b) Change in price of substitute or complementary goods
(c) Change in income
(d) None

[26] The elasticity between two points:
(a) Point elasticity (b) Arc elasticity
(c) Cross elasticity (d) None

[27] When price remains constant and quantity demanded changes, then the elasticity of demand will be:
(a) Vertical to X-axis (b) Horizontal to X-axis
(c) Either (a) or (b) (d) None

[28] Demand of a commodity depends upon:
(a) Price (b) Income
(c) Price of related good (d) All of the above

[29] In case of substitute goods, cross elasticity is _______.
(a) Negative (b) Zero
(c) Positive (d) None of these

[30] The prices of a commodity were increased from ₹ 4 to ₹ 6. As a result, demand decreased from 15 units to 10 units. What is the price elasticity? (Point elasticity)
(a) 0.66 (b) 0.33
(c) 1.00 (d) 1.5

[31] Other things remaining constant, if the price of the inferior goods decreases then what will be the effect?
(a) Demand increases
(b) Demand decreases
(c) Quantity demanded increases
(d) Quantity demand decreases.

[32] When the price falls from ₹ 6 to ₹ 4, the demand rises from 10 to 15 units. Calculate price elasticity of demand. (Point elasticity)
(a) 1.5 (b) 3.5
(c) 0.5 (d) 2

[33] Cross elasticity of perfect substitutes is:
(a) Zero (b) Negative
(c) One (d) Infinity

[34] What is Engel's Curve?
(a) Curve showing three demand curve
(b) Named after Ernst Engel
(c) Both (a) and (b)
(d) None

[35] A consumer spends ₹ 80 on purchasing a commodity when its price is ₹ 1 per unit and spends ₹ 96 when the price is ₹ 2 per unit. Calculate the price elasticity of demand.
(a) 0.2 (b) 0.3
(c) 0.4 (d) 0.5

[36] When the price of cylinder rises from ₹ 120 to ₹ 200, the demand falls from 300 to 200. Calculate the price elasticity of demand.
(a) 1.00 (b) 0.50
(c) 5.00 (d) None

[37] If the price is decreased from ₹ 10 to ₹ 8 of a commodity but the quantity demanded remains the same price elasticity is ______.
(a) 1 (b) 0
(c) 8 (d) none

[38] Demand for electricity power is elastic because _______.
(a) it is available at a very high price
(b) it is essential for life
(c) it has many uses
(d) it has many substitutes

[39] If the income of a person increases by 10% and his demand for goods increases by 30%, income elasticity will be_____.
(a) equal to one
(b) less than one
(c) more than one
(d) none of these

[40] In the case of luxury goods, the income elasticity of demand will be_____.
(a) zero
(b) negative but greater than one
(c) positive but greater than one
(d) positive but less than one

[41] In the case of a straight-line demand curve meeting two axes, the price elasticity of demand at the point where the curve meets y-axis would be_______.
(a) zero (b) greater than one
(c) less than one (d) infinity

[42] Calculate income elasticity for the household when the income of the household increases by 10% and the demand for cars rises by 20%.
(a) + 2 (b) – 2
(c) + 5 (d) – 5

[43] The commodity whose demand is associated with the name of Sir Robert Giffen?
(a) Necessary good
(b) Luxury good
(c) Inferior good
(d) Ordinary good

[44] In expansion and contraction of demand ______.
(a) demand curve remains unchanged
(b) demand curve changes
(c) The slope of the demand curve changes
(d) both (a) & (c) above

[45] Certain goods for which Quantity demanded decreases when Income Increases are called _______.
(a) superior goods (b) inferior goods
(c) prestige goods (d) conspicuous goods

[46] When the price falls by 5% and the demand in rises by 6%, then elasticity of demand is ________.
(a) elastic (b) inelastic
(c) unitary elastic (d) zero

[47] Cross elasticity of complementary goods is :
(a) Positive (b) Negative
(c) Infinity (d) None of these.

[48] Demand of i-pod increases from 950 to 980 and income increases from 9,000 to 9,800. What is income elasticity?
(a) 0.53 (b) 0.35
(c) 0.43 (d) None

[49] Contraction of demand results due to ______.
(a) increase in the price of the goods
(b) decrease in the no. of the producers
(c) decrease in the output of the sellers
(d) decrease in the price of the goods.

[50] Bricks for houses is an example of which kind of demand?
(a) Composite (b) Competitive
(c) Joint (d) Derived.

[51] Normal goods have_______.
(a) zero income elasticity
(b) negative income elasticity
(c) positive income elasticity
(d) infinite income elasticity

[52] In which of the following cases the demand for goods tends to be less elastic?
(a) Good is necessary
(b) The time-period is shorter
(c) Number of close substitutes is less
(d) All of the above

[53] Which of the following elasticity of demand measures a movement along the demand curve rather than a shift in the curve?
(a) Income elasticity of demand
(b) Price elasticity of demand
(c) Substitution elasticity of demand
(d) None of these.

[54] If the price elasticity of demand is zero, the shape of the curve will be:
(a) Horizontal (b) Vertical
(c) Sloping downwards (d) None of these.

[55] If a 20% fall in the price of a commodity brings about a 40% increase in its demand, then the demand for the commodity will be termed as:
(a) Inelastic (b) Elastic
(c) Highly elastic (d) Perfectly elastic

[56] Expansion and contraction in demand are caused by:
(a) Change in the income of the buyer
(b) Change in the taste and preference of the buyer
(c) Change in the price of the commodity
(d) Change in the price of the related goods.

[57] A fall in the price of normal goods leads to:
(a) A shift in the demand curve
(b) Fall in demand
(c) A rise in consumers real income
(d) A fall in consumers real income.

[58] A 10% increase in the price of tea results is an 8% increase in the demand for coffee. Cross elasticity of demand will be :
(a) 0.80 (b) 1.25
(c) 1.50 (d) 1.80

[59] When the total expenditure incurred by the consumers on a commodity due to a change is its price remains the same, then the elasticity of demand for that commodity will be:-
(a) Zero (b) One
(c) More than one (d) Less than one

[60] What will be the price elasticity if the original price is ₹ 5, the original quantity is 8 units and the changed price is ₹ 6, and the changed quantity is 4 units:
(a) 2.5 (b) 2.0
(c) 1.5 (d) 1.0

[61] The original price of a commodity is ₹ 500 and quantity demanded of that is 20 kgs. If the price rises to ₹ 750 and the quantity demanded falls to 15 kgs. The price elasticity of demand will be:
(a) 0.25 (b) 0.50
(c) 1.00 (d) 1.50

[62] The demand for factors of production is ——
(a) fundamental demand (b) derived demand
(c) market demand (d) joint demand.

[63] Cross elasticity of demand between two perfect substitutes will be
(a) Very high (b) Very low
(c) Infinity (d) Zero

[64] What is the elasticity between the midpoint and the upper extreme point of a straight line continuous demand curve?
(a) Infinite (b) Zero
(c) Greater than one (d) Less than one

[65] The price of a Tiffin Box is ₹ 100 per unit and the quantity demanded in the market is 1,25,000 units. Company increased the price to ₹125. Due to this increase in price, the quantity demanded decreases to 1,00,000 units. What will be the price elasticity of demand?

(a) 1.25 (b) 0.80
(c) 1.00 (d) None of the above.

[66] The price of a commodity decreases from 10 to 8 and the quantity demanded of it increases from 25 to 30 units, then the coefficient of price elasticity will be ——
(a) 1.00 (b) -1.00
(c) 1.5 (d) -1.5

[67] Which statement is true about the law of demand?
(a) Income rises, demand rises
(b) Price rises, demand rises
(c) Price falls, demand falls
(d) Price falls, demand rises

[68] Which of the following is not a determinant of demand?
(a) Consumer's tastes and preferences
(b) Quality supplied of a commodity
(c) Income of the consumers
(d) Price of related goods

[69] A demand curve parallel to the Y-axis implies:
(a) $E_p = 0$ (b) $E_p = 1$
(c) $E_p < 1$ (d) $E_p > 1$

[70] Generally, when the income of a consumer increases, he goes in for superior goods, leading to a fall in the demand for inferior goods. It means, income elasticity of demand for superior goods_____.
(a) less than 1 (b) unitary
(c) zero (d) negative

[71] If the quantity demanded of X commodity increases by 5% when the price of Y commodity increases by 20%, the cross-price elasticity of demand between X and Y commodity will be:
(a) -0.25 (b) 0.25
(c) -4.00 (d) 4.00

[72] Which amongst the following is the right formula for calculating the price elasticity of demand using ratio method?
(a) $(\Delta Q/\Delta P) \times (P/Q)$ (b) $(\Delta P/\Delta Q) \times (Q/P)$
(c) $(\Delta Q/\Delta P) \times (Q/P)$ (d) $(\Delta P/\Delta Q) \times (1/P)$

[73] Straight line demand curve at the point of meeting the x-axis will indicate elasticity coefficient Equal to ________.
(a) one (b) infinity
(c) zero (d) more than one

[74] Changes in the quantity demanded in response to changes in the price of the same commodity is called:
(a) change in demand (b) change in quantity demanded
(c) income demand (d) cross demand

[75] Other things being equal, a fall in the price of the complementary goods will cause the ________ of the other to rise.
(a) price (b) supply
(c) demand (d) utility

[76] A horizontal demand curve parallel to X-axis shows that the elasticity of demand is:
(a) zero (b) equal to unity
(c) greater than unity (d) infinite.

[77] When the price of a commodity increases from ₹ 8 to ₹ 9, its demand decreases by 10%. The price elasticity of demand for the commodity is:
(a) 0.8 (b) 0.9
(c) 1.0 (d) 1.1

[78] Which one of the following is correct about the price elasticity of demand for a commodity?
(a) It remains the same under all situations
(b) It has several degrees/nature
(c) It remains unaffected by the price of any other commodity
(d) It is an immeasurable concept.

[79] The supply of a good refers to :
(a) Actual production of goods
(b) Total stock of goods
(c) Stock available for sale
(d) Amount of goods offered for sale at a particular price per unit of time

[80] Increase or Decrease in Supply means:
(a) A shift in Supply curve
(b) Movement along the same supply curve
(c) Both (a) and (b)
(d) Neither (a) or (b)

[81] If the supply curve is Perfectly Inelastic, the supply curve is:
(a) Vertical (b) Horizontal
(c) Upward sloping (d) Downward sloping

[82] When supply price increase in the short run, the profit of the producer ______ :
(a) increases (b) decreases
(c) remains constant (d) decreases marginally

[83] A change in the supply of a commodity along with the same supply curve may occur due to:
(a) Change in the price of the commodity
(b) Change in the prices of related goods
(c) Change in future expectations about the price of the goods
(d) Change in the cost of inputs

[84] What is the elasticity of supply, when price changes from ₹ 15 to ₹ 12 and supply change from 6 units to 5 units?
(a) 0.77 (b) 0.87
(c) 0.833 (d) 0.58

[85] A perfectly inelastic supply curve will be:
(a) Parallel to X-axis (b) Parallel to Y-axis
(c) Downward sloping (d) None of these

[86] If the supply of a commodity is perfectly elastic, an increase in demand will result in:
(a) Decrease in both the price and quantity at equilibrium
(b) Increase in both the price and quantity at equilibrium
(c) Increase in equilibrium quantity, equilibrium price remaining constant
(d) Increase in equilibrium price, equilibrium quantity remaining constant

[87] When the change in the quantity supplied is proportionate to the change in the price, the producer is said to have ____:
(a) perfectly elastic supply
(b) relatively elastic supply
(c) unitary elastic supply
(d) perfectly inelastic supply

[88] Expansion in supply refers to a situation when the producers are willing to supply a:
(a) Larger quantity of the commodity at an increased price
(b) Larger quantity of the commodity due to increased taxation on that commodity
(c) Larger quantity of the commodity at the same price
(d) Larger quantity of the commodity at the decreased price

[89] When supply is perfectly inelastic, elasticity of supply is equal to :
(a) + 1 (b) 0
(c) .1 (d) Infinity

[90] If there is an improvement in the technology,______:
(a) the supply curve shifts to the left
(b) the supply curve shifts to the right
(c) quantity supplied increase
(d) Both (b) and (c)

[91] If the price of apples rises from ₹ 30 per Kg to ₹ 40 per Kg and the supply increases from 240 Kg to 300 Kg. Elasticity of supply is :
(a) 0.75 (b) 0.67
(c) 00.67 (d) 00.77

[92] A horizontal supply curve parallel to the quantity axis implies that the elasticity of supply is :
(a) Zero (b) Infinite
(c) Equal to one (d) Greater than zero but less than one

[93] Supply refers to the quantity supplied at a particular price for a particular period of time:
(a) True (b) False
(c) Partly true (d) None

[94] Increase or decrease in supply means:
(a) Change in supply due to change in its own price
(b) Change in supply due to change in factors other than its own price
(c) Both the above
(d) None of the above

[95] When Supply Curve shifts to the right there is__________ in Supply.
(a) an increase (b) expansion
(c) contraction (d) decrease.

[96] Elasticity of supply is defined as the responsiveness of quantity supplied of a good to a change in the _________.
(a) price of concerned good (b) price of substitute good
(c) demand (d) none.

[97] The supply of the commodity implies?
(a) Total Output during a specified period
(b) Its total stock
(c) Its stock available for sale
(d) Its Quantity Offered for sale at a particular price per unit of time

[98] Supply of a commodity is a _________.
(a) stock concept
(b) flow concept
(c) both stock and flow concept
(d) wholesale concept

[99] The price of mangoes increases from ₹ 30 per kilogram to ₹ 40 per kilogram and the supply increases from 240 kilograms the 300 kilograms. What will be the elasticity of supply for mangoes?
(a) – 0.67
(b) + 0.67
(c) – 0.77
(d) + 0.75

[100] If a 20% fall in price brings about a 10% fall in quantity supplied, in such a case elasticity of supply will be equal to:
(a) 2.0 (b) 0.5
(c) 1.0 (d) 1.5

[101] At a price of ₹ 25 per kg, the supply of a commodity is 10,000 kg per week. An increase in its price to ₹ 30 per kg, increases the supply of the commodity to 12,000 kg per week. The elasticity of supply will be:
(a) 0.75 (b) 1.00
(c) 1.50 (d) 1.75

[102] Short- run price is also called by the name of ______.
(a) market price
(b) showroom price
(c) maximum retail price
(d) none of these.

[103] If a 20% fall in the price brings about a 10% fall in the quantity supplied, then the elasticity of supply will be equal to:
(a) 2.0
(b) 0.5
(c) 1.0
(d) 1.5

[104] The elasticity of supply is greater than one when:
(a) Proportionate change in price is more than the proportionate change in quantity supplied
(b) Proportionate change in quantity supplied is more than the proportionate change in price
(c) Change in price and quantity supplied are equal
(d) All of the above

[105] Supply refers to which of the following?
(a) Total stock of the goods
(b) Stock of the goods available for sale
(c) Quantity of a good offered for sale at a particular price
(d) Quantity of a good actually sold

[106] After reaching saturation point consumption of additional units of commodity causes
(a) Total utility to fall and marginal utility to increase
(b) Total and marginal utility both to increase
(c) Total utility to fall and marginal utility to become negative
(d) Total utility to become negative and marginal utility to fall

[107] The elasticity of supply is greater than one when
(a) Proportionate change in price is greater than the proportionate change in quantity supplied
(b) Proportionate change in quantity supplied is more than the proportionate change in price
(c) Change In price and quantity supplied are equal
(d) All of the above

[108] As the price of a commodity increases, normally, its supply:
(a) Decreases (b) Remains unchanged
(c) Increases (d) Cannot be determined.

[109] If equilibrium is present in a market then it can be said that:
(a) The price of the product will tend to rise
(b) Quantity demanded equals quantity supplied
(c) Quantity demanded exceeds quantity supplied
(d) Quantity supplied exceeds quantity demanded

[110] Supply is a ____________concept.
(a) flow (b) stock
(c) flow and stock, both (d) qualitative

[111] Elasticity of supply is measured by dividing the percentage change in quantity supplied of a good by:
(a) Percentage change in income
(b) Percentage change in price
(c) Percentage change in quantity demanded of goods
(d) Percentage change in taste preferences

[112] An increase in supply denotes a shift in the supply curve to the right. If there is an increase in supply without a change in demand, the equilibrium price will ______ and the quantity demanded will go up.
(a) fall (b) remain constant
(c) increase (d) becomes zero.

[113] Which among the following is not a determinant of supply?
(a) Price of the commodity concerned
(b) Prices of the factors of production
(c) State of technology used in the production process
(d) Customs and traditions in society

[114] When the price of the commodity increases from ₹ 200 per unit to ₹ 250 per unit and consequently the quantity supplied rises from 1000 units to 1100 units. What will be the coefficient of elasticity of supply?

(a) 4.0 (b) 0.4

(c) 5.0 (d) 0.5

[115] The Supply Curve shifts to the right because of:

(a) Improved technology

(b) Increased price of factors of production

(c) Increased excise duty

(d) All of the above.

[116] The supply of a good refers to

(a) Stock available for sale

(b) Total stock in the warehouse

(c) Actual production of the goods

(d) Quantity of the good offered for sale at a particular price per unit of time.

ANSWER

1	(d)	**2**	(b)	**3**	(c)	**4**	(a)	**5**	(b)	**6**	(c)
7	(a)	**8**	(a)	**9**	(b)	**10**	(b)	**11**	(b)	**12**	(b)
13	(a)	**14**	(c)	**15**	(c)	**16**	(a)	**17**	(a)	**18**	(b)
19	(b)	**20**	(a)	**21**	(a)	**22**	(b)	**23**	(c)	**24**	(a)
25	(a)	**26**	(b)	**27**	(b)	**28**	(d)	**29**	(c)	**30**	(a)
31	(d)	**32**	(a)	**33**	(d)	**34**	(c)	**35**	(c)	**36**	(b)
37	(b)	**38**	(c)	**39**	(c)	**40**	(c)	**41**	(d)	**42**	(a)
43	(c)	**44**	(d)	**45**	(b)	**46**	(a)	**47**	(b)	**48**	(b)
49	(a)	**50**	(d)	**51**	(c)	**52**	(d)	**53**	(b)	**54**	(b)
55	(b)	**56**	(c)	**57**	(c)	**58**	(a)	**59**	(b)	**60**	(a)
61	(b)	**62**	(b)	**63**	(c)	**64**	(c)	**65**	(b)	**66**	(b)

67	(d)	**68**	(b)	**69**	(a)	**70**	(a)	**71**	(b)	**72**	(a)
73	(c)	**74**	(b)	**75**	(c)	**76**	(d)	**77**	(a)	**78**	(c)
79	(d)	**80**	(a)	**81**	(a)	**82**	(a)	**83**	(a)	**84**	(c)
85	(b)	**86**	(c)	**87**	(c)	**88**	(a)	**89**	(b)	**90**	(b)
91	(a)	**92**	(b)	**93**	(a)	**94**	(b)	**95**	(a)	**96**	(a)
97	(d)	**98**	(b)	**99**	(d)	**100**	(b)	**101**	(b)	**102**	(a)
103	(b)	**104**	(b)	**105**	(c)	**106**	(c)	**107**	(b)	**108**	(c)
109	(b)	**110**	(a)	**111**	(b)	**112**	(a)	**113**	(d)	**114**	(b)
115	(a)	**116**	(d)								

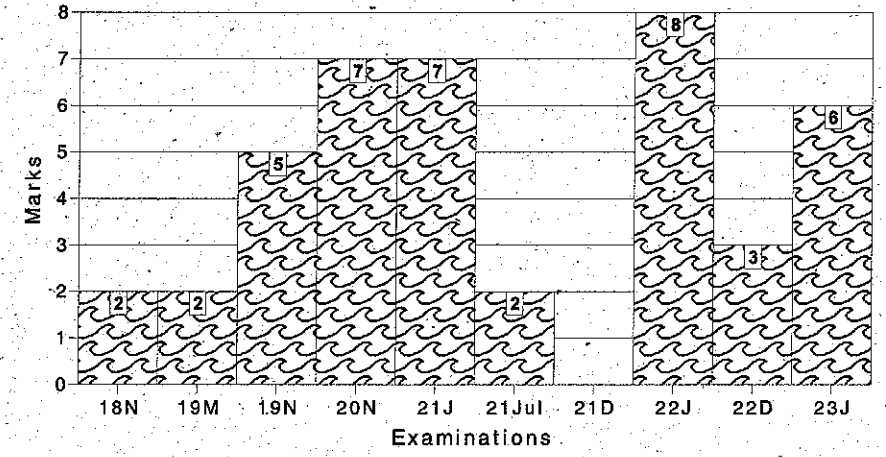
3 THEORY OF PRODUCTION AND COST

Unit:1 **Theory of Production**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



PAST YEAR QUESTIONS AND ANSWERS

2006 - NOVEMBER

[1] _______ shows the overall output generated at a given level of input:
(a) Cost function
(b) Production function
(c) ISO cost
(d) Marginal rate of technical substitution (1 mark)

Answer:

(b) Production function states the relationship between inputs and outputs generated.

[2] If LAC curve falls as output expands, this is due to ______:
(a) law of diminishing returns (b) economies of scale
(c) law of variable proportion (d) dis-economics of scale (1 mark)

Answer:

(b) In the long run, when output expands total cost first increases, then becomes constant and finally decreases.
When output expands, and cost curve falls it is the first stage of returns to scale which occurs due to economies of scale.

[3] Isoquants are equal to:
(a) Product Lines
(b) Total utility lines
(c) Cost lines
(d) Revenue lines (1 mark)

Answer:

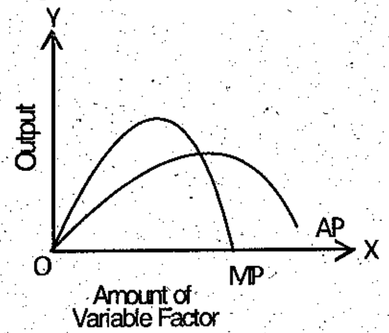
(a) An isoquant consist of alternative combinations of input to produce a given quantity of output and product lines are lines representing various combinations of factors of production to produce a given output.

2007 - February

[4] The marginal product curve is above the average product curve when the average product is:
(a) Increasing
(b) Decreasing
(c) Constant
(d) None (1 mark)

Answer:

(a) Marginal product and average product are so related that when average product increases, MP increases at a faster rate and cuts AP at its Maximum and when AP falls MP falls at a faster rate. So the marginal product curve is above the average product curve when AP is increasing.



[5] Increasing returns to scale can be explained in terms of:
(a) External and internal economies
(b) External and internal diseconomies
(c) External economics and internal diseconomies
(d) All of these (1 mark)

Answer:

(a) Increasing returns to scale i.e. When output increases more than the increase in input. It occurs due to external and internal economics.

2007 - May

[6] An isoquant is ________ to an isocost line at the equilibrium point:
(a) convex (b) concave
(c) tangent (d) perpendicular (1 mark)

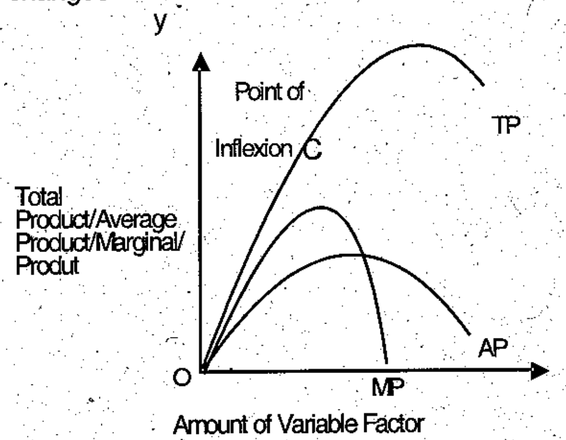
Answer:

(c) An isoquant is tangent to an isocost line. This point of tangency defines the equilibrium position of a firm. A higher isoquant shows an unalterable point and a lower one shows underutilized resources. Hence an isoquant with an isocost line as tangent is the equilibrium position.

[7] At the point of inflexion, the marginal product is:
(a) Increasing (b) Decreasing
(c) Maximum (d) Negative (1 mark)

Answer:

(c) Point of inflexion is a point in the first stage of law of variable proportion i.e. When MP becomes maximum. At this point, the slope of TP changes.



[8] Diminishing marginal returns implies:
(a) Decreasing average variable costs
(b) Decreasing marginal costs
(c) Increasing marginal costs
(d) Decreasing average fixed costs (1 mark)

Answer:

(c) Keeping other things constant when marginal cost increases with a considerable increase in variable factors, the marginal product declines. This is the second stage of law of variable proportion or the stage of diminishing returns.

2007 - AUGUST

[9] If the marginal product of labour is below the average product of labour, it must be true that:
(a) Marginal product of labour is negative
(b) Marginal product of labour is zero
(c) Average product of labour is falling
(d) Average product of labour is negative (1 mark)

Answer:

(c) *Same as Ans. 4*

2007 - NOVEMBER

[10] Law of variable proportion is valid when:
(a) Only one input is fixed and all other inputs are kept variable
(b) All factors are kept constant
(c) All inputs are varied in the same proportion
(d) None of these (1 mark)

Answer:

(a) Law of variable proportion occurs in short- run. Short-run is a period when only one input is fixed and all other inputs are kept variable.

[11] Change in total revenue due to incremental change in quantity supplied is called:
(a) Marginal Revenue
(b) Marginal Change
(c) Average Revenue
(d) Average Change (1 mark)

Answer:

(a) Marginal revenue is defined as an addition made to the total revenue by selling one more unit of a commodity. It is the incremental change in total revenue.

$M.R._n = T.R._n - T.R._{n-1}$

2008 - FEBRUARY

[12] Increase in all input leading to less than proportional increase in output is called____________.
(a) increasing returns to scale
(b) decreasing returns to scale
(c) constant returns to scale
(d) both increasing and decreasing returns to scale (1 mark)

Answer:

(b) Decreasing returns to scale is the stage when the increase in the output is less than the increase in input, this occurs due to internal and external diseconomies.

[13] Consider the following combinations of inputs and outputs:
This production technology satisfies

Labour	Capital	Output
5	10	1
6	12	2
7	14	3
8	16	4
9	18	5
10	20	6

(a) Increasing returns to scale
(b) Diminishing returns to scale
(c) Constant returns to scale
(d) Increasing returns initially, following by decreasing returns to scale. (1 mark)

Answer:

(c) In the given production technology the increase in input is proportionate to the increase in output.

With an increase of every 1 unit of labour and 2 units of capital the output increases by 1 unit.

Hence, it is the case of constant returns to scale as both fixed and variable factors are changing (all factors are variable).

2008 - JUNE

[14] During IInd stage of law of diminishing returns:
(a) MP and TP is maximum
(b) MP and AP are decreasing
(c) AP is negative
(d) TP is negative (1 mark)

Answer:

(b) During the second stage of Law of Diminishing Returns (i.e. Law of Variable Proportion) both MP and AP are decreasing because at this stage the optimum combination between fixed and variable factors have been attained and now if the input is increased, output starts decreasing. At this stage, total product increases at a diminishing rate i.e. MP and AP decreases.

[15] Consider the following table:

Labour	Total Output	Marginal Product
0		
1	100	100
2		80
3	240	

What is the total output, when 2 labours are employed?
(a) 80
(b) 100
(c) 180
(d) 200 (1 mark)

Answer:

(c) When 1 unit of labour is employed TP = 100, MP = 100 when 2nd unit of labour is employed MP = 80 i.e. addition made to total product is 80.

Total product when 2 labours are employed is 100 + 80 = 180.

OR

$MP_2 = TP_2 - T.P_{2-1}$

$80 = TP_2 - 100.$

TP2 = 80+100 =180.

[16] Who has given the concept of Innovative Entrepreneurship?
(a) Robbins (b) Adam Smith
(c) Schumpeter (d) Sweezy (1 mark)

Answer:

(c) The concept of Innovative Entrepreneurship was given by Schumpeter.

2008 - DECEMBER

[17] AT 10 units Total Cost → ₹ 200
20 units Total Cost → ₹ 600
Marginal Cost = ?
(a) 50 (b) 40
(c) 30 (d) 400 (1 mark)

Answer:

(b) Given Original total cost = ₹ 200
Original quantity produced = 10 units
New total cost = ₹ 600
New quantity produced = 20 units

Marginal cost is the addition made to the total cost by production of an additional unit of output:

Additional Cost = ₹ 600 - ₹ 200
= ₹ 400

Additional quantity produced = 20 units - 10 units
= 10 units

∴ M. C = $\frac{1}{2}$
= ₹ 40

[18] Average Fixed Cost = ₹ 20
Quantity Produced = 10 units
What will be the Average Fixed Cost of 20th unit?
(a) ₹ 10
(b) ₹ 20
(c) ₹ 5
(d) None (1 mark)

Answer:

(a) Average fixed cost (AFC) is the total fixed cost divided by the number of units produced i.e. AFC = $\frac{TFC}{Q}$

Where Q is the number of units produced

TFC = ₹ 20 × 10 units
= ₹ 200

Q = 10 units

AFC = $\frac{200}{20}$
= ₹ 10

Since AFC steadily falls as output increases hence for 20th unit AFC is ₹ 10.

[19] What is Production in Economics:
(a) Creation / Addition of Utility
(b) Production of food grains
(c) Creation of services
(d) Manufacturing of goods (1 mark)

Answer:

(a) In Economics, production is the process by which man utilizes or converts the resources of nature, works upon them so as to make them satisfy human wants. The satisfying power of goods and services is called utility. Hence we can conclude that production can also be defined as creation or addition of utility.

[20] External Economies of Scale are obtained by:
(a) a firm (b) a group of firm
(c) Small Production (d) Society (1 mark)

Answer:

(b) External Economies of scale accrues to firms as a result of expansion in the output of the whole industry and they are not dependant on the output level of individual firms. They are external in the sense that they accrue to firms not because of their internal situation but from outside i.e. expansion of the industry.

2009 - JUNE

[21] If a firm's output is zero, then:
(a) AFC will be positive (b) AVC will be zero
(c) Both of (a) and (b) (d) None of (a) and (b) (1 mark)

Answer:

(c) Average fixed cost may be expressed as- Fixed cost divided by the number of units. When the firm's output is zero, average fixed cost is positive as fixed cost is incurred even if no units are produced.

Average variable cost may be expressed as- variable cost per unit produced. When the firm's output is zero, there will be no variable cost hence average variable cost will be zero.

[22] Functions of the entrepreneur are:
(a) Risk bearing
(b) Initiating a business enterprise and resource co-ordinating
(c) Introducing new innovations
(d) All of the above (1 mark)

Answer:

(d) The entrepreneur has also been called the organiser, the manager or risk- taker. The task of an entrepreneur is to initiate production work and to bear the risks involved. An entrepreneur performs the following functions:
 (i) Initiating a business enterprise and resource co-ordination
 (ii) Risk bearing or uncertainty bearing
 (iii) Innovation

[23] Law of diminishing returns is applicable in:
(a) Manufacturing industry
(b) Agriculture
(c) Neither (a) nor (b)
(d) Any economic activity at a point of time (1 mark)

Answer:

(d) Law of diminishing returns states that as more and more factors of production are employed, the total production first increases, and then eventually declines. This law applies to all economic activities at some point or the other.

2009 - DECEMBER

[24] Labour force wants more _______.
(a) facility (b) leisure
(c) benefit (d) all of the above (1 mark)

Answer:

(b) Labour is one of the factors of production. A labourer has to make a choice between hours of labour and hours of leisure. Labour force prefers to have more of the rest and leisure than earning money.

[25] Production activity in the short-run is analysed by:
(a) Returns to scale (b) Economies of scale
(c) Law of variable proportion (d) None of these (1 mark)

Answer:

(c) Short- run is a time period when only one factor is fixed and rest all are variable. The law of variable proportion operates in the short run. Therefore, in short- run production activity is analysed by this law.

[26] Increasing returns to scale occurs due to:
(a) Economies of scale (b) Specialization
(c) Indivisibility of factors (d) All of these (1 mark)

Answer:

(d) Increasing returns to scale occurs when the output increases more than the increase in input. This occurs due to economies of scale also it occurs due to the indivisibility of factors and returns to scale may also increase because of greater possibilities of specialization of land and machinery.

2010 - JUNE

[27] Law of diminishing returns is applicable in ______.
(a) only manufacturing industries
(b) only agriculture
(c) neither in agriculture nor in industries
(d) in all economic activities after a limit (1 mark)

Answer:

(d) Law of diminishing returns states that as more and more factors of production are employed, the total product first increases and then eventually declines. This law applies to all economic activities after a limit.

[28] Law of increasing returns is applicable because of______.
(a) indivisibility of factors (b) specialization
(c) economies of scale (d) both (a) & (b) above (1 mark)

Answer:

(d) The two causes of Law of Increasing Returns are:
 (A) Indivisibility of Factors.
 (B) Division of Labour and specialization.
 Hence both options A and B are correct.

[29] When output decreases by 20% due to an increase in inputs by 20%, this stage is called the law of ________.

(a) increasing returns to scale (b) decreasing returns to scale

(c) constant returns to scale (d) none of the above (1 mark)

Answer:

(d) Law of constant returns states that with increase in input, the output also increases in the same proportion.

However, in the given question, the output is decreasing by 20% due to an increase in input by 20%. This is not the case of constant returns to scale. This is neither the case of increasing returns to scale nor decreasing returns to scale, hence, the answer would be none of the above.

2010 - DECEMBER

[30] In the first stage of the law of variable proportions, the total product increases at the ________.

(a) decreasing rate (b) increasing rate

(c) constant rate (d) both a and b. (1 mark)

Answer:

(b) The law of variable proportion states that as we increase the quantity of one input which is combined with other fixed inputs, the MP of variable input eventually declines. It is divided into three stages (laws):

(i) Law of increasing returns

(ii) Law of decreasing returns

(iii) Law of negative returns

[31] What will be the total product when two labourers are hired according to the table given below?

No. of labourers	Total product	Marginal product
0	–	–
1	350	350
2	–	230

(a) 680 (b) 580

(c) 350 (d) 230 (1 mark)

Answer:

(b) $TP_n = TP_{n-1} + MP_n$

$= 350 + 230$

$= 580$

[32] Which function shows the relationship between input and output?

(a) Consumption function (b) Investment function

(c) Production function (d) Cost function (1 mark)

Answer:

(c) Production function states the relationship between inputs and output i.e. the maximum amount of output that can be produced with given quantities of inputs under a given state of technical knowledge.

2011 - JUNE

[33] External economies are enjoyed:

(a) By large producers only (b) As the firm expands

(c) Both (a) and (b) (d) None of above. (1 mark)

Answer:

(c) External economies are those economies which accrue to firms as a result of expansion in the output of the whole industry and they are not dependent on the output level of individual firms. External economies are enjoyed by large producers.

2012 - JUNE

[34] The Law of Diminishing Returns is applicable in ______ .

(a) only in manufacturing industries

(b) only in agriculture

(c) neither in agriculture nor in industries

(d) all economic activities after a point. (1 mark)

Answer:

(d) Law of diminishing returns occurs in the short run and states that as more and more units of variable factors are employed to a fixed factor total product first increases and then eventually declines.

This law occurs on all economic activities after a point of time because after reaching an optimum combination the factors become over utilized and lead to lesser production.

[35] The concept of Returns to Scale is related to:
(a) Very short period
(b) Short period
(c) Long period
(d) None of above. (1 mark)

Answer:

(c) Long -run refers to the time period when all the factors change and no factor is fixed.
When all inputs are changed in the same proportion, it leads to a change in scale. Therefore, returns to scale occurs in the long run.

[36] The function of an entrepreneur is:
(a) Initiating an enterprise and resource coordination
(b) Risk bearing
(c) Introducing innovations
(d) All of the above. (1 mark)

Answer:

(d) An entrepreneur is a person who combines all factors of production, bears risk and initiates the process of production. An entrepreneur performs the following functions:
(a) Initiating a business and resource coordination
(b) Risk bearing and uncertainty bearing
(c) Taking innovations

2012 - DECEMBER

[37] Which of the following is not a characteristics of land?
(a) It is a free gift of nature
(b) It is a mobile factor of production
(c) It is limited in quantity
(d) Its productive power is indestructible. (1 mark)

Answer:

(b) A factor of production should have the following characteristics to be called land :
1. It is a free gift of nature
2. It is strictly limited in quantity
3. It is indestructible
4. It cannot be shifted from one place to another.
5. It is a specific factor of production

[38] A production function is defined as the relationship between ________.
(a) the quantity of physical inputs and physical output of a firm
(b) stock of inputs and stock of output
(c) prices of inputs and output
(d) price and supply of a firm. (1 mark)

Answer:

(a) Production function states the relationship between inputs and output i.e. the maximum amount of output that can be produced with given quantities of inputs under a given state of technical knowledge.

[39] Production activity in the short period is analysed with the help of:
(a) Law of variable proportion (b) Laws of returns to scale
(c) Both (a) & (b) (d) None of the above. (1 mark)

Answer:

(a) Production function states the relationship between inputs and outputs. The production activity can be in short-run or long-run. Short period is that period of time which is too short for a firm to install new capital equipment to increase production. This is done when the law of variable proportion is analysed.

2013 - June

[40] Which of the following is the reason for the working of the law of increasing returns?
(a) Fuller utilisation of fixed factors
(b) Indivisibility of the factors
(c) Greater specialization of labour
(d) All of the above. (1 mark)

Answer:

(d) The causes of the law of increasing returns are:
— Indivisibility of factors.
— Division of labour and specialisation.

When variable factor is increased, fuller utilisation of fixed factor becomes possible and it results in increasing returns.

Hence, all of the above are the reasons for working of the law of increasing returns.

[41] External economies can be achieved through:
(a) Foreign trade only
(b) Superior managerial skill
(c) Extension of transport and credit facilities
(d) External assistance. (1 mark)

Answer:

(c) External economies of scale are those which accrue to firms as a result of expansion in the output of the whole industry. These are available to one or more of the firms in the form of —
(i) Cheaper raw materials and capital equipment
(ii) Technological external economies
(iii) Development of skilled labour
(iv) Growth of ancillary industries
(v) Better transportation and marketing facilities. Thus, external economies can be achieved through the extension of transport and credit facilities.

[42] External economies arise due to:
(a) Growth of ancillary industries
(b) High cost of technologies
(c) Increase in the price of factors of production
(d) None of the above. (1 mark)

Answer:

(a) External economies arises due to the following reasons:
(i) Cheaper raw materials and capital equipment
(ii) Technological external economies
(iii) Development of skilled labour
(iv) Growth of ancillary industries
(v) Better transportation and marketing facilities

2013 - December

[43] Innovation theory of entrepreneurship is propounded by:
(a) Knight (b) Schumpeter
(c) Max Weber (d) Peter Drucker (1 mark)

Answer:

(b) The concept of innovative entrepreneurship was propounded by Schumpeter.

[44] Production function is:
(a) Purely a technical relationship between input & output
(b) Purely an economic relationship between input & output
(c) Both the technical & economical relationship between input & output
(d) None of the above. (1 mark)

Answer:

(a) Production function states the relationship between inputs and the output i.e. the maximum amount of the output that can be produced with the given quantities of inputs under a given state of technical knowledge.

Thus, production function is purely a technical relationship between input & output.

[45] The concept of returns to scale is related with:
(a) very short period (b) short period
(c) long period (d) none of the above (1 mark)

Answer:

(c) Long -run refers to the time period when all the factors change and no factor is fixed, when all inputs are changed in the same proportion, it leads to a change in scale. Therefore, returns to scale occurs in the long run.
Thus, option (c) is correct.

[46] In Cobb-Douglas production function, two inputs are:
(a) Land and Labour (b) Labour and Capital
(c) Capital and Entrepreneur (d) Entrepreneur and land (1 mark)

Answer:

(b) Cobb-Douglas Production function applies not to an individual firm but to the whole of manufacturing. In this case, output is manufacturing production and inputs used are labour and capital.

2014 - June

[47] Which one of the following is not a characteristic of land?
(a) A free gift of nature
(b) Its supply is fixed
(c) An active factor of production
(d) It has different uses. (1 mark)

Answer:

(c) As a theoretical concept, land has the following characteristics:
(1) Land is Nature's gift.
(2) Supply of land is fixed.
(3) It has indestructible powers.
(4) It is a passive factor.
(5) It has different uses.
Hence, land is not an active factor of production, thus option (c) is the correct answer.

[48] An Entrepreneur undertakes which one of the following functions?
(a) Initiating a business and resource co-ordination
(b) Risk or uncertainty bearing
(c) Innovations
(d) All of the above. (1 mark)

Answer:

(d) An entrepreneur performs the following functions in general:
(1) Initiating a business enterprise & resource co-ordination.
(2) Risk bearing/uncertainty bearing.
(3) Innovations.
Hence, option (d) i.e. all of the above is the correct answer.

[49] With a view to increase his production, Hariharan a manufacturer of shoes, increases all the factors of production in his unit by 100%. But at the end of the year, he finds that instead of an increase of 100%, his production has increased by only 80%. Which law of returns to scale is operating in this case?
(a) Increasing returns to scale (b) Decreasing returns to scale
(c) Constant returns to scale (d) None of the above. (1 mark)

Answer:

(b) When output increases in a smaller proportion with an increase in all inputs, decreasing returns to scale are said to prevail. In this case, inputs are increased by 100% in comparison to outputs which are increased by 80%.
Hence, option (b) is correct.

2014 - December

[50] Linear homogeneous production function is based on:
(a) Increasing returns to scale (b) Decreasing returns to scale
(c) Constant returns to scale (d) None of the above (1 mark)

Answer:

(c) Linear homogeneous production function is based on constant returns to scale. It occurs when the inputs increase by some proportion and the output also increases by the same proportion.

2015 - JUNE

[51] Which of the following statement is true in relation to an ISO-Quant Curve?

(a) It represents those combinations of two factors of production that will give the same level of output

(b) It represents those combinations of all the factors that will give the same level of output

(c) It slopes upward to the right

(d) It can touch either axis. (1 mark)

Answer:

(a) An iso-quant represents all those combinations of two factors of production which are capable of producing the same level of output.

[52] Production is defined as:

(a) Creation of matter

(b) Creation of utility in matter

(c) Creation of infrastructural facilities

(d) None of the above. (1 mark)

Answer:

(b) By production we mean that process by which man utilises or converts the resources of nature, working upon them so as to make them satisfy human wants.

[53] Long period production function is related to:

(a) Law of variable proportions

(b) Laws of returns to scale

(c) Law of diminishing returns

(d) None of the above. (1 mark)

Answer:

(b) Long period production function is related to law of returns to scale which relate to the long-period production function by changing one or more of its factors. Long period production function is related to law of returns to scale which relate to the long-period production function by changing one or more of its factors.

2015 - DECEMBER

[54] The conclusion drawn from Cobb-Douglas production function is that labour contributed about_____ and capital about _____ of the increase in the manufacturing production.

(a) $\frac{3^{th}}{4}, \frac{1^{th}}{4}$

(b) $\frac{1}{2}, \frac{1}{2}$

(c) $\frac{1^{th}}{4}, \frac{3^{th}}{4}$

(d) None of the above. (1 mark)

Answer:

(a) Cobb-Douglas production function states that labour contributed about $\frac{3}{4}$th and capital about $\frac{1}{4}$th of the increase in the manufacturing production $Q = KL^a C^{(1-a)}$

Where 'Q' is output, 'L' the quantity of labour, 'C' the Quantity of capital, 'K' and 'a' are positive constants.

2016 - JUNE

[55] ISO quants are also known as:

(a) Production possibility curves

(b) Indifference curves

(c) Production indifference curves

(d) None of the above. (1 mark)

Answer:

(c) ISO quants are also known as production indifference curves. They show all those combinations of different factors of production which gives the same output to the producer. ISO quants are similar to indifference curves of the theory of consumer behaviour.

[56] Human capital refers to:
(a) Savings by individuals
(b) Mobilisation of savings
(c) Human skills and abilities
(d) Productive investment. (1 mark)

Answer:

(c) Human capital refers to human skill and ability. This is called human capital because a good deal of investment has gone into creation of these abilities in human.

[57] The Law of Variable Proportions is associated with:
(a) Short period
(b) Long period
(c) Both short and long periods
(d) Neither short nor long period. (1 mark)

Answer:

(a) The law of variable proportions examines the production function with one factor variable, keeping quantities of other factor fixed. This law operates in the short run when all the factors of production cannot be increased or decreased simultaneously. In other words, it refers to input-output relationship.

[58] Which one of the following statements is not correct?
(a) Land has indestructible powers
(b) Labour is mobile
(c) Capital is nature's gift
(d) Land is a passive factor. (1 mark)

Answer:

(c) Capital has been rightly defined as 'produced means of production'. If has been produced by man by working with nature. Therefore, capital may well be defined as man made instruments of production. Example: machine, tools, instruments, factories etc.

2016 - December

[59] Which of the following is not a characteristic of labour?
(a) It is perishable
(b) It has weak bargaining power
(c) Labour and Labour power cannot be separated
(d) Labour is not mobile (1 mark)

Answer:

(d) Labour is not mobile. This is not a characteristic of labour. Labour is mobile.

[60] Which among the following is not a characteristic of Land?
(a) It is an active factor
(b) It has variety of uses
(c) Its production powers are indestructible
(d) Its supply is limited (1 mark)

Answer:

(a) Land is a passive factor of production. It is not a active factor.

[61] When average product rises as a result of an increase in the quantity of variable factor, marginal product is:
(a) Equal to average product
(b) More than average product
(c) Less than average product
(d) Becomes negative (1 mark)

Answer:

(b) When average product rises as a result of an increase in the quantity of variable factor, marginal product is more than average product.

[62] Suppose the first four units of a variable input generate corresponding total output of 150, 200, 350, 550. What will be the marginal product of the third unit of input?
(a) 50 (b) 100
(c) 150 (d) 200 (1 mark)

Answer:

(c) Marginal product of the third unit of input

$= TP_3 - TP_2$

$= 350 - 250$

$= 150$

2017 - JUNE

[63] The famous Cobb-Douglas production function is based on studies of ______ industries in the United States of America.

(a) manufacturing (b) construction
(c) consumer (d) aviation. (1 mark)

Answer:

(a) A famous statistical production function is Cobb-Douglas production function. Paul H. Douglas and C.W. Cobb of the U.S.A. Studied the production function of the American manufacturing industries. In its original form, this production function applies not to an individual firm but to the whole of manufacturing in the United States. Thus, option (a) is correct.

[64] In Economics, entire process of ______ is nothing but creation of utilities in the form of goods and services.

(a) consumption (b) production
(c) exchange (d) distribution. (1 mark)

Answer:

(b) Production is nothing but the creation of utilities in the form of goods and services. For example, in the production of a woolen suit, utility is created in some form or the other. Firstly wool is changed into woolen cloth at the spinning and weaving mill (utility created by changing the form) then it is taken to a place where it is to be sold (utility added by transporting it). Since woolen clothes are used only in winter, it will be retained until such time when then they are required by purchasers(time utility). In the whole process, services of various groups of people are utilized (as that of mill

workers, shopkeepers, agents etc.) to contribute to the enhancement of utility. Thus, the entire process of production is nothing but creation of form utility, place utility, time utility and/or personal utility.

2018 - MAY

[65] Cobb Douglas function is given by $Q = KL^a C^b$

(a) If $\propto + \beta > 1$, increasing returns
(b) If $\propto + \beta > 1$, increasing returns to scale
(c) if $\propto + \beta < 1$, diminishing returns
(d) if $\propto + \beta = 1$, decreasing returns to scale. (1 mark)

Answer:

(b) Cobb-Douglas function is given by Paul H. Douglas and C.W. Cobb of U.S.A. studied the production of American Manufacturing industries. They describe that output is manufacturing and input are labour and capital. It is given by $Q = K L^a C^{(1-a)}$ if, $a + b > l$, increasing return to scale.

[66] Production is defined as:

(a) Creation of matter
(b) Creation of utility in matter
(c) Creation of infrastructural facilities
(d) None of the above. (1 mark)

Answer:

(b) Man cannot create matter. Man can create only utility in matter. Production should not be taken as creation of matter but it is taken as creation of utility in matter.

For Example: When man produces a table, he does not create the matter of which the wood is composed of. He only transforms wood into chair and utility to wood which did not have utility before.

[67] The conclusion drown from Cobb Douglas production function is that labour contributed about _____ and capital about _____ of the increase in the manufacturing production.

(a) $\frac{3^{th}}{4}, \frac{1^{th}}{4}$ (b) $\frac{1^{th}}{2}, \frac{1^{th}}{2}$

(c) $\frac{1^{th}}{4}, \frac{3^{th}}{4}$ (d) None of the above. (1 mark)

Answer:

(a) As Cobb-Douglas function is below:

$Q = K L^a C^{(1-a)}$

Which shows that labour produces $3/4^{th}$ and capital produces 1/4 of the increase in manufacturing production

[68] At the point of inflexion, the marginal product is:

(a) Increasing (b) Decreasing

(c) Maximum (d) Negative (1 mark)

Answer:

(c) Point of inflexion is a point where marginal product is at maximum. First marginal product utility increase then reach at maximum points which is point of inflexion and then decrease. Marginal product can be negative.

[69] Isoquants are equal to:

(a) Product lines (b) Total utility lines

(c) Cost lines (d) Revenue lines (1 mark)

Answer:

(a) Isoquants are similar to indifference curves of theory of consumer behaviour. An isoquants represents all those combinations which are capable of producing same level of output. Production indifference curve is another. Name of isoquants as it represents product lines.

[70] Increasing returns to scale can be explained in terms of:

(a) External and internal economics

(b) External and internal diseconomies

(c) External economies and internal diseconomies

(d) All of these. (1 mark)

Answer:

(a) Increasing return to scale means increase in output is greater than increase in input and increasing return to scale causes due to external and internal economies while decreasing return to scale causes due to external and internal diseconomies.

2018 - NOVEMBER

[71] According to Cobb-Douglas production function, will get_____ returns to scale?

(a) Constant

(b) Diminishing

(c) Increasing

(d) Any of the above (1 mark)

Answer:

(a) According to Cobb- Douglas production function is stated as

$Q = KL^aC^{(1-a)}$

When 'Q' is output , 'L' is the quantity of labour and 'C' the quantity of capital. 'K' and 'a' are positive constants.

[72] Which of the following statement about factors of production is not true?

(a) Land is a passive factor

(b) Land is a free gift of nature

(c) Land is immobile

(d) Land is perishable (1 mark)

Answer:

(d) Characteristics of land are

1. Land is a free gift of nature
2. Supply of land is fixed
3. Land is permanent and has indestructible power
4. Passive factor
5. Land in Immobile.

Therefore, land is not perishable and **(d)** option will the answer.

2019 - MAY

[73] Which of the following is considered as production in economics?
(a) Helping a blind person in crossing the road
(b) Group dance performance in a collage annual function
(c) Holding a child who is falling from a wall
(d) Performing an art in a theatre (1 mark)

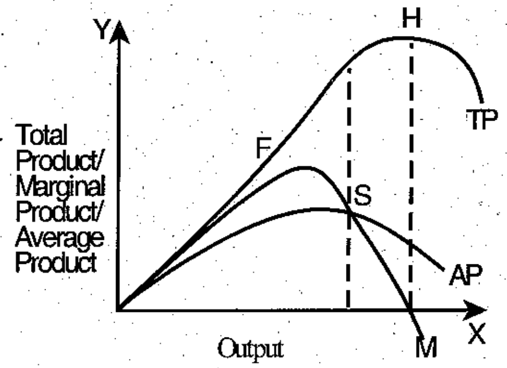
Answer :

(d) Production consists of various processes to add utility to natural resources for gaining greater satisfaction from them by making use of personal skills in the form of services.
Example: Performing an art in a theatre.

[74] Marginal, average and total product of a firm in the short run will not comprise with
(a) When marginal product is at a maximum, average product is equal to marginal product, and total product is rising
(b) When average product is maximum, average product is equal to marginal product, and total product is rising
(c) When marginal product is negative, total product and average product are falling
(d) When total product is increasing, average product and marginal product may be either rising or falling (1 mark)

Answer :

(a) The relationship between average product and marginal product is as follows:
(i) When average product rises, marginal product is more than average product
(ii) When average product is maximum, MP = AP
(iii) When average product falls, marginal product is less than the average product.



Hence, **option (a)** is not the relation between MP and AP.

2019 - NOVEMBER

[75] Supply of land is ______ in case of economy?
(a) Elastic
(b) Inelastic
(c) Perfectly elastic
(d) Perfectly inelastic (1 mark)

Answer:

(d) Supply of land is perfectly inelastic in case of economy. Land is strictly limited in quantity. It is different from other factors of production in that no change in demand can affect the amount of land in existence. However, it is relatively elastic from the point of view of a firm.

[76] MP is the slope of ______
(a) TP
(b) AP
(c) Both
(d) None (1 mark)

Answer:

(a) Marginal Product is the slope of Total Product as-

Total product is the total output resulting from the efforts of all factors of production combined together at any time.

Marginal product is the change in total product per unit change in the quantity of variable factor, i.e. it is the addition made in additional unit of output.

$MP_n = TP_n - TP_{n-1}$

Or

$\frac{\Delta TP}{\Delta Q}$ ΔTP = Change in Total Product

ΔQ = Change in Quantity

For Question [77] - [79] used the data table given below :

No of workers	Total output	Marginal output
0	0	0
1	10	_
2	_	8
3	24	_

[77] What will be total output for 2 workers.
(a) 6
(b) 18
(c) 12
(d) 17 (1 mark)

[78] What will be marginal output for 3 workers?
(a) 6
(b) 12
(c) 7
(d) 8 (1 mark)

[79] Average Product for three labour:
(a) 12
(b) 11
(c) 8
(d) None (1 mark)

Answer:

For Answer [77] - [79] used the data table given below:

At first unit of output. Total output and Marginal output are equal i.e.

TP = MP = 10 units (given as TP = 10)

$TP = \sum MP$

$\therefore$ TP = 10 + 8 = 18 units of output

No. of Workers	Total Output	Marginal Output
0	0	0
1	10	10
2	10 + 8 = 18	8
3	24	24 - 18 = 6

As $Mp_n = TP_n - TP_{n-1}$

i.e. $TP_n = TP_3$ i.e. total product at 3 units of labour (worker)

$TP_{n-1} = TP_{3-1} = TP_2$ $\therefore$ Total product at 2 units of labour (worker)

$MP_n = MP_3$ = i.e. marginal product at 3 units of labour (worker)

$\therefore$ 24 units – 18 units = 6 units.

And marginal product is Maximum at 8 units of labour.

[77] (b) Total output for 2 workers is (b) = 18

[78] (a) Marginal output for 3 workers is (a) = 6

[79] (c) The average product at 3 units of labour is 8

$$AP = \frac{TP}{Q} = \frac{24}{3} = 8$$

2020 - NOVEMBER

[80] The concept innovative entrepreneurship was given by:
(a) Marshall (b) Schumpeter
(c) J. K. Mehta (d) Adam Smith (1 mark)

Answer:

(b) The concept of innovative entrepreneurship was propounded by Schumpeter.

[81] Which activity is the base of all the production activities:
(a) Production
(b) Exchange
(c) Investment
(d) Consumption (1 mark)

Answer:

(c) Investment is the base for all production.

[82] When output increases more than the increase in input it occurs due to:
(a) External and internal diseconomies
(b) External and internal economies
(c) External diseconomies and internal diseconomies
(d) External economies and internal economies (1 mark)

Answer:

(b) Internal economies of scale are firm-specific, while external economies of scale occur based on larger changes costs down while increasing the volume of output.

[83] A functional relationship between inputs and output is called:
(a) Cost function
(b) Revenue function
(c) Consumption
(d) Production function (1 mark)

Answer:

(d) The production function is a technical relationship between the amount of inputs that a firm uses and the maximum level of output that can be obtained.

[84] Among the following statements which is incorrect in relation to isoquants:
(a) Isoquants are negatively sloped
(b) Isoquants are convex to origin
(c) Isoquants are not intersecting
(d) Isoquants are concave to origin (1 mark)

Answer:

(b) Isoquants are convex to the origin:

Like indifference curves, isoquants are convex to the origin. In order to understand this fact, we have to understand the concept of diminishing marginal rate of technical substitution (MRTS), because convexity of on isoquant implies that the MRTS diminishes along the isoquants.

[85] External economies can be achieved through:
(a) Technological external economies
(b) External assistance
(c) Development of unskilled labour
(d) Superior managerial efficiency (1 mark)

Answer:

(a) External Economies can be achieved through all external sources like technology etc.

Un-skilled labour development and superior managerial efficiency are internal economies.

[86] Marginal product will be ______ at the point of inflexion is:
(a) Maximum
(b) Minimum
(c) Negative
(d) Zero (1 mark)

Answer:

(a) At the point of inflexion, the marginal product is maximum upto the point of inflexion. TP has been increasing at increasing rate resulting in increasing MP.

2021 - JANUARY

[87] Production may be defined as an act of:
(a) Creating utility
(b) Destroying utility
(c) Earning profit in best way
(d) Providing services professionally. (1 mark)

Answer:

(a) Creating utility

Production may be defined as act of creating utility

Production may be defined as an act of making goods and thus adding utility to the object.

[88] Which of the following is correct in relation to Marginal Product?

(a) What is produced units when all factors of production are employed at optimum efficiency?

(b) The extra output obtained from employing an additional unit of a factor

(c) The left revenue to the entrepreneur after he has incurred all expenses

(d) None of the above. (1 mark)

Answer:

(b) The extra output obtained from employing an additional utility of a factor

Marginal product refers to the addition to the total product

When an additional unit of a commodity is employed and thus produced.

$MP = TP_A - Tp_n - 1$

[89] According to Cobb-Douglas production function, labour contribution in increasing manufacturing production is

(a) 2/3

(b) 3/4

(c) 1/4

(d) 1/2 (1 mark)

Answer:

(b) 3/4

Cobb – Douglas production function, labour contribution is increasing manufacturing production is 3/4

[90] When Average Product falls, marginal product is.........the Average Product.

(a) Less than

(b) More than

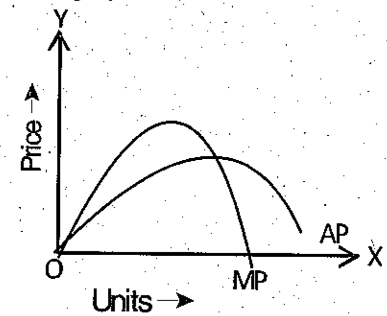
(c) Equal to

(d) Maximum (1 mark)

Answer:

(a) Less than

When Average Product falls marginal product is less than the average product.



[91] How many kinds are of Economies of scale?

(a) 5

(b) 3

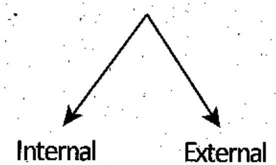
(c) 2

(d) 1 (1 mark)

Answer:

(c) 2

There are two types of Economies of scale



[92] In short run the Law of variable proportions is also known as

(a) Law of increasing returns (b) Law of diminishing returns

(c) Law of decreasing returns (d) Law of constant returns (1 mark)

Answer:

(b) Law of diminishing returns

In short run, the law of variable proportion is known as law of diminishing returns.

[93] The Law of returns to scale is.

(a) Short run (b) Long run

(c) Short and Long run (d) Medium run (1 mark)

Answer:

(b) Long run

The law of return to scale is applicable in long run only.

2021 - JULY

[94] Which of the following is not passive factor of production?

(a) Land

(b) Building

(c) Labour

(d) Machine (1 mark)

Answer:

(c) Labour is not passive factors of production i.e. Labour is an active factor, without the active participation of labour, land and capital may not produce anything .

[95] Which one of the following is not a necessary function of an entrepreneur?

(a) Risk and uncertainty bearing

(b) Initiating a business enterprise

(c) Innovations

(d) Supervision of day to day production activities. (1 mark)

Answer:

(d) Functions of an entrepreneur are:

- Initiating business enterprise
- Risk bearing and uncertainty bearing
- Innovations

2022 - JUNE

[96] Land is heterogeneous because of:

(a) Lands are alike

(b) Lands are not alike

(c) Lands are fixed

(d) Lands are mobile (1 mark)

Answer:

(b) Land is heterogenous because no two lands are alike they differ in size, fertility and situation.

Land is a free gift of nature, fixed in supply, passive, and immobile.

[97] When TP is decreasing, MP becomes?

(a) Positive

(b) Zero

(c) Undefined

(d) Negative (1 mark)

Answer:

(d) When TP is increasing, MP is increasing, MP is when zero, TP is maximum, when MP is negative and average revenue is diminishing, TP is decreasing/diminishing.

[98] Profit is an income from:

(a) Land

(b) Investment

(c) Business

(d) Labour (1 mark)

Answer:

(c) Profit is an income from business.

Profit is the revenue that remains after expenses in a business.

The main aim of business is the acquisition of profits.

[99] If the output has to max then:

(a) MR < MC

(b) MR = MC

(c) MR > MC

(d) None of the above (1 mark)

Answer:

(b) If the output is to be maximum level then the Marginal Revenue should be equal Marginal Cost.
When MR, MC, a firm has maximum output produced with additional products/outputs for maximum revenue.

[100] Marginal Cost changes due to change in _____cost

(a) Total

(b) Fixed

(c) Average

(d) Variable (1 mark)

Answer:

(d) Marginal cost is the addition made to the total cost by the production of an additional unit of output. It is independent of fixed cost. It is only the variable cost which changes with a change in the level of output in a short run.

[101] Which cost increases continuously with the increase in production ?

(a) Fixed cost

(b) Variable cost

(c) Total cost

(d) Average cost (1 mark)

Answer:

(b) Variable cost increases as production increases as every additional unit of output increases the variable cost.
Find cost remains the same.

[102] The market where small quantities of goods sold-

(a) Wholesale

(b) Retail

(c) Manufactures

(d) None of the above (1 mark)

Answer:

(b) The market where the small quantities of goods sold are Retail Markets.

[103] The Law of variable proportion is associated with.

(a) Short period

(b) Long period

(c) Both short & long periods

(d) Neither short or long period (1 mark)

Answer:

(a) Law of variable proportion is applicable to short run period. Law of variable proportion exhibits the relationship between the change of output in respect do the change in only one variable factor, only in short run economy.

2022 - DECEMBER

[104] Producer's surplus arises when:

(a) The price of the commodity is more than the minimum price at which the producer is willing to supply.

(b) The price of the commodity is less than the minimum price at which the producer is willing to supply.

(c) The price of the commodity is equal to the minimum price the producer is willing to supply at.

(d) The price of the commodity is zero to the maximum price of the producer is willing to supply at. (1 mark)

Answer:

(a) A producer surplus is generated by market prices in excess of the lowest price producers would otherwise be willing to accept for their goods.

[105] Scale of production can be changed in:

(a) Short period

(b) Very short period

(c) Long period

(d) Both short and very short period (1 mark)

Answer:

(c) Since all the factors are only variable in the long run, the scale of production is only changed in the long run, thus, the law of returns to scale will only apply in the long run.

[106] Which of the following is not a quality of the factor of land:
(a) Passive factor
(b) Active factor
(c) Heterogeneous
(d) Trimobile (1 mark)

Answer:

(b) Land is not an active factor unless human effort is exercised on land, it does not produce anything on its own.

2023 - June

[107] The concept of "Innovative Entrepreneurship" was propounded by:
(a) Joel Dean
(b) Schumpeter
(c) Marshall
(d) Karl Marx (1 mark)

Answer:

(b) **Schumpeter**
According to Schumpeter, the true function of an entrepreneur is to introduce innovations.

[108] Returns to scale occurs in:
(a) Small run
(b) Long run
(c) Very-small run
(d) Undetermined (1 mark)

Answer:

(b) **Long run**
Returns to scale (i.e. all factors are variable) occurs due to long run.

[109] Which one of the following is not a characteristic of land?
(a) Land is immobile
(b) Land is active factor
(c) Land has multiple uses
(d) Land is heterogeneous (1 mark)

Answer:

(b) **Land is Active factor**
Land is passive factor of production not active factor of production like labour. Unless, human efforts are involved land cannot produce anything on its own.

[110] When TP is decreasing, MP becomes:
(a) Zero (b) Negative
(c) Positive (d) Infinite (1 mark)

Answer:

(b) **Negative**
At stage of Negative Returns, total product declines, MP becomes negative and average product starts diminishing.

[111] Technical relationship between inputs and output:
(a) Production function (b) Supply function
(c) Marketing function (d) Social function (1 mark)

Answer:

(a) **Production function**
Production function states technological relationship between inputs and outputs that results from use of firm's scarce resources.

[112] The stage of "Decreasing Returns to Scale" will occur, when:
(a) Decrease in output is less than increase in input
(b) Decrease in output is greater than increase in input
(c) Increase in output is greater than increase in input
(d) Increase in output is less than increase in input (1 mark)

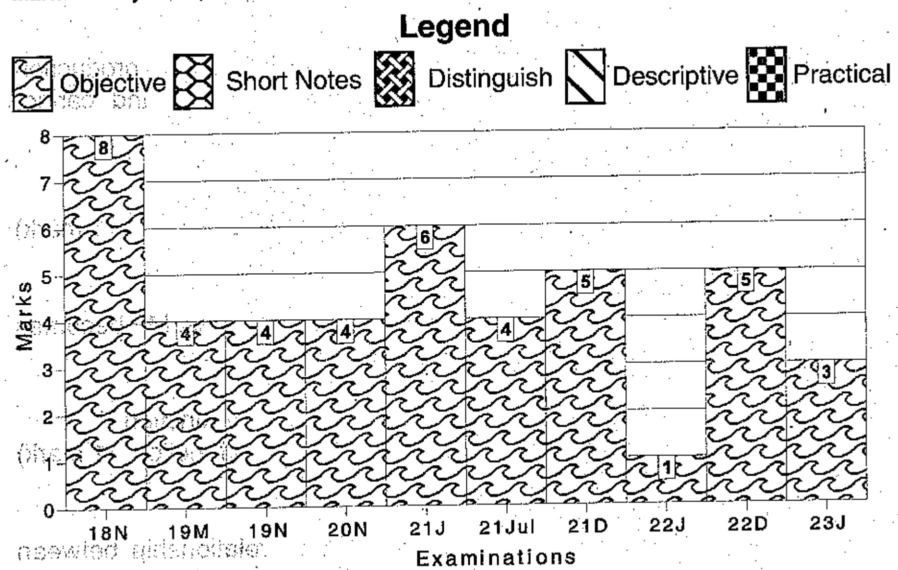
Answer:

(d) **Increase in output is less than increase in input**
If increase in output is less than increase in input it is called decreasing returns to scale.

3 THEORY OF PRODUCTION AND COST

Unit:2 **Theory of Cost**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



PAST YEAR QUESTIONS AND ANSWERS

2006 - NOVEMBER

[1] Opportunity cost is:
(a) Direct cost (b) Total cost
(c) Accounting cost (d) Cost of foregone opportunity (1 mark)

Answer:

(d) Opportunity cost is the cost of the next best alternative forgone. It's the cost of foregone opportunity.

[2] As output increases, average fixed cost:
(a) Remains constant (b) Starts falling
(c) Start rising (d) None (1 mark)

Answer:

(b) Average fixed cost is expressed as :

$$AFC = \frac{\text{Fixed Cost}}{\text{No. of units produced}}$$

Fixed cost always remains fixed. It does not increase with an increase in output. So the average fixed cost falls as more and more units are produced as the fixed cost remains the same.

[3] Average fixed cost can be obtained through :
(a) $AFC = \frac{TFC}{TS}$ (b) $AFC = \frac{EC}{TU}$
(c) $AFC = \frac{TC}{PC}$ (d) $AFC = \frac{TFC}{TU}$ (1 mark)

Answer:

(d) Average fixed cost = $\frac{\text{Total Fixed Cost}}{\text{No. of units produced}}$

In given Question,
AFC = Average fixed cost
TFC = Total fixed cost
TU = Total no. of units produced.

2007 - FEBRUARY

[4] AFC curve is :
(a) Convex & downward sloping
(b) Concave & downward sloping
(c) Convex & upward sloping
(d) Concave & upward rising (1 mark)

Answer:

(a) Average fixed cost always decreases with an increase in output so the AFC curve is convex and downward sloping.

[5] A firm's average fixed cost is ₹ 20 at 6 units of output what will it be at 4 units of output?
(a) ₹ 60
(b) ₹ 30
(c) ₹ 40
(d) ₹ 20

Answer:

(b) $AFC = \frac{TFC}{\text{No. of units}}$

$20 = \frac{TFC}{6}$

So Total fixed cost = 20× 6
= ₹ 120.

So Average Fixed Cost of 4 units of output

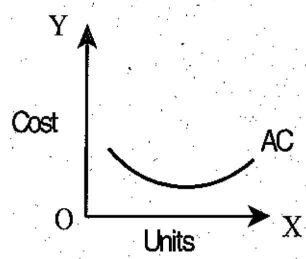
$AFC = \frac{TFC}{\text{No. of units}}$

$AFC = \frac{120}{4} = ₹ 30$

[6] U-shaped average cost curve is based on:
(a) Law of increasing cost
(b) Law of decreasing cost
(c) Law of constant returns to scale
(d) Law of variable proportions (1 mark)

Answer:

(d) Average cost curve is U shaped due to law of variable proportion. In the first stage T.P increases so AC decreases, then T.P becomes constant and finally T.P decreases and AC increases. Hence, it gives a U shape to the average cost curve.



2007 - MAY

[7] When shape of average cost curve is upward, marginal cost :
(a) Must be decreasing (b) Must be constant
(c) Must be rising (d) Any of these (1 mark)

Answer:

(c) Average cost and marginal cost are so related that when average cost falls, MC falls at a faster rate, when AC rises, MC cuts AC at its minimum.
So when AC curve is upward MC must be rising.

[8] If total cost at 10 units is ₹ 600 and ₹ 640 for 11th unit. The marginal cost of 11th unit is :
(a) ₹ 20 (b) ₹ 30
(c) ₹ 40 (d) ₹ 50 (1 mark)

Answer:

(c) Marginal $Cost_n = TC_n - TC_{n-1}$
$= TC_{11} - TC_{11-1}$
$= 640 - 600$
$= ₹ 40$

Marginal cost of 11th unit is ₹ 40.

[9] Economic cost excludes which of the following :

(a) Accounting cost + explicit cost
(b) Accounting cost + implicit cost
(c) Explicit cost + Implicit cost
(d) Accounting cost + opportunity cost (1 mark)

Answer:

(a) Economic cost take into account accounting (explicit) cost and in addition to this it also includes amount of money the entrepreneur could have earned if he had invested his money and sold his services and other factors in the next best alternative use.

In a nutshell:

Economic Cost = Implicit cost + Explicit cost
OR = Accounting cost + Implicit cost
OR = Accounting cost + opportunity cost

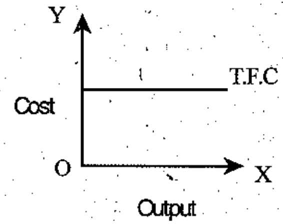
2007 - AUGUST

[10] Which of the following cost curves is never 'U' shaped?

(a) Average total cost curve (b) Marginal cost curve
(c) Total cost curve (d) Total Fixed cost curve (1 mark)

Answer:

(d) Total fixed cost refers to the cost which remains same even if the production total increases. Fixed cost has no effect with an increase or decrease in production. Examples of such cost are rent of factory, electricity charges, etc. Since fixed cost always remains constant so the fixed cost curve is not U shaped but it's a straight line.



[11] Suppose, the total cost of production of commodity X is ₹ 1,25,000. Out of this cost implicit cost is ₹ 35,000 and normal profit is ₹ 25,000. What will be the explicit cost of commodity X?

(a) 90,000
(b) 65,000
(c) 60,000
(d) 1,00,000 (1 mark)

Answer:

(b) Total cost = ₹ 1,25,000
Implicit cost = ₹ 35,000
Normal profit = ₹ 25,000
Explicit cost = ?
Total cost = Explicit Cost + Implicit Cost + Normal Profit
1,25,000 = Explicit Cost + 35,000 + 25,000
Explicit Cost = ₹ 65,000

[12] What is the total cost of production of 20 units, if fixed cost is ₹ 5,000 and variable cost is ₹2/-?

(a) 5,400
(b) 5,040
(c) 4,960
(d) 5,020 (1 mark)

Answer:

(b) Total Cost = Fixed Cost + Variable Cost
₹ 5,000 + 20 × 2.
= ₹ 5,040

2007 - November

[13] External economies accrue due to________ :
(a) increasing returns to scale (b) increasing returns to factor
(c) law of variable proportion (d) low cost (1 mark)

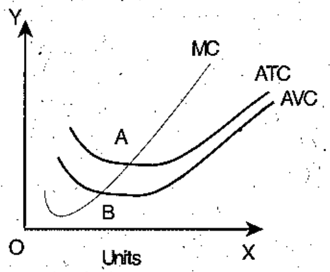
Answer:

(a) External economies accrue to firms as a result of expansion of output of whole industry. Increasing returns to scale occurs due to external economies.

[14] At which point does the marginal cost curve intersect the average variable cost curve and short run average total cost curve?
(a) At equilibrium points (b) At their lowest points
(c) At their optimum points (d) They don't intersect at all
(1 mark)

Answer:

(b) Marginal cost curve and average cost curve have a tendency that when AC curve falls, MC curve falls faster when AC curve rises MC curve rises on a faster rate and MC curve cuts the AC curve at its minimum (lowest point).



[15] Implicit cost may be defined as the:
(a) Costs which do not change over a period of time.
(b) Costs which the firm incurs but doesn't disclose
(c) Payment to the non-owners of the firm for the resources
(d) Money payment which the self employed resources could have earned in their best alternative employment (1 mark)

Answer:

(d) Implicit cost is the cost of self employed resources.
It is the cost of inputs owned by the firms and used by the firm in its own production process.
Implicit cost includes:
(a) return on money invested by the entrepreneur in its own business
(b) rent of self owned building of the entrepreneur .

2008 - February

[16] A firm's average fixed cost is ₹ 40 at 12 units. What will be the average fixed cost at 8 units:
(a) ₹ 60
(b) ₹ 70
(c) ₹ 90
(d) ₹ 80 (1 mark)

Answer:

(a) $AFC = \frac{TFC}{\text{No. of units produced}}$

$40 = \frac{TFC}{12}$

$TFC = 40 \times 12 = ₹\ 480$

Average fixed cost of 8 units:

$AFC = \frac{TFC}{\text{No. of units produced}} = \frac{480}{8} = ₹\ 60.$

[17] Returns to scale will said to be in operation when quantity of :
(a) All inputs are changed
(b) All inputs are changed in already established proportion
(c) All inputs are not changed
(d) One input is changed while quantity of all other inputs remain the same (1 mark)

Answer:

(b) Returns to scale comes into operation when all inputs whether fixed or variable are changed in same proportion i.e. the scale of production changes.

[18] Which of the following curves never touch any axis but is downward?

(a) Marginal cost curve (b) Total cost curve

(c) Average fixed cost curve (d) Average variable cost curve

(1 mark)

Answer:

(c) Average fixed cost curve never touches any axes but it slopes downward. Average fixed cost can never be zero even if there is no production so it can never touch any axes. AFC falls when output increases as fixed cost is always fixed. Hence, the curve is downward sloping.

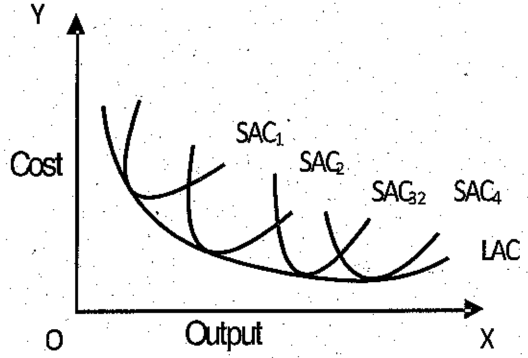
[19] Which of the following is known as Envelope curve?

(a) MC curve (b) AFC curve

(c) LAC curve (d) TFC curve (1 mark)

Answer:

(c) Long run average cost curve is called enveloping curve as it envelops all short run average cost curves (SAC curves are tangent to LAC curve)



2008 - JUNE

[20] A firm producing 7 units of output has an average total cost of ₹ 150 and has to pay ₹ 350 to its fixed factors of production. How much of the average total cost is made up of variable cost?

(a) ₹ 200 (b) ₹ 50

(c) ₹ 300 (d) ₹ 100 (1 mark)

Answer:

(d) $ATC = \frac{TC}{\text{No. of units}}$

$150 = \frac{T.C.}{7}$

Total cost of 7 units = 150 × 7 = 1050

Fixed Cost = ₹ 350

Total cost = Fixed Cost + Variable Cost

1050 = 350 + V.C.

So variable cost of 7 units = 1050 - 350 = ₹ 700

Average variable cost of 7 units = $\frac{700}{7}$ = ₹ 100

[21] A firm's average fixed cost is ₹ 20 at 6 units of output. What will it be at 3 units of output?

(a) ₹ 60 (b) ₹ 30

(c) ₹ 40 (d) ₹ 20 (1 mark)

Answer:

(c) Average fixed cost = $\frac{TFC}{\text{No. of units}}$

$20 = \frac{TFC}{6}$

T.F.C. = 20 × 6 = ₹ 120.

Average fixed cost of 3 units of output = $\frac{TFC}{\text{Total units}} = \frac{120}{3}$ = ₹ 40.

2008 - December

[22] Calculate total cost of 4 units :

Units	Total Cost (₹)	Marginal Cost (₹)
2	80	40
4	—	30

(a) 140 (b) 120
(c) 50 (d) 40 (1 mark)

Answer:

(a) Let the total cost of producing 4 units be ₹ x

$$\text{Marginal Cost} = \frac{\text{Change in Total Cost}}{\text{Change in Total Quantity}}$$

$$= \frac{x - 80}{4 - 2} = 30$$

$$= \frac{x - 80}{2} = 30$$

$$= x - 80 = 60$$

$$= x = 60 + 80$$

= ₹ 140

[23]

OUTPUT(Units)	TOTAL COST
0	30
1	40
2	50
3	60

Find Average Fixed Cost of 3 units

(a) 10 (b) 30
(c) 65 (d) 60 (1 mark)

Answer:

(a) Average Fixed Cost

$$= \frac{\text{Average Fixed Cost}}{\text{Quantity}} = \frac{30}{3} = ₹\ 10$$

[24] Long run does not have:
(a) Average Cost
(b) Total Cost
(c) Fixed Cost
(d) Variable Cost (1 mark)

Answer:

(c) Long run is a period of time during which the firm can vary all its inputs, unlike short run in which some inputs are fixed and other are variable. In other words, in short run the firm is tied with a given plant, in the long run the firm moves from one plant to another, so long run does not have any fixed cost.

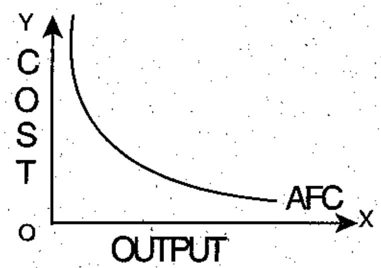
2009 - June

[25] Which of the following curve is not U shaped?

(a) AFC (b) AVC
(c) MC (d) TC. (1 mark)

Answer:

(a) Fixed cost remains fixed irrespective of number of units produced and therefore average fixed cost keeps on decreasing as more and more units are produced. Due to this, the average fixed cost curve always slopes downward throughout its length and it is not of U shape.



[26] From the following details, find out the average variable cost of 10 units:

OUTPUT :	0	10	20
Total cost:	₹ 200	₹ 400	₹ 800

(a) ₹ 40 (b) ₹ 20
(c) ₹ 200 (d) ₹ 400 (1 mark)

Answer:

(b) Variable cost per unit = $\frac{\text{Difference in cost}}{\text{Difference in units produced}}$

$= \frac{₹400 - ₹200}{10} = ₹\ 20$ per unit

Variable cost of 10 units = ₹ 20 × 10 = ₹ 200

Therefore, average variable cost = $\frac{₹200}{10} = ₹\ 20$

[27] The total cost incurred for 10 units is ₹ 400 and 20 units is ₹ 800. Find the marginal cost.

(a) ₹ 400 (b) ₹ 40
(c) ₹ 200 (d) ₹ 20 (1 mark)

Answer:

(b) Variable/Marginal cost may be expressed as :
Difference in cost/difference in units
In the given case,
Marginal cost = $\frac{₹800 - ₹400}{20 - 10} = \frac{₹400}{10} = ₹\ 40$ per unit.

2009 - DECEMBER

[28] Which one of the following is correct?

(a) AFC = AVC + ATC (b) ATC = AFC - AVC
(c) AVC = AFC + ATC (d) AFC = ATC - AVC. (1 mark)

Answer:

(d) Total cost of a business is the sum of total variable cost and total fixed cost. Symbolically, TC = TFC + TVC. Similarly, average total cost is a sum of average variable cost and average fixed cost i.e. ATC = AFC + AVC. This formula can also be expressed as: AFC = ATC – AVC

[29] Calculate AFC of 3 units from the following data:

Unit	0	1	2	3
Total Cost	30	40	50	60

(a) 30 (b) 15
(c) 10 (d) 5 (1 mark)

Answer:

(c) Fixed cost is the cost incurred even when no production is done, whereas cost incurred on production of units is called variable cost. Total cost is the summation of fixed cost and variable cost.

In the given case, at 0 units of output, the total cost is ₹ 30. This total cost comprises of only fixed cost and not variable cost as no units are produced.

Fixed cost always remains same, irrespective of the number of units.

Therefore, average fixed cost of 3 units will be:

AFC = $\frac{\text{TFC}}{\text{No. of units}}$

AFC of 3 units = $\frac{₹30}{3} = ₹\ 10.$

[30] Find AFC of 3 units :

Unit	0	1	2	3
Total Cost	15	25	35	45

(a) 5 (b) 10
(c) 15 (d) 25 (1 mark)

Answer:

(a) Fixed cost remains same, irrespective of the level of output.
In the given case, fixed cost = ₹ 15
Average fixed cost of 3 units = $\frac{\text{Total fixed cost}}{\text{No. of units}} = \frac{₹15}{3}$

AFC of 3 units = ₹ 5

2010 - JUNE

[31] What will be the TVC if we produce 2 units?

Units	0	1	2
TC	20	37	50

(a) 15 (b) 05
(c) 17 (d) 30 (1 mark)

Answer:

(d) At zero units of output TC = FC (since TC=FC+VC)
So FC = 20,
At 2 units of output: TC = 50 and FC = 20 so
variable cost = Total cost – Fixed cost
50 - 20 = 30

[32] The total cost of production of 10 units is ₹ 200. When production is increased to 20 units its total cost becomes ₹ 600. What will be its marginal cost.

(a) 400 (b) 40
(c) 4 (d) 30 (1 mark)

Answer:

(b) Marginal Cost is expressed as:

$$= \frac{\text{Difference in total cost}}{\text{Difference in total units}}$$

$$\Rightarrow \frac{₹600 - ₹200}{20 - 10} \Rightarrow \frac{₹400}{10}$$

$\Rightarrow$ ₹ 40 per unit.

[33]

Units	0	1	2	3	4
Total Cost	20	30	40	45	50

What will be the AFC at 4 units of output.

(a) 2 (b) 3
(c) 4 (d) 5 (1 mark)

Answer:

(d) Average fixed cost is expressed as:

$$= \frac{\text{Total fixed cost}}{\text{Quantity}} = \frac{₹\,20}{4\text{ units}} = ₹\,5 \text{ per unit.}$$

2010 - DECEMBER

[34] Payment made to outsiders for their goods and services are called:

(a) Opportunity cost (b) Real cost
(c) Explicit cost (d) Implicit cost (1 mark)

Answer:

(c) Explicit cost (or Accounting cost) takes care of all the payments and charges made by the entrepreneur to the suppliers of various productive factors E.g. wages to workers employed, prices for the raw materials, fuel and power used, rent for hired building, interest on money borrowed for doing business etc. These costs are included in cost of production.

[35] Direct Cost is also known as :

(a) Indirect Cost (b) Traceable Cost
(c) Opportunity Cost (d) Accounting Cost. (1 mark)

Answer:

(b) Indirect cost also known as non-traceable cost. Traceable cost also known as direct cost. Accounting cost also known as explicit cost.

[36] A firms AFC is ₹ 200 at 10 units of output what will be it at 20 units of output?

(a) 500 (b) 100
(c) 150 (d) 200 (1 mark)

Answer:

(b) $AFC = \frac{TFC}{Output}$

Now, TFC for 10 units of output = 200 × 10 = 2000

$\Rightarrow$ AFC for 20 units $= \frac{2000}{20} = 100$

[37] Long run price is also called by the name of ___________.
(a) market price (b) normal price
(c) administered price (d) wholesale price. (1 mark)

Answer:

(b) Long Run price is also known as Normal price

[38] What will be the AFC of 2 units according to the table given below :

Output	0	1	2
Total Cost (in ₹)	580	689	850

(a) 105 (b) 135
(c) 235 (d) 290 (1 mark)

Answer:

(d) TC at 0 Units of output = ₹ 580

⇒ TFC = ₹ 580

$$AFC = \frac{TFC}{Output} = \frac{580}{2} = 290$$

[39] Fixed cost is known as _______ cost.
(a) prime (b) supplementary
(c) overhead (d) direct (1 mark)

Answer:

(c) Fixed cost is also known as overhead cost since it continues to exist even if the operations are suspended. For example rent of factory.

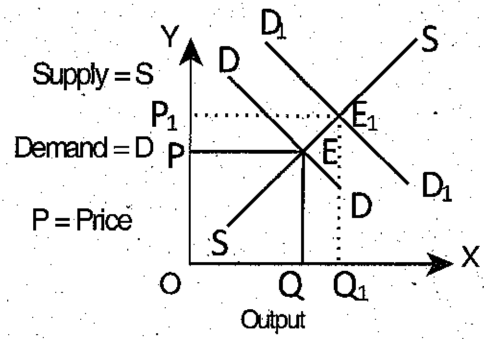
[40] Average Revenue Curve is also known as _______.
(a) profit curve. (b) demand curve.
(c) supply curve. (d) average cost curve. (1 mark)

Answer:

(b) Average Revenue Curve is also known as Demand Curve.

[41] Supply curve remaining unchanged, an increase in demand will lead to.
(a) A fall in price
(b) A rise in price
(c) No change in price
(d) An increase in supply. (1 mark)

Answer:



(b) An increase in demand without a change in supply leads to a rise in price and quantity.

2011 - June

[42] Find out AFC of 3 unit :

Unit	0	1	2	3
TC	300	1,000	2,000	3,000

(a) 100 (b) 200
(c) 300 (d) 400 (1 mark)

Answer:

(a) Average fixed cost (AFC) = $\frac{\text{Total Fixed cost}}{\text{No. of units}}$

In the given case,

Total fixed cost = ₹ 300

$\therefore$ AFC for 3 units = $\frac{300}{3}$ = ₹ 100

Hence, AFC for 3 units is ₹ 100

[43] Units 0 1 2

Units	0	1	2
TC	580	1,200	1,500

Calculate AFC at 2nd unit of output

(a) 235 (b) 290
(c) 310 (d) 920. (1 mark)

Answer:

(b) Average fixed cost (AFC) = $\frac{\text{Total Fixed cost}}{\text{No. of units}}$

In the given case, fixed cost = ₹ 580

$\therefore$ AFC of 2 unit = $\frac{580}{2}$ = ₹ 290.

[44] In the long run all factors are –

(a) Fixed
(b) Variable
(c) All factors remain unchanged
(d) None. (1 mark)

Answer:

(b) Long run is the period of time during which the firm can vary all of its inputs. In other words, in the long run all factors are variable and no factor is fixed.

[45] What is the total cost of production of 20 units, if fixed cost is ₹ 5,000 and variable cost is ₹2/-?

(a) 5,400 (b) 5,040
(c) 4,960 (d) 5,020

Answer:

Same as Ans. 12

2011 - DECEMBER

[46] What will be the AFC of 3 units of Output as per table given below?

Output	0	1	2	3
Total Cost (in ₹)	300	1,000	2,500	3,000

(a) 100 (b) 1,000
(c) 200 (d) 400 (1 mark)

Answer:

(a) Total Fixed Cost = ₹ 300

Total output = 3 units

$\therefore$ AFC = $\frac{TFC}{Q} = \frac{300}{3}$ = ₹ 100

[47] What will be marginal cost of 67 units of production according to the table given below :

Units of Production	0	10	25	37	67
Total Cost	160	200	300	500	1,400

(a) 10 (b) 20
(c) 30 (d) 50 (1 mark)

Answer:

(c) Change in total cost = 1400 – 500 = ₹ 900

Change in units of production = 67 – 37 = 30 units

MC per unit = $\frac{\text{Change in Total Cost}}{\text{Change in units}} = \frac{900}{30}$ = ₹ 30

[48] Which of the following is known as Envelope Curve?

(a) Average variable cost curve
(b) Average total cost curve
(c) Long run average cost curve
(d) Short run average cost curve (1 mark)

Answer:

(c) If is a firm has a choice that a plant can be varied by infinitely small gradations so that there are infinite number of plants corresponding to which there are numerous average cost curves. In this case, the Long Run average cost Curve will be a smooth curve enveloping all these short run average cost curves. Thus, Long Run average cost curve is also known as envelope curve.

[49] The average fixed cost for producing an output of 6 units of a product by a firm is ₹ 30. The same cost for producing an output of 4 units will be ₹________.

(a) 50 (b) 45
(c) 25 (d) 20 (1 mark)

Answer:

(b) Total fixed cost = 30 × 6 = ₹ 180

$\therefore$ AFC for 4 units of output = $\frac{TFC}{Q} = \frac{180}{Q} =$ ₹ 45

[50] Given

Output	0	4	8
Total Cost (₹)	20	24	48

What will be the AFC of 4 units of Output

(a) 2 (b) 3

(c) 4 (d) 5 (1 mark)

Answer:

(d) Total Fixed Cost (TFC) = ₹ 20

Total units of output (Q) = 4 units

AFC = $\frac{TFC}{Q} = \frac{20}{4} =$ ₹ 5

[51] Suppose the total cost of production of commodity 'X' is ₹ 1,25,000 Out of other cost implicit is ₹ 35,000 and normal profit is ₹ 25,000 what will be the explicit cost of commodity 'X'?

(a) ₹ 60,000 (b) ₹ 65,000

(c) ₹ 90,000 (d) ₹ 80,000 (1 mark)

Answer:

(b) Explicit Cost = Total Cost – Implicit Cost – Normal Profit

= 1,25,000 – 35,000 – 25,000 = ₹ 65,000

2012 - JUNE

[52] What will be the total fixed cost for the production of three units as per the details given below:

Units	0	1	2	3
Total Cost	620	940	1555	3670

(a) 620 (b) 640

(c) 1115 (d) 2650 (1 mark)

Answer:

(a) Fixed cost is the cost which remains fixed even if the total output is zero. Also,

Total Cost = Fixed Cost + Variable Cost

At zero units of output, variable cost will be zero.

620 = Fixed Cost + 0

So total fixed cost = ₹ 620.

Fixed cost remains constant irrespective of units of output.

Hence at 3 units of output also total fixed cost will be ₹ 620.

[53] Cost in terms of pain, discomfort, disability involved in supplying the various factors of production by their owners are termed as ______.

(a) social cost (b) explicit cost

(c) real cost (d) implicit cost (1 mark)

Answer:

(c) Real cost refers to all those payments which are made to the factors of production to compensate for the efforts, pains, exertions or sacrifices suffered by them.

Real cost = efforts, pains, exertions and sacrifices of labour and capital + wait and abstinence of entrepreneur.

Real cost is the cost in terms of pain and sacrifice made to produce goods and services. It includes the cost of producing goods and services as well as the cost of all resources used and the cost of not employing those resources in alternative uses.

[54] Which of the following is known as the Envelope Curve?

(a) Average variable cost curve

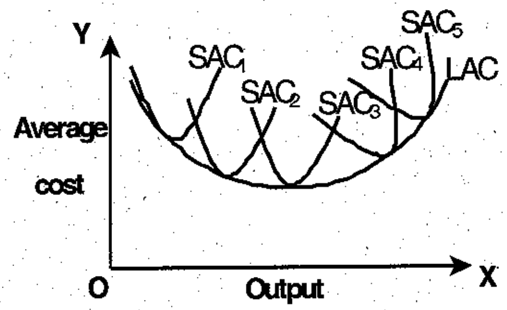
(b) Average total cost curve

(c) Long run average cost curve

(d) Short run average cost curve. (1 mark)

Answer:

(c) Long Run Average Cost Curve (LAC) is a U shaped curve. When LAC curve is declining it is tangent to the falling portions of the short run cost curves and when LAC is rising it is tangent to the rising portions of the short run cost curves. In simple words, long run average cost curve envelops all the short run cost curves and hence is known as the envelope curve.



[55] The cost of resources owned and employed by the entrepreneur himself in his business is termed as _______ cost.

(a) explicit (b) implicit
(c) fixed (d) variable. (1 mark)

Answer:

(b) Implicit costs are the cost for which payment in money terms is not made. These are the cost of factors owned by the entrepreneur himself and employed in his own business. For e.g. An entrepreneur uses his own land for production. If he would have rented that land he would have earned rent. So the cost of using his own land in the business is known as the implicit cost.

[56] A firm will close down in the short period if its average revenue is less than its:

(a) Average cost
(b) Average variable cost
(c) Marginal cost
(d) Average fixed cost (1 mark)

Answer:

(b) A firm should close down in the short run if it is not able to recover its variable cost. A firm shall continue to run if it is not able to meet its fixed cost because it may recover it in future. But variable cost is incurred to meet the payment of raw material, labour etc. which should be met otherwise the firm should close down.

2012 - DECEMBER

[57] A firm's total cost is ₹ 200 at 5 units of output and ₹ 220 at 6 units of output. The marginal cost of producing 6th unit of output will be ________.

(a) 20
(b) 120
(c) 220
(d) 320. (1 mark)

Answer:

(a) Marginal $\text{Cost}_n = TC_n - TC_{n-1}$

$= TC_6 - TC_{6-1}$

$= TC_6 - TC_5$

$= 220 - 200$

$=$ ₹ 20 per unit

[58] Consider the following data

Units of output : 0 1 2 3 4

Total Cost : 25 45 60 85 105

The Average Variable Cost (AVC) for an output of 4 units will be :-

(a) ₹ 20
(b) ₹ 30
(c) ₹ 25
(d) ₹ 26 (1 mark)

Answer:

(a) VC P.u. $= \dfrac{\text{Difference in Total Cost}}{\text{Difference in units produced}}$

$= \dfrac{105 - 25}{4 - 0}$

$= \dfrac{80}{4} =$ ₹ 20 p.u.

VC of 4 units = 20 x 4 = ₹ 80

$\therefore$ AVC $= \dfrac{80}{4} =$ ₹ 20

[59] The change in total cost due to one unit change in the output is called ____________ cost.
(a) marginal (b) average
(c) average variable (d) average fixed (1 mark)

Answer:

(a) Marginal cost is the addition made to the total cost by production of an additional unit of output.

[60] When AC curve is rising, the MC curve must be ____________ to it.
(a) equal (b) above
(c) below (d) parallel. (1 mark)

Answer:

(b) When the AC curve rises as a result of an increase in output, MC is more than AC i.e. MC curve is above AC curve.

[61] The Average fixed cost for producing an output of 6 units of a product by a firm is ₹ 30. The same cost for producing an output of 4 units will be ₹ ____________.
(a) 50 (b) 45
(c) 25 (d) 20 (1 mark)

Answer:

(b) $AFC = \frac{TFC}{\text{No. of units}}$

$30 = \frac{TFC}{6}$

$\therefore TFC = 30 \times 6 = ₹180$

So, AVC for 4 units of output $= \frac{180}{4}$

$= ₹45$

2013 - JUNE

[62] Which of the following cost curve will slope downward and does not touch the x-axis?
(a) Average cost curve
(b) Marginal cost curve

(c) Average variable cost curve
(d) Average fixed cost curve. (1 mark)

Answer:

(d) The total fixed cost is a constant amount, i.e. it is fixed in nature. Average fixed cost will steadily fall as output increases. Therefore, if we draw average fixed cost curve it will slope downwards throughout its length but will not touch to x-axis as AFC cannot be zero.

[63] Suppose the total cost production of a commodity 'x' is ₹ 1,25,000 out of which Implicit cost is ₹ 35,000 and normal profit is ₹ 25,000. What would be the explicit cost of commodity x?
(a) ₹ 90,000 (b) ₹ 65,000
(c) ₹ 1,00,000 (d) ₹ 60,000 (1 mark)

Answer:

(b) Total cost = ₹ 1,25,000
Implicit cost = ₹ 35,000
Normal profit = ₹ 2,50,000
Explicit cost = ?
Total cost = Explicit cost + Implicit cost + Normal profit
1,25,000 = Explicit cost + 35,000 + 25,000
Explicit cost = 1,25,000 - 35,000 - 25,000
= 65,000

[64] In which of the following cases opportunity cost concept applies?
(a) Resources have alternative uses
(b) Resources have limited uses
(c) Resources have no use
(d) None of the above. (1 mark)

Answer:

(a) Opportunity cost refers to the cost of opportunity forgone involving a comparison between the alternative chosen and the alternative forgone. It relates to the sacrificed alternatives.

Thus, opportunity cost concept applies where the resources have alternative uses.

[65] Direct costs are also known as ________.
(a) traceable costs (b) indirect costs
(c) opportunity costs (d) real costs. (1 mark)

Answer:

(a) Direct cost are costs that are readily identified and are traceable to a particular product operation or plant. It is also known as Traceable Cost.

2013 - December

[66] Which statement among below is correct in reference in Average Fixed Cost
(a) Never becomes zero (b) Curve never touches x-axis
(c) Curve never touches y-axis (d) All of the above. (1 mark)

Answer:

(d) Average fixed cost never touches any axis but it slopes downward, Average fixed cost can never be zero even if there is no production so it can never touch any axis. AFC falls when output increases as fixed cost is always fixed.
Thus option (d) is correct.

2014 - June

[67] Marginal cost changes due to change in ______ cost.
(a) total
(b) fixed
(c) average
(d) variable (1 mark)

Answer:

(d) Marginal cost is the addition made to the total cost by the production of an additional unit of output. It is independent of fixed cost. It is only the variable costs which changes with a change in the level of output in a short run.

[68] A firm produces 10 units of a commodity at an average total cost of ₹ 200 and with a fixed cost of ₹ 500. Find out the component of average variable cost in the total cost :
(a) ₹ 300 (b) ₹ 200
(c) ₹ 150 (d) ₹ 100 (1 mark)

Answer:

(c) Average total cost of 1 unit = ₹ 200
Total cost of 10 units = 200 × 10 = ₹ 2,000
⇒ Total fixed cost = ₹ 500
⇒ Total variable cost = total cost - total fixed cost
= 2,000 - 500 = ₹ 1,500
⇒ Variable cost of 1 unit = $\frac{1,500}{10}$ = ₹ 150
⇒ Hence, component of average variable cost in the total cost is ₹ 150.

[69] Average total cost to a firm is ₹ 600 when it produces 10 units of output and ₹ 640 when the output is 11 units. The MC of the 11th unit is :
(a) ₹ 40 (b) ₹ 540
(c) ₹ 840 (d) ₹ 1,040 (1 mark)

Answer:

(d) Average total cost of 10 units of output = ₹ 600
Average total cost of 11 units of output = ₹ 640
∴ Marginal cost of 11^{th} unit = Total cost of 11 units - Total cost of 10 units
= (640 × 11) - (600 × 10)
= ₹ 1,040

2014 - December

[70] Average cost of producing 50 units of any commodity is ₹ 250 and fixed cost is ₹ 1,000. What will be the average fixed cost of producing 100 units of the commodity?
(a) ₹ 10 (b) ₹ 30
(c) ₹ 20 (d) ₹ 05 (1 mark)

Answer:

(a) Fixed Cost of producing 50 units is ₹ 1,000 and the fixed cost of producing 100 units will also be the same i.e. ₹ 1,000.

∴ The Average Fixed Cost of 100 units

$$AFC \Rightarrow \frac{\text{Fixed Cost}}{\text{Quantity}} \Rightarrow \frac{1,000}{100} = ₹\ 10$$

[71] A company produces 10 units of output and incurs ₹ 30 per unit as variable cost and ₹ 5 per unit of fixed cost. What will be its total cost of producing 10 units?

(a) ₹ 300
(b) ₹ 35
(c) ₹ 305
(d) ₹ 350 (1 mark)

Answer:

(d) The total cost of producing 10 units is:

Total Cost ⇒ Total Fixed Cost + Total Var. Cost

⇒ 10 x 5 + 10 x 30

⇒ 50 + 300

⇒ ₹ 350

[72] On the basis of the following data what will be the marginal cost of the 6th unit of output?

Output	0	1	2	3	4	5	6
Total Cost (in ₹)	240	330	410	480	540	610	690

(a) ₹ 133
(b) ₹ 75
(c) ₹ 80
(d) ₹ 450 (1 mark)

Answer:

(c)

Output	Total Cost	Marginal Cost
0	240	0
1	330	90
2	410	80
3	480	70
4	540	60
5	610	70
6	690	80

[73] The positively sloped (rising) part of the long run average cost curve indicates working of the ________.

(a) diseconomies of scale
(b) increasing returns to scale
(c) constant returns to scale
(d) economies of scale (1 mark)

Answer:

(a) The positively sloped (rising) part of the long run average cost curve indicates working of the diseconomies of scale. Because rising LFAC and diminishing returns to scale result from internal and external diseconomies of scale.

[74] Average fixed cost curve is always:

(a) Declining when output increases
(b) U-Shaped, if there are increasing returns to scale
(c) U-Shaped, if there are decreasing returns to scale
(d) Intersected by marginal cost at its minimum point (1 mark)

Answer:

(a) Average fixed cost will steadily decline as output increases. If we draw an AFC it will slope downwards throughout its length but will not touch the x-axis as AFC can't be zero.

2015 - JUNE

[75] Planning curve is related to which of the following?

(a) Short run average cost curve
(b) Long run average cost curve
(c) Average variable cost
(d) Average total cost. (1 mark)

Answer:

(b) Long range average cost curve is often called a planning curve because a firm plans to produce any output in long run by choosing a particular plant in the long run and the average cost curve corresponding to the given output.

[76] Using the following data find out the marginal cost (MC) of the sixth unit of output:

Output	0	1	2	3	4	5	6	7
Total Cost	48	73	94	114	130	148	168	189

(a) 24 (b) 16
(c) 20 (d) 21 (1 mark)

Answer:

(c) $MC = \frac{\Delta TC}{\Delta Q}$ or $MC_n = TC_n - TC_{n-1}$
$MC_6 = TC_6 - TC_5$

$MC = 168 - 148$
$= 20$

2015 - DECEMBER

Solve question no. 77 given below the following table:

Output (Units)	TFC (in ₹)	TVC (in ₹)	MC (in ₹)
0	500	–	–
1	500	400	400
5	500	1600	–

[77] What will be marginal cost, when output is 5 units?
(a) 300
(b) 400
(c) 500
(d) 600. (1 mark)

Answer:

(a) $M.C = \frac{\Delta T.C}{\Delta Q} = \frac{\text{Change in Total Cost}}{\text{Change in Quantity}}$

T.F.C = 500 T.V.C for 5 units = 1,600
T.C. for 5 units = T.F.C + T.V.C
= 500 + 1,600
= 2,100

T.F.C = 500 T.V.C for 1 unit = 400
T.C. for 1 unit = 500 + 400 = 900

$= \frac{1,200}{4} = 300$

[78] Diminishing marginal returns implies
(a) Decreasing average variable costs
(b) Decreasing marginal costs
(c) Increasing marginal costs
(d) Decreasing fixed costs. (1 mark)

Answer:

(c) It states that as one input variable is increased there is a point at which the marginal increase in output increase and then begins to decrease, leading to the increase in the marginal cost with every additional unit.

[79] When the output of a firm increase in the short run, its average fixed cost
(a) Increases (b) Decreases
(c) Remains constant (d) First declines and then rises. (1 mark)

Answer:

(b) Since TFC is a constant amount, AFC will steadily fall as output increases.

[80] Which of the following cost curves is never 'U' shaped?
(a) Average cost curve
(b) Marginal cost curve
(c) Average variable cost curve
(d) Average fixed cost curve. (1 mark)

Answer:

(d) Average fixed cost curve is never "U" shaped because it slopes Downward through its length and never touch X1 axis.

2016 - JUNE

[81] Fixed cost curve normally:
(a) Starts from the origin
(b) Is U shaped
(c) Is vertical line
(d) Is horizontal line. (1 mark)

Answer:

(d) Fixed cost are those cost which are independent of output i.e. they do not change with changes in output. Thus, fixed cost curve normally is a horizontal line.

[82] A rational producer will produce in the stage in which marginal product is positive and :
(a) MP > AP
(b) MP = AP
(c) MP < AP
(d) MP is zero. (1 mark)

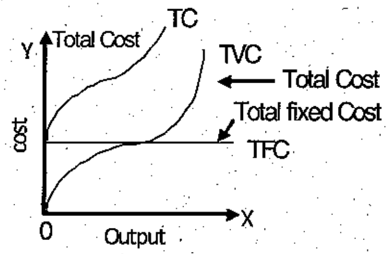
Answer:

(c) A rational producer will produce in the stage in which marginal product is positive and MP<AP. As in this case a producer could increase the average product of labour by decreasing the quantity of labour slightly.

[83] The vertical difference between TVC and TC curves is equal to:
(a) MC (b) AVC
(c) TFC (d) None of the above. (1 mark)

Answer:

(c) Total cost of a business is the sum of total variable cost and total fixed cost or symbolically TC = TFC + TVC.



The total variable cost curve rises upward showing thereby that as output increases, total variable cost increases. This curve starts from the origin which shows when output is zero, variable cost are also nil. The total cost curve thus has obtained by adding vertically the total fixed cost curve and the total variable cost curve.

[84] What happens to marginal cost when average cost increases?
(a) Marginal cost is below average cost
(b) Marginal cost is above average cost
(c) Marginal cost is equal to average variable cost
(d) Marginal cost is equal to average cost. (1 mark)

Answer:

(b) The relationship between marginal cost and average cost is the some as that between any other marginal average quantities when average cost rises as a result of increase in output marginal cost is more than the average cost.

[85] If the market price of good is more than the opportunity cost of producing it, then:
(a) The market price of the product will increase in the long run
(b) Producers will increase supply in the long run
(c) Resources will flow away from production of the good, causing supply to decline with the passage of time
(d) The situation will remain unchanged as long as supply and demand remain in balance. (1 mark)

Answer:

(b) If the market price of good is more than the opportunity cost of producing it then producer will increase supply in long run that is the amount of a good or services that producer are willing and able to offer to the market at various prices during the time.

2016 - DECEMBER

[86] A firm has variable cost of ₹ 1,000 at 5 units of output. If fixed costs are ₹ 400, what will be the average total cost at 5 units of output?

(a) 380 (b) 600

(c) 280 (d) 400 (1 mark)

Answer:

(c) Variable Cost = ₹ 1,000 at 5 unit

Fixed Cost = ₹ 400

Total cost = Variable cost + Fixed cost

∵ =1,000 + 400

=1,400 at 5 unit.

∴ Average total cost = $\frac{1,400}{5}$

= ₹ 280

[87] The average total cost of producing 50 units is ₹ 250 and total fixed cost is ₹ 1,000. What is the average fixed cost of producing 100 units?

(a) 5 (b) 30

(c) 20 (d) 10 (1 mark)

Answer:

(d) ATC of 50 units = ₹ 250

TFC = ₹ 1,000

AFC of 100 units = $\frac{1,000}{100}$

= ₹ 10.

[88] When average fixed cost is ₹ 20 at 6 units of output, what will it be at 4 units of output?

(a) ₹ 60 (b) ₹ 30

(c) ₹ 40 (d) ₹ 20 (1 mark)

Answer:

(b) AFC = 20 at 6 units of output

∴ TFC = 20 × 6

= 120

∴ AFC at 4 units of output

= $\frac{120}{4}$ = ₹ 30

2017 - JUNE

[89] Modern industrial units face _______ cost curve due to change in their technology of production.

(a) U shaped (b) L shaped

(c) Dish shaped (d) J shaped. (1 mark)

Answer:

(b) L shaped cost curve.

U shaped cost curve could exist only when the state of technology remains constant but, the empirical evidence shows that the state of technology changes in the long run.

Therefore, modern industrial units face 'L' shaped cost curve than 'U' shaped cost curve.

[90] What will be AVC in the production of 3 units according to the following cost data?

Production (units)	:	0	1	2	3
Total Cost (₹)	:	140	230	310	380

(a) ₹ 80 (b) ₹ 100

(c) ₹ 110 (d) ₹ 240 (1 mark)

Answer:

(a) AVC = $\frac{TVC}{Q} = \frac{TC - TFC}{Q} = \frac{380 - 140}{3} = \frac{240}{3} = 80$

[91] The costs which remain fixed over certain range of output but suddenly jump to a new higher level when production goes beyond a given limit are called:

(a) Variable cost (b) Semi- variable cost
(c) Stair- step variable cost (d) Jumping cost. (1 mark)

Answer:

(c) STAIR-STEP VARIABLE COSTS are the costs which increase in a stair step fashion i.e. they remain fixed over certain range of output; but suddenly jump to a new higher level when output goes beyond a given limit. Eg. Fixed salary of foreman will have a sudden jump if another foreman is appointed when the output crosses a particular limit.

[92] A firm producing 9 units of output has an average total cost of ₹ 200 and has to pay ₹ 630 to its fixed cost of production. How much of the average total cost is made up of variable cost?

(a) ₹ 150 (b) ₹ 130
(c) ₹ 70 (d) ₹ 300 (1 mark)

Answer:

(b) Variable Cost = Total Cost - Fixed Cost

= (200 × 9) - 630

= 1,170

$$AVC = \frac{TVC}{Q} = \frac{1,170}{9} = ₹\ 130$$

[93] The cost of one thing in terms of alternative given up is known as:

(a) Opportunity Cost (b) Real Cost
(c) Production Cost (d) Physical Cost. (1 mark)

Answer:

(a) Opportunity cost is concerned with the cost of forgone opportunity; it involves a comparison between the policy that was chosen and the policy that was rejected.

For example, the opportunity cost of using capital is the interest that it can earn in the next best use with equal risk.

2017 - DECEMBER

[94] In the short run, when the output of a firm increases, its average fixed cost

(a) Remains constant (b) Decreases
(c) Increases (d) First decreases and then rises (1 mark)

Answer:

(b) Yes in the short run, when the output of a firm increases its average fixed cost decreases. When the output is 100 units the AFC will be ₹ 20. And now if the output increases to 200 units, AFC will be ₹ 10. Hence, cost decreases.

[95] What will be average variable cost of producing 5 units of blankets as per details given in the following table?

Blankets	0	1	2	3	4	5
Total Cost (in ₹)	1,500	2,575	3,800	4,500	5,300	6,000

(a) ₹ 500 (b) ₹ 750
(c) ₹ 900 (d) ₹ 1,000 (1 mark)

Answer:

(c) $$\text{Average variable} = \frac{\text{Difference in Total Cost}}{\text{Different in units}}$$

$$= \frac{6,000 - 1,500}{5 - 0}$$

$$= \frac{4,500}{5}$$

= ₹ 900 per unit

[96] Which of the following is/are example(s) of an economic cost?

(a) wage paid to labourers
(b) raw materials purchase cost
(c) interest paid on short term loan
(d) all of the above. (1 mark)

Answer:

(d) Economic cost = explicit cost + implicit cost.

Explicit cost refers to those costs only which involve cash payments of the entrepreneur of the firm.

Implicit cost refers to the amount of money the entrepreneur could have earned if he had invested his money and sold his own services and other factors in the next best alternatives.

2018 - MAY

[97] Opportunity Cost is:

(a) Marginal cost
(b) Variable cost
(c) Total fixed cost
(d) None of these. (1 mark)

Answer:

(d) Opportunity Cost of a given activity defined as the value of next best activity and it is not related with any cost. It means sacrifice of one good for another good to give satisfaction to self.

[98] The "law of diminishing returns " applies to

(a) the short run, but not the long run
(b) the long run, but not the short run
(c) both the short run and the long run
(d) neither the short run nor the long run (1 mark)

Answer:

(a) 'Law of diminishing return' applies to short run but not in long run as in short run a fixed cost do not change while variable cost changes but in long run both change. Supply/Production cannot increase in short run whether there is loss or profit.

[99] Linear homogenous production function is based on

(a) Increasing returns to scale
(b) Decreasing returns to scale
(c) Constant returns to scale
(d) None of the above. (1 mark)

Answer:

(c) Linear Homogenous production is based on constant return to scale because output increase in the same way as increase in input or we can say that increase in output is equal to increase in input. Sole proprietorship production is based on constant return to scale for lifetime.

[100] Which of the following curve is not U shaped?

(a) AFC
(b) MC
(c) AVC
(d) TC (1 mark)

Answer:

(a) AFC is the cost obtained by dividing total fixed cost by the number of units of output.

$$AFC = \frac{TFC}{Q} \frac{\text{(Total Fixed Cost)}}{\text{(No. of units of output)}}$$

TFC can never be U-shaped as it will fall as total output increases and will not touch the X-axis. It can also never be zero.

[101]

Unit	0	1	2
TC	580	1200	1500

Calculate AFC at 2nd unit of output:

(a) 235
(b) 290
(c) 310
(d) 920 (1 mark)

Answer:

(b) Here: 580 is a fixed cost because it will be incurred whether firm produces or not. So, it is fixed cost,

We know

$$AFC = \frac{TFC}{Q}$$

AFC = ?, TFC = 580, Q = 2

So,

$$AFC = \frac{580}{2}$$

$$= 290$$

[102] Which of the following curves never touch any axis but is downward
(a) Marginal cost curve
(b) Total cost curve
(c) Average fixed cost curve
(d) Average variable cost curve (1 mark)

Answer:

(c) Average fixed cost is a curve which cannot touch any axis so, it can never be zero. When total production increases then average fixed cost steadily falls but never touch axis.

[103] External economies accrue due to ______.
(a) Increasing returns to scale (b) Increasing returns to factor
(c) Law of variable proportions (d) LOW cost (1 mark)

Answer:

(a) Increasing return to scale means when there is a increase in output is more than increase in input or in other words increase in, output > increase in input and there are some factors or external economies which tends to increasing return to scale.

[104] A firms average fixed cost is ₹ 20 at 6 units of output what will be at 3 units of output?
(a) ₹ 60
(b) ₹ 30
(c) ₹ 40
(d) ₹ 20 (1 mark)

Answer:

(c) Average fixed cost is 20 at 6 units and what will be at 3 units?

AFC at 6 units = 20

AFC at 3 units = $\frac{20}{3} \times 6$

= ₹ 40

as we AFC is decreasing steadily by increasing total production. So, AFC at 3 units is 40 and at 6 is 20.

[105] Which of the following is correct?
(a) AFC = AVC + ATC
(b) ATC = AFC - AVC
(c) AVC = AFC + ATC
(d) AFC = ATC - AVC (1 mark)

Answer:

(d) Average fixed can be obtained in two ways:

(a) $AFC = \frac{TFC}{Q} \frac{\text{Total Fixed Cost}}{\text{No. of units of output}}$

(b) AFC = ATC – AVC

Where, ATC = Average total cost and AVC = Average variable cost.

[106] The vertical difference between TVC and TC curves is equal to:
(a) MC (b) AVC
(c) TFC (d) None of the above. (1 mark)

Answer:

(c) Total Variable Cost (TVC) and Total Cost (TC) is differences of TFC (Total Fixed Cost) Formula Derived is:

TC = TVC + TFC

TC – TVC = TFC

This is vertical difference between Total Variable Cost and Total Cost.

[107] The cost of one thing in terms of alternative given up:
(a) Real cost (b) Production cost
(c) Opportunity cost (d) Physical cost (1 mark)

Answer:

(c) Opportunity cost is the cost which means the next best activity or sacrificing of one good thing for other.

[108] The cost which remains fixed over certain range of output but suddenly jumps to a new higher level when production goes beyond a given limit are called:
(a) Variable cost (b) Semi-variable cost
(c) Stair-step variable cost (d) Jumping cost (1 mark)

Answer:

(c) There are so many types of variable cost and these are:
(a) Variable cost or pure Variable Cost
(b) Semi-Variable or mixture of fixed and Variable cost.

(c) Stair-step Variable cost which means the cost which remains fixed for a long time but suddenly jumped to a new higher level when production goes beyond a given limit.

2018 - NOVEMBER

[109] The shape of Average Fixed cost curve is?

(a) Falls from left to right
(b) Rises from left to right
(c) Parallel to x-axis
(d) Parallel to y-axis (1 mark)

Answer:

(a) Shape of Average Fixed Cost is hyperbola in shape it falls from left to right but does not touch x axis.

[110] Price of a commodity is best expressed as

(a) Exchange value
(b) Cost of goods sold
(c) Production cost
(d) Nominal value (1 mark)

Answer:

(a) Price of commodity is expressed as its exchange value as it is the price at which it will be sold or purchased.

[111] Accounting cost is ______ Economic cost

(a) Equal to
(b) Less than
(c) More than
(d) Not Included (1 mark)

Answer:

(b) Accounting cost is explicit cost and economic cost is Explicit + Cost + National cost therefore, accounting cost is less than economic cost.

[112] When AC Curve is at minimum then MC Curve is ______?

(a) Minimum then AC Curve
(b) Equals to AC Curve
(c) Above AC Curve
(d) Less then AC Curve (1 mark)

Answer:

(b) When average cost is minimum, MC is equal to the Ac. In other word, MC curve cuts AC curve at its minimum point.

[113] Which of the following equation represents profit maximisation condition?

(a) MC = MR
(b) MC > MR
(c) MC < MR
(d) None. (1 mark)

Answer:

(a) Profit will be at maximum level when marginal Revenue is equal to marginal cost therefore, it is able to cover its cost and survive in economy.

[114] MC curve of a firm in a perfectly competitive industry depicts?

(a) Demand curve
(b) Supply curve
(c) Average cost curve
(d) Total cost curve (1 mark)

Answer:

(b) MC curve is rising upward in a competitive market therefore, it depicts supply curve.

[115] Issues requiring decision making in the context of business are:

(a) How much should be the optimum output at what price should the firm sell?
(b) How will the product be placed in the market?
(c) How to combat the risks and uncertainties involved?
(d) All of the above. (1 mark)

Answer:

(d) All the given options are required for making business decisions in context of business therefore, answer will be **(d)** all of the above.

[116] Law of production does not include?

(a) Returns to scale

(b) Law of variable proportion

(c) Law of diminishing returns to a factor

(d) Least cost combination factors (1 mark)

Answer:

(d) Least cost combination factor is not included in law of production function.

2019 - MAY

[117] A firm producing 15 units of output has average cost of ₹ 250 and ₹ 125 as per unit cost for fixed factors of production. Then average variable cost will be

(a) 180

(b) 150

(c) 125

(d) None of the above (1 mark)

Answer :

(c) Average total cost (ATC) = AFC + AVC

ATC = 250; AFC = 125

AVC = ATC – AFC

= 250 – 125 = 125

[118] Which of the following statement is incorrect?

(a) AC is sloping downwards, MC is below AC

(b) AC is sloping downwards, MC must fall

(c) AC is sloping upwards, MC is above AC

(d) MC cuts AC at its lowest point. (1 mark)

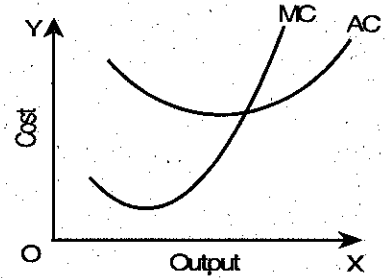
Answer :

(b) The relationship between Average cost and Marginal cost is as following:

(i) when average cost falls as a result of an increase in output, marginal cost is less than average cost.

(ii) when average cost rises as a result of increase in output, marginal cost is more than average cost.

(iii) when average cost is minimum, marginal cost is equal to average cost.



[119] Diminishing marginal returns implies.

(a) Decreasing average fixed cost

(b) Decreasing average variable cost

(c) Decreasing marginal cost

(d) Increasing marginal cost (1 mark)

Answer:

(d) Diminishing marginal Returns implies an increase in marginal cost. Marginal cost is the increase in total cost of production if one additional unit of output is produced.

[120] Opportunity Cost is ________

(a) Recorded in the book of accounts

(b) Sacrificed alternative

(c) Both (a) and (b)

(d) None of the above (1 mark)

Answer:

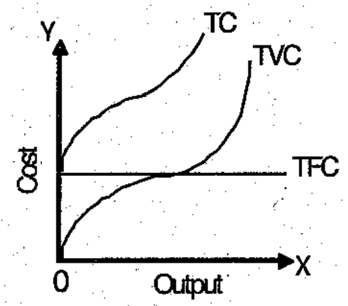
(b) Opportunity cost is the cost of the next best alternative foregone. It is generally not recorded in the books of accounts. Thus, it can be said that opportunity cost is the sacrificed alternative whose cost is not recorded in books of accounts.

2019 - NOVEMBER

[121] Which of the following is true?
(a) TC = TFC + TVC
(b) TC + TVC + TFC
(c) 2TC - TVC = TFC
(d) none (1 mark)

Answer:

(a) Total Cost = Total Fixed Cost + Total Variable Cost
i.e. TC = TFC + TVC



Short - Run Total Cost Curves

[122] Total Economic Cost = Explicit Cost + Implicit Cost + ______
(a) Normal Profit
(b) Super Normal Profit
(c) Loss
(d) None (1 mark)

Answer:

(a) Total Economic Cost = Explicit Cost + Implicit Cost + Normal Profit
As economic cost includes :
(a) Normal return an money capital invested by the entrepreneur himself in his cum business.
(b) The wages or salary not paid to entrepreneur, but could have been earned if the services had been sold somewhere else.
(c) It also takes into account, accounting cost.
(d) And also the normal profit earned.

[123] Economic cost of production differs from accounting cost of production
(a) Partially True
(b) True
(c) False
(d) None (1 mark)

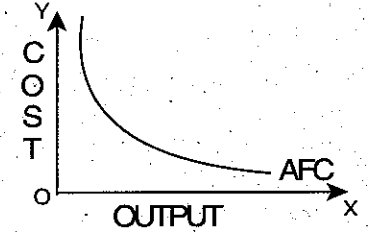
Answer:

(b) Economic cost of production differs from accounting cost of production is TRUE as
Economic cost includes both explicit cost and implicit cost.
Whereas Accounting cost only includes the amount spent i.e. EXPLICIT COST

[124] Which curve is never U- shaped
(a) AFC
(b) AVC
(c) AC
(d) None (1 mark)

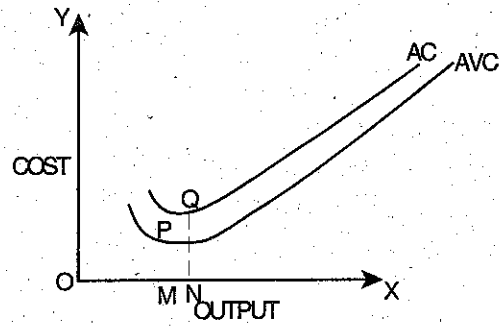
Answer:

(a) Average fixed cost curve is never U-shaped.
As Average Fixed Cost diminishes as the production increases (though the fixed cost remains constant)



$$AFC = \frac{TFC}{Q}$$

It will slope downwards throughout its length but will not touch the X-axis as AFC cannot be zero.
And AVC and AC curves are U-shaped i.e.



2020 - NOVEMBER

[125] Use the table and answer for the following questions

Output	0	1	2	3	4	5	6
Total cost in ₹	100	180	250	310	360	420	490

The average fixed cost of 4 units of output is:
(a) 80
(b) 90
(c) 25
(d) 350 (1 mark)

Answer:

(c) In the given table, we see that o level of output TC = 100 which is also equal to TFC.
Thus TC = TFC = 100
Thus TFC of 4 units = 100

$$AFC = \frac{TFC}{Q} = \frac{100}{4} = 25$$

[126] The average variable cost of 5 units of output:
(a) 84
(b) 64
(c) 420
(d) 104 (1 mark)

Answer:

(b) AVC at 5 units

$$AVC = \frac{TVC}{Q}$$

$$TVC = TC - TFC$$
$$= 420 - 100$$
$$= 320$$

$$AVC = \frac{320}{5}$$
$$= 64$$

[127] The marginal cost of 5^{th} unit of output is:
(a) 60
(b) 70
(c) 540
(d) 90 (1 mark)

Answer:

(a) MC = at 5 units
$MC = TC_5 - TC_{5-1}$
$= TC_5 - TC_4$
$= 420 - 360$
$= 60$

[128] The total cost is ₹ 4,200 and fixed cost is ₹ 1,200 then find the variable cost:
(a) ₹ 5,450
(b) ₹ 1,200
(c) ₹ 4,200
(d) ₹ 3,000 (1 mark)

Answer:

(d) TC = 4200
TFC = 1200
Variable cost = 4200 - 1200
= ₹ 3000

2021 - JANUARY

[129] A Firm producing 7 units of output has an average total cost of ₹ 150 and has to pay ₹ 350 to its fixed factors of production whether it produces or not? How much of the average total cost is made up of variable costs?
(a) 200
(b) 50
(c) 300
(d) 100 (1 mark)

Answer:

(d) 100

Units	ATC	PC
7	150	350

$ATC = \frac{TC}{Q}$

$150 \times 7 = TC$
$= 1050 = TC$
$TC = FC + VC$
$1050 = 350 + 700$
$ATC = AFC + AVC$

$\frac{TC}{Q} = \frac{FC}{Q} + \frac{VC}{Q}$

$= \frac{1050}{7} = \frac{350}{7} + \frac{700}{7}$

$= 150 = 50 + 100$

Thus Average variable cost is of ₹ 100.

[130] A Firm has a variable cost of ₹ 2,000 at 5 units of output. If fixed costs are ₹ 800, what will be the average total cost at 5 units of output?
(a) 560
(b) 120
(c) 240
(d) 2,800 (1 mark)

Answer:

(a) 560

Units	VC	FC
5	2000	800

$TC = FC + VC$
$= 2000 + 800$
$= 2800$

$ATC = \frac{TC}{Q}$

$= \frac{2800}{5}$

$= 560$

[131] Which of the following Statements is false?

(a) Economic costs include the opportunity costs of the resources owned by the firm.

(b) Accounting costs include only explicit costs.

(c) Economic profit will always less than accounting profit if resources owned and used by the firm have any opportunity costs.

(d) Accounting profit is equal to total revenue less implicit costs.

(1 mark)

Answer:

(d) Accounting profit is equal to total revenue less implicit cost

Accounting profit = TR – Implicit Cost

[132] Average cost curve is

(a) 'U' Shaped

(b) Positively sloped

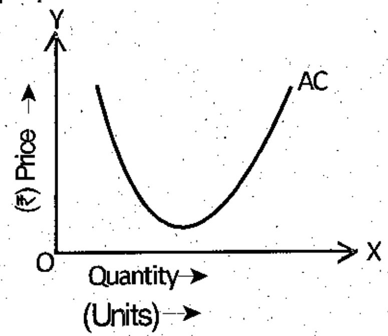
(c) Negatively sloped

(d) Rectangular hyperbola (1 mark)

Answer:

(a) 'U' shaped

Average cost curve is of 'U' shaped due to the law of variable proportion.



[133] Isoquants are equal to:

(a) Product lines (b) Total utility lines

(c) Cost lines (d) Revenue lines (1 mark)

Answer:

(a) Product lines

Isoquants are equal to product lines.

An Isoquants consists of alternative combinations of input to produce a given quantity of output and product lines are lines representing various combinations of factors of production to produce a given output.

[134] Average fixed cost can be obtained through.

(a) AFC = $\frac{TFC}{TS}$ (b) AFC = $\frac{EC}{TU}$

(c) AFC = $\frac{TC}{PC}$ (d) AFC = $\frac{TFC}{TU}$ (1 mark)

Answer:

(d) AFC = $\frac{TFC}{TU}$

Average fixed cost can be obtained through

AFC = $\frac{\text{Total Fixed Cost}}{\text{No. of Units produced}}$

2021 - JULY

[135] Use table below to answer question [35 to 37]

Output	0	1	2	3	4	5	6
Total Cost (₹)	360	495	615	720	810	915	1035

The average fixed cost of 3 unit of output is ______.

(a) ₹ 180 (b) ₹ 225

(c) ₹ 120 (d) ₹ 134 (1 mark)

Answer:

(c) AFC = $\frac{IFC}{Q}$

AFC = $\frac{360}{3}$ = ₹ 120

AFC = ₹120 option **(c)** is correct.

[136] The marginal cost of the fifth unit of output is ______.
(a) ₹ 174
(b) ₹ 225
(c) ₹ 675
(d) ₹ 105 (1 mark)

Answer:

(d)

Output	Total Cost	TFC	Total Variable Cost	Marginal Cost
0	360	360	–	
1	495	360	135	135
2	615	360	255	120
3	720	360	360	105
4	810	360	450	90
5	915	360	555	105
6	1035	360	675	120

Marginal Cost of the Fifth unit = 105

[137] Diminishing marginal returns starts to occurs between ______ units.
(a) 4 and 5 (b) 3 and 2
(c) 5 and 6 (d) 1 and 2 (1 mark)

Answer:

(a) According to the above table Diminishing marginal return starts to occur between 4 and 5 units.

[138] The difference between TFC and TC is equal to:
(a) Zero
(b) TVC
(c) MC
(d) AFC (1 mark)

Answer:

(b) The difference between TFC and TC is equal to TVC
TC = TFC + TVC
TVC = TC - TFC

2021 - DECEMBER

[139] Marginal Revenue curve moves ______ and Marginal cost curve moves ______
(a) downward, downward (b) downward, upward
(c) upward, upward (d) Downward, remains same. (1 mark)

Answer

(b) The marginal revenue curve is downward sloping and below the demand curve and the additional gain from increasing the quantity sold is lower than the chosen market price. Both these curves are intersected at their minimum points by Marginal Cost (MC), which slopes upward. If the price of the variable input increases all three cost curves move upwards as shown alongside. They retain their shape and characteristics as described above.

[140] Average Revenue curve is also known as ______ (1 mark)
(a) Firm's Demand Curve
(b) Marginal Revenue Curve
(c) Total Revenue Curve
(d) Marginal Cost Curve

Answer

(a) The average revenue curve is also known as a demand card in the business market. Average revenue is the division of total revenue (TR) by quantity (Q) which also means Average revenue is equal to the price of each product.

[141] If quantity demanded for a commodity increases from 15 units to 20 units and there is a 25 percent decrease in price. If the initial price was ₹ 20, then what is the marginal revenue?
(a) 15
(b) 20
(c) 0
(d) 10 (1 mark)

Answer

(c) If quantity demanded for a commodity increases from 15 units to 20 units and there is 25% decrease in price. The initial price is ₹20;
20-25% of 20
20-5
₹ 15
Then marginal revenue will be zero.

[142] The marginal, average and total product curves encountered by the firm producing in the short-run exhibit all of the following relationships except ________ (1 mark)
(a) When TP is rising, Average and Marginal product may be either rising or falling.
(b) When marginal product is negative, total product and Average Product are falling
(c) When Average product is maximum, marginal product equals Average Product and total product is rising
(d) When Marginal Product is at maximum, Average Product equals Marginal Product and total product is rising

Answer

(d) The marginal, average and total product curves encountered by the firm producing in the short run exhibit all of the following relationships except when marginal product is at maximum, average product equals marginal product and total product is rising.

[143] Marginal cost can be directly derived from -
(a) Total variable cost
(b) Total fixed cost
(c) Average cost
(d) Average fixed cost (1 mark)

Answer

(b) It is derived from the variable cost of production, given that fixed costs do not change as output changes, hence, no additional fixed cost is incurred in producing another unit of a good or service once production has already started.

2022 - JUNE

[144] Total economic cost = implicit cost + explicit cost + ________
(a) Normal Profit
(b) Abnormal Profit
(c) Economic Profit
(d) None of the above (1 mark)

Answer

(a) Total economic cost = Implicit Cost + Explicit Cost + Normal Cost .

2022 - DECEMBER

[145] The marginal product of a variable input is described as?
(a) The additional output resulting from one unit increase in both the variable and fixed inputs
(b) The additional output resulting from one unit increase in fixed input
(c) The additional output resulting from one unit increase in the variable inputs
(d) The additional output resulting from all unit increase in variable inputs (1 mark)

Answer:

(c) The marginal cost is the cost of producing one extra unit of output, in the short run, the fixed cost does not change by producing one extra unit, thus the marginal cost is entirely comprised of the variable cost.

[146] Total profit are maximized when?
(a) TR equal TC
(b) The TR curve and the TC curve are parallel
(c) TC exceeds TR
(d) TR exceeds TC (1 mark)

Answer:

(d) The profits are maximised where the gap between the total revenue and the total cost curves is the maximum. This happens only when both the curves are parallel to each other. The profits will be positive only when the total revenues exceed the total cost.

[147] A firm producing 7 unit of output has an average total cost of ₹ 150 and has to pay ₹ 350 to its fixed factors of production whether it produce or not. How much of the average total cost is made up of variable costs?

(a) ₹100 (b) ₹200
(c) ₹50 (d) ₹300 (1 mark)

Answer:

(a) No. of units = 7

ATC = ₹ 150

TFC = ₹ 350

$$AFC = \frac{TFC}{Q} = \frac{350}{7} = ₹\ 50$$

AVC = ATC - AFC
= 150 - 50
= ₹ 100

[148] Economic costs include:

(a) Implicit costs (b) Explicit costs
(c) Implicit and explicit costs (d) None of the above (1 mark)

Answer:

(c) Economic cost include both Explicit and implicit cost. Therefore, economic cost are useful for businessmen while making decisions.

[149] At the shut-down point, the price is:

(a) below ATC (b) below AVC
(c) equal to ATC (d) above AVC (1 mark)

Answer:

(b) The firm always has the option of not producing at all. If a firms total revenues are not enough to make goods even the total variable cost. It is better for the firm to shut down. In other words, a competitive firm should shut down if the price is below AVC.

2023 - JUNE

[150] Economic cost includes which of the following?

(a) Accounting cost
(b) Implicit cost
(c) Both (a) and (b)
(d) None of the above (1 mark)

Answer:

(c) **Both (a) and (b)**

Economic cost includes both accounting cost (actual payment) and implicit cost (notional expense).

[151] External economies are due to:

(a) Development of skilled labour
(b) Technologies
(c) Cheaper raw material
(d) All of the above (1 mark)

Answer:

(d) **All of the above**

External Economies are due to development of skill labour, technology, cheaper raw material, etc.

[152] Planning curve is related to:

(a) Long run average cost curves
(b) Short run average cost curves
(c) Average revenue curve
(d) None of the above (1 mark)

Answer:

(a) **Long Run Average Cost Curve**

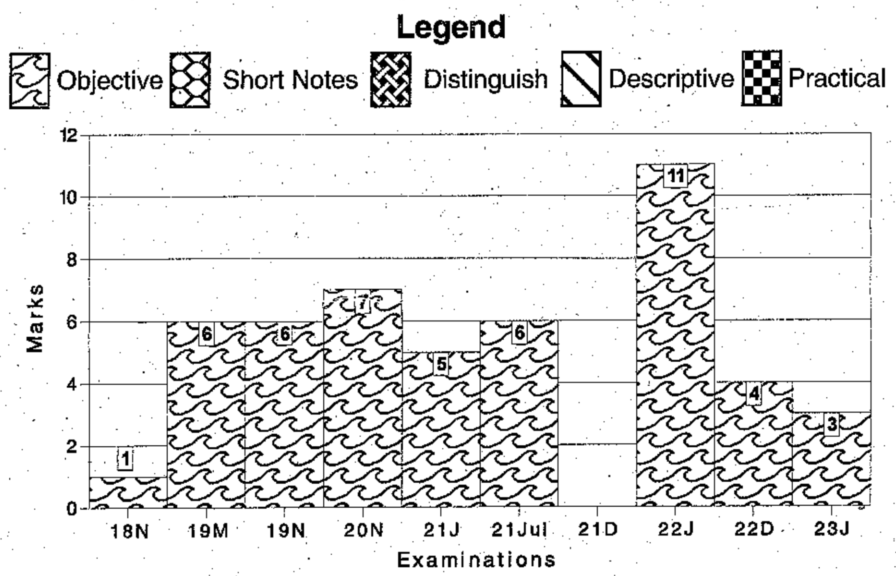
Long Run Average Cost Curve is after called as planning curve because firm plans to produce any output in long run by choosing a plant on long run average cost curve.

4

PRICE DETERMINATION IN DIFFERENT MARKETS

Unit: 1 **Meaning and Types of Market**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



PAST YEAR QUESTIONS AND ANSWERS

2006 - NOVEMBER

[1] Which of the following is not an essential condition of pure competition?
(a) Large number of buyers and sellers
(b) Homogeneous product
(c) Freedom of entry
(d) Absence of transport cost (1 mark)

Answer:

(d) Pure competition is a part of perfect competition. The essential conditions of pure competition are:
(a) Large number of buyers and sellers
(b) Homogeneous products
(c) Freedom of entry and exit of firms.

2007 - FEBRUARY

[2] Under which of the following forms of market structure does a firm has no control over the price of its product :
(a) Monopoly
(b) Oligopoly
(c) Monopolistic competition
(d) Perfect competition (1 mark)

Answer:

(d) Perfect competition is a price taking firm. The prices in such a market are determined by market forces of demand and supply. Neither the buyer nor the seller can influence the prices.

[3] Given the relation $MR = P\left(1-\frac{1}{e}\right)$ *if* $e > 1$, *then*:

(a) $MR > 0$ (b) $MR < 0$
(c) $MR = 0$ (d) None (1 mark)

Answer:

(a) $MR = P\left(\frac{e-1}{e}\right)$

If e >1

The relation $\frac{e-1}{e}$ will be positive.

2007 - MAY

[4] Profits of the firm will be more at :

(a) MR = MC
(b) Additional revenue from extra unit equals its additional cost
(c) Both of above
(d) None (1 mark)

Answer:

(c) Profits of the firm are maximum at profit maximization level i.e. MC=MR, Additional revenue from extra unit equals its additional cost.

[5] What should firm do when Marginal revenue is greater than marginal cost?

(a) Firm should expand output
(b) Effect should be made to make them equal
(c) Prices should be covered down
(d) All of these (1 mark)

Answer:

(a) When marginal revenue is greater than marginal cost, the producer shall expand output as it is profitable for the firm to expand output.

2007 - AUGUST

[6] Under monopoly price discrimination depends upon :

(a) Elasticity of demand for commodity
(b) Elasticity of supply for commodity
(c) Size of market
(d) All of above (1 mark)

Answer:

(a) Monopoly has a feature of price discrimination i.e. charging different prices from different customer. It depends upon the elasticity of demand of various customers. Difference in elasticity forces the monopolist to charge different prices from different customers.

[7] Firms in a monopolistic market are price ________ :

(a) takers (b) givers
(c) makers (d) acceptors (1 mark)

Answer:

(c) In a monopoly market the prices are decided by the monopolist. He is the maker of the price. Buyers cannot influence the prices.

2007 - NOVEMBER

[8] Market which have two firms are known as :

(a) Oligopoly
(b) Duopoly
(c) Monopsony
(d) Oligopsony (1 mark)

Answer:

(b) Duopoly is composed of two words - "Duo" and "Poly". Duo means two and "poly" means seller. Hence, duopoly is a market where there are two sellers.

2008 - February

[9] Monopolist can determine :

(a) Price

(b) Output

(c) Either price or output

(d) None (1 mark)

Answer:

(c) Monopolist firm is the price maker firm. In this market only the seller can influence the prices. He can determine either output or price.

[10] MR of n th unit is given by :

(a) TR_n / TR_{n-1} (b) $TR_n + TR_{n-1}$

(c) $TR_n - TR_{n-1}$ (d) All of these (1 mark)

Answer:

(c) Marginal revenue is the addition made to the total revenue by producing one more unit of a commodity. It is expressed as:

$M.R._n = TR_n - TR_{n-1}$

2008 - June

[11] The market structure in which the number of sellers is small and there is inter dependence in decision making by the firms is known as :

(a) Perfect competition

(b) Oligopoly

(c) Monopoly

(d) Monopolistic competition (1 mark)

Answer:

(b) Oligopoly is often described as "competition among the few". It is characterized by small number of sellers who are interdependent in decision making.

[12] In perfect competition, since the firm is a price taker, the ______ curve is a straight line :

(a) marginal cost

(b) total cost

(c) total revenue

(d) marginal revenue (1 mark)

Answer:

(d) In a perfect competitive market, the prices of all the firms are same. Hence, there is no change in marginal revenue and the MR curve is a straight line.

2011 - June

[13] Given the relation $MR = P\left(1 - \frac{1}{e}\right)$, *if* $e < 1$, *then*:

(a) MR < 0

(b) MR > 0

(c) MR = 0

(d) None of these. (1 mark)

Answer:

(a) If MR = P(1 - 1/e) and e < 1

Lets assume e = 0.5

putting it in the formula we get

$$P\left(1 - \frac{1}{0.5}\right)$$

$$MR = -P$$

So MR will always be less than zero.

2012 - June

[14] For a discriminating monopolist the condition for equilibrium is:

(a) MR > MC (b) $MR_1 = MR_2$

(c) $MR_a = MR_b = MC$ (d) All of the above. (1 mark)

Answer:

(c) One of the important conditions of price discrimination is that the seller should be able to divide his market into two or more submarkets. If marginal revenue in both markets are different then price discrimination is possible. The seller will transfer his products more to that market which gives more marginal revenue. Suppose MR of market A is more than market B. So the seller will transfer the products from market B to market. A Due to this the prices of market B will rise and A will fall. Gradually the MR of B will start increasing. He will continue to transfer units from B to A till the marginal revenue from both markets become equal. After this point it will be no longer profitable to transfer units and hence the position of equilibrium will be when

$$MR_a = MR_b = MC$$

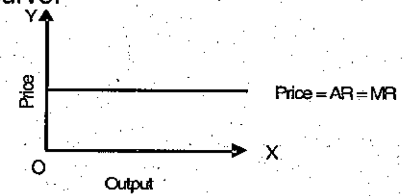
[15] Average revenue curve is also known as:

(a) Profit curve (b) Demand curve

(c) Supply curve (d) Average cost curve. (1 mark)

Answer:

(b) In perfect competition market the same price prevails throughout the market. Since the price is constant hence the demand of the commodity determines the total revenue and average revenue. Due to this reason the A.R. curve can also be called as the demand curve.



2013 - June

[16] Given, AR = 5 and Elasticity of demand = 2 Find MR.

(a) + 2.5

(b) - 2.5

(c) + 1.5

(d) + 2.0 (1 mark)

Answer:

(a) $MR = AR \times \frac{e-1}{e}$

$= 5 \times \frac{2-1}{2}$

$= +2.5$

Hence, option (a) is the correct answer.

2013 - December

[17] If a seller obtains ₹ 3,000 after selling 50 units and ₹ 3,100 after selling 52 units, then marginal revenue will be

(a) ₹ 59.62

(b) ₹ 50.00

(c) ₹ 60.00

(d) ₹ 59.80 (1 mark)

Answer:

(b) S.P of 50 units = ₹ 3,000

S.P of 52 units = ₹ 3,100

$\therefore$ S.P of additional 2 units = ₹ 100 & marginal revenue of 1 unit.

$= \frac{100}{2}$ = ₹ 50.

Thus, option (b) is correct.

2014 - JUNE

[18] A firm will close down in the short period, if its AR is less than :
(a) AC
(b) AVC
(c) MC
(d) None of the above (1 mark)

Answer:

(b) In short run, if the firm is able to meet its VC and a part of fixed cost it will try to continue production in the short run. If it recovers a part of FC, it will be beneficial to continue production. However, if a firm is unable to meet its AVC, it will be better for it to shut down.

2016 - JUNE

[19] Which one of the following expressions is correct for Marginal Revenue?

(a) $MR = AR\left(\frac{1-e}{e}\right)$ (b) $MR = TR_n - TR_{n+1}$

(c) $MR = \frac{\Delta TR}{\Delta Q}$ (d) $MR = \frac{TR}{Q}$ (1 mark)

Answer:

(c) Marginal revenue is the rate of change in total revenue resulting from the sale of an additional unit.

$$MR = \frac{\Delta TR}{\Delta Q}$$

Where MR is marginal revenue
TR is total revenue
Q is quantity of commodity sold
Δ stands for small change.

2016 - DECEMBER

[20] The market for ultimate consumer is known as:
(a) Wholesale market
(b) Regulated market
(c) Unregulated market
(d) Retail market (1 mark)

Answer:

(d) The market for ultimate consumer is known as retail market.

2017 - JUNE

[21] For a firm to become profitable it should expand output whenever:
(a) Marginal revenue is equal to marginal cost
(b) Marginal revenue is less than marginal cost
(c) Marginal revenue is greater than marginal cost
(d) Average revenue is greater than average cost. (1 mark)

Answer:

(c) It will be profitable for the firm to expand output whenever marginal revenue is greater than the marginal cost, and to keep on expanding output until marginal revenue equals marginal cost. Not only marginal cost should be equal to marginal revenue, its curve should cut marginal revenue curve from below.

[22] On the basis of nature of transactions, a market may be classified into:
(a) Spot market and future market
(b) Regulated market and unregulated market
(c) Wholesale market and retail market
(d) Local market and national market. (1 mark)

Answer:

(a) On the basis of nature of transactions market may be classified into:-

a. Spot Market: It refers to those markets where goods are physically transacted on the spot.

b. Future Market: It is related to those transaction which involves contracts of a future date.

2018 - MAY

[23] In very short period market:

(a) Supply changes but demand remains same

(b) Supply changes but price remains same

(c) Supply remains fixed

(d) Supply and demand both changes (1 mark)

Answer:

(c) In very short period market, it is not possible and easy to increase the supply as it is very difficult to install new machinery or increase more labour so, in this market supply is fixed. This leads to only profits commodities like vegetables flower, fish, eggs, fruit, milk etc. which are of perishable nature are examples of very short period market.

[24] A firm will close down in the short period, if its AR is less than:

(a) AC

(b) AVC

(c) MC

(d) None of the above. (1 mark)

Answer:

(b) In the short run, fixed cost is fixed and variable cost is not fixed and if average revenue or total revenue is less than its average variable cost or total variable cost then firm has to close down its business because no one want to suffer losses by increase cost than revenue.

2018 - NOVEMBER

[25] Which of the following is correct?

(a) MR = AR (e -1)/e

(b) MR = AR (e +1)/e

(c) MR = AR (1- e)/e

(d) None of the above (1 mark)

Answer:

(a) MR. AR and price elasticity of demand are uniquely related to one another through the formula, $MR = AR \times \frac{e-1}{e}$, therefore **(a)** is the correct option.

2019 - MAY

[26] According to Behavioural Principles.

(a) a firm should not produce at all if its total variable costs are not met.

(b) a firm will be making maximum profits by expanding output to the level where marginal revenue is equal to marginal cost.

(c) Both (a) and (b)

(d) None of these (1 mark)

Answer :

(c) According to Behavioural Principles:

Principle 1 - A firm should not product at all if its total variable costs are not met is better to shut down in such case.

Principle 2 - The firm will be making maximum profits by expanding output to the level where marginal revenue is equal to marginal cost as additional units add more to revenue than to cost.

Hence, **option (c)** is correct.

[27] Market consists of__________

(a) Buyer and Seller
(b) One price for one product at a given time
(c) Both (a) and (b)
(d) None (1 mark)

Answer :

(c) A market is a collection of buyers and sellers with the potential to trade. The elements of a market are:

(i) Buyers and sellers
(ii) A product or service
(iii) Bargaining for a price
(iv) Knowledge about market conditions and
(v) One price for a product or service at a given time.

Hence, **option (c)** is correct.

[28] Demand for a product is unitary elastic then

(a) MR = 0
(b) MR > 0
(c) MR < 0
(d) None of the above (1 mark)

Answer :

(a) Marginal revenue, average revenue and price elasticity are related through the following formula

$MR = AR \times \frac{e-1}{e}$, e = price elasticity of demand

If elasticity = 1, $MR = AR \times \frac{(1-1)}{1} = 0$

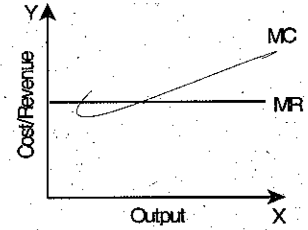
Hence, **option (a)** is correct.

[29] Which of the following is true, when the firm is at equilibrium?

(a) MC < MR
(b) MC curve cuts the MR curve from below
(c) Both (a) and (b)
(d) None of the above (1 mark)

Answer :

(b) At the point of equilibrium,
MC = MR and
MC curves cuts the MR curve from below. At this point a firm will earn maximum profits,



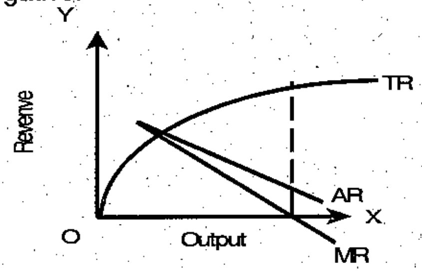
[30] When TR is at its peak then MR is equal to –

(a) Zero
(b) Positive
(c) Negative
(d) None of the above (1 mark)

Answer:

(a) The relationship between TR and MR is that initially.

1. Total Revenue curve increases at a diminishing rate due to diminishing marginal revenue.
2. When marginal revenue becomes zero, total revenue is maximum.
3. Total revenue starts falling again when marginal revenue is negative.



[31] When price is ₹ 20, Quantity demanded is 10 units and price is decreased by 5% then quantity demand increased by 10% then Marginal revenue is ______.

(a) ₹ 10
(b) ₹ 11
(c) ₹ 9
(d) ₹ 20 (1 mark)

Answer:

(c) $MR = \frac{\Delta TR}{\Delta Q}$; $TR = P \times Q$

TR (existing)= $20 \times 10 = 200$

TR`(new) = $[20 - (5\% \text{ of } 20)] \times [10 + (10\% \text{ of } 10)]$

$= 19 \times 11 = 209$

$\Delta TR = 209 - 200 = 9$

$\Delta Q = 20 - 19 = 1$

$MR = \frac{9}{1} = 9$

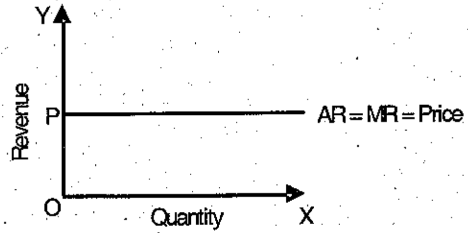
2019 - November

[32] Which of the following represents the supply curve in a perfect competitive market.

(a) MC curve
(b) AC curve
(c) AR curve
(d) MR curve (1 mark)

Answer:

(a) A perfect competitive firm's supply curve is that portion of its marginal cost curve that lies above the minimum of the average variable cost curve. In other words, the firm produces by moving up and down along its marginal cost curve. The marginal cost curve is thus the perfectly competitive firm's supply curve.



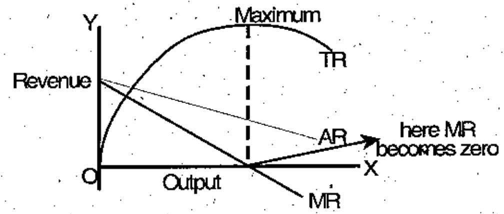
AR and MR Curves under Perfect competition

[33] When TR is max, then MR is

(a) Zero
(b) One
(c) Both (a) & (b)
(d) None (1 mark)

Answer:

(a) When Total Revenue is max, then Marginal Revenue is zero.



[34] ______ is also called a free market as there are no stipulations on the transactions

(a) Unregulated
(b) Regulated
(c) Retail
(d) Spot (1 mark)

Answer:

(a) **Unregulated Market:** It is also called a free market as there are no stipulations on the transactions.

Regulated Market: In this market, transactions are statutorily regulated so as to put an end to unfair practices. Such markets may be established for specific products or for a group of products. Eg. Stock exchange.

[35] In this market, transactions involve contracts with a promise to pay and deliver goods at some future date

(a) Spot market

(b) Future market

(c) Unregulated market

(d) Retail market (1 mark)

Answer:

(b) On the basis of Nature of Transactions

(a) Spot or cash Market: Spot transactions or spot markets refers to those markets where goods are exchanged for money payable either immediately or within a short span of time.

(b) Forward or Future Market: In this market, transaction involve contracts with a promise to pay and deliver goods at some future date.

[36] A firm reaches its shut down point

(a) When price is less than AVC in long run.

(b) When price is less than AVC in short run.

(c) When price is more than AC in long run.

(d) When price is more than AC in short run. (1 mark)

Answer:

(b) A firm reaches its shut down point when price is less than AVC in short run

i.e. AR < AVC

AVC = Average Variable Cost

AR = Average Revenue

It is a matter of common sense that a firm should produce only if it will do better by producing than by not producing. The firm always has the option of not producing at all.

If a firm's total revenues are not enough to make good even the total variable cost, it is better for the firm to shut down.

In other words, a competitive firm should shut down if the price is below AVC.

Shutting down is temporary and does not necessarily mean going out of business.

[37] Demand of good increases from 15 units to 16 units if price decreases from ₹ 40 to ₹ 38. What will be MR of 16^{th} units.

(a) 8

(b) 16

(c) 38

(d) 15 (1 mark)

Answer:

(a)

Price (P)	Quantity (Q)	Total Revenue (P × Q)
40	15	600
38	16	608

$\therefore$ $MR_n = TR_n - TR_{n-1}$

$MR_{16} = TR_{16} - TR_{16-1}$

$MR_{16} = TR_{16} - TR_{15}$

$MR_{16} = 608 - 600$

$MR_{16} = 8$

2020 - November

[38] If a seller obtains ₹ 6,000 after selling 50 units and ₹ 6,204 after selling 53 units, then marginal revenue will be:

(a) 204

(b) 68

(c) 118

(d) 120 (1 mark)

Answer:

(b) MR $= \dfrac{\Delta TR}{\Delta Q}$

TR $= P \times Q$

$6000 = P \times 50$

$\dfrac{6000}{50} = P$

$120 = P$

MR $= \dfrac{6204-6000}{53-50}$

$= \dfrac{204}{3}$

$= 68$

[39] On the basis of nature of transaction, a market may be classified into:

(a) Regulated and Unregulated Market
(b) Wholesale and Retail Market
(c) Cash and Forward Market
(d) National and International Market (1 mark)

Answer:

(c) Cash and forward market: In this market, transactions involve contracts with a promise to pay and deliver goods at some future date.

[40] When a firm produces 7 units of production and the TR is ₹ 42 after raising the production to 8 units TR reached ₹ 46 marginal revenue will be:

(a) ₹ 6
(b) ₹ 4
(c) ₹ 5
(d) ₹ 8 (1 mark)

Answer:

(b) 7 Units TR 42

8 Units TR 46

MR $= \dfrac{\Delta TR}{\Delta Q}$

$= \dfrac{46-42}{8-7}$

$= \dfrac{4}{1} = 4$

[41] A market where goods are exchanged for money payable either immediately or within a short space of time.

(a) Forward market
(b) Regulated market
(c) Spot market
(d) Whole sale market (1 mark)

Answer:

(c) Spot or cash market: Spot transaction or spot markets refer to those market, where goods are exchanged for money payable either immediately or within a short spot time.

[42] What is the average revenue when ABC Ltd. sells 121 units and TR is ₹ 6,050?

(a) ₹ 6,000
(b) ₹ 6,050
(c) ₹ 50
(d) ₹ 100 (1 mark)

Answer:

(c) Average Revenue $= \dfrac{\text{Total Revenue}}{\text{Number of units}}$

$= \dfrac{₹6050}{121 \text{ units}} = ₹\ 50$ per unit

[43] When ABC Ltd. sells 130 units at ₹ 50 p.u. then total revenue will be:
(a) ₹ 18,550
(b) ₹ 12,050
(c) ₹ 6,000
(d) ₹ 6,500 (1 mark)

Answer:

(d) Total Revenue = Number of units × Revenue per unit
= 130 × ₹ 50
= ₹ 6,500/-

[44] Answer the following questions:

Units	0	1	2	3	4	5	6
Total Revenue	100	180	250	310	360	400	430

Find the marginal revenue at 5th unit is:
(a) 60
(b) 55
(c) 45
(d) 40 (1 mark)

Answer:

(d) Marginal revenue at 5th unit = $TU_n - TU_{n-1}$
= 400 - 360
= 40/-

2021 - JANUARY

[45] Which one is not a part of the elements of a market?
(a) Buyers and sellers
(b) A product or service
(c) Bargaining for a price
(d) Volume of business (1 mark)

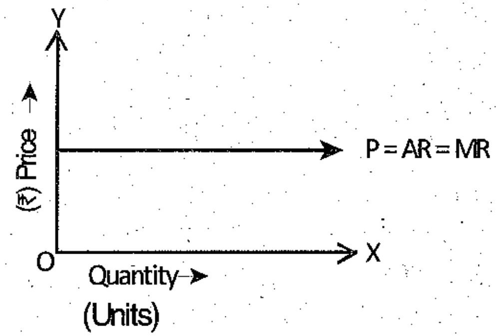
Answer:

(d) Volume of business
Element which is not a part of market is volume of business.

[46] In the market structure, demand curve is also known as
(a) Marginal cost curve
(b) Average revenue curve
(c) Total production curve
(d) Marginal utility curve (1 mark)

Answer:

(b) Average revenue curve
In the market structure demand curve is also known as Average revenue curve



[47] Secular period is also known as
(a) Very short period
(b) Very long period
(c) Short period
(d) Long period (1 mark)

Answer:

(b) Very long period.
Secular period is also known as the very long period.

[48] Total revenue curve initially increases at a diminishing rate due to.....
(a) Diminishing average revenue curve.
(b) Diminishing marginal revenue curve.
(c) Diminishing average fixed revenue curve.
(d) Diminishing cost curve. (1 mark)

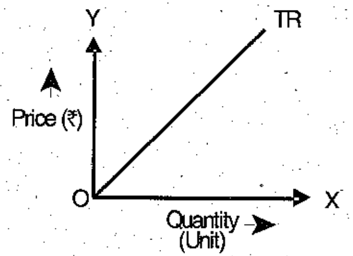
Answer:

(b) Diminishing marginal revenue curve.
TR Curve, i.e. Total revenue curve initially increases at a diminishing rate due to the diminishing marginal revenue at stage I of law of variable proportion.

[49] Total revenue curve is
(a) Positively Sloped
(b) Negatively Sloped
(c) Downward Sloped
(d) Vertical to X axis (1 mark)

Answer:

(a) Positively Sloped
Total revenue i.e., (TR) curve is positively sloped in the case of perfect competitive market.



2021 - July

[50] Marginal revenue will be positive where price elasticity of demand is:
(a) Zero
(b) More than one
(c) Less than one
(d) Equal to one (1 mark)

Answer:

(b) Marginal revenue, average revenue and price elasticity are related through the following formula.

$MR = AR \times \frac{e-1}{e}$, e = price elasticity of demand.

If elasticity more than one e > 1 MR will be positive

$MR = AR \times \frac{2-1}{2}$

$MR = 2 \times \frac{1}{2} = 1$

Hence, option **(b)** is correct.

[51] A seller realizes ₹ 25,000/- after selling 15 units and he realizes ₹ 35,000/- after selling 25 units, what is the marginal revenue here?
(a) ₹ 2,500/-
(b) ₹ 100/-
(c) ₹ 1,000/-
(d) ₹ 3,500/- (1 mark)

Answer:

(c)

Units (Q)	Total Revenue (₹)
15	25,000
↓	↓
25	35,000

$$MR = \frac{\Delta TR}{\Delta Q}$$

$$MR = \frac{10,00\cancel{0}}{1\cancel{0}} = ₹\ 1,000$$

$$MR = ₹\ 1,000$$

Hence, Option **(c)** is correct

[52] Which of the following is the price at which the quantity demanded of a commodity is equal to the quantity supplied of the commodity and there is no unsold stock or no unsupplied demand?
(a) Selling Price
(b) Market Clearing Price
(c) Asking Price
(d) Future Price (1 mark)

Answer:

(b) Market clearing price is the price at which the quantity demanded of a commodity is equal to the quantity supplied of the commodity and there is no unsold stock or no unsupplied demand.

[53] Which of the following is not an element of a market?
(a) Knowledge about market conditions.
(b) No bargaining for a price
(c) A product or service
(d) Buyer and Seller (1 mark)

Answer:

(b) Elements of a market are:
(i) Buyers and sellers
(ii) A product or Services
(ii) Bargaining for a price
(iv) Knowledge about market conditions
(v) One price for a product or service at a given time

[54] The __________ is the market where the commodities are bought and sold in bulk or large quantities transactions generally take place between trades.
(a) Wholesale market
(b) Regulated market
(c) Local market
(d) Retail market (1 mark)

Answer:

(a) Wholesale market is the market where the commodities are bought and sold in bulk or large quantities, transacties is generally take place between trades.

[55] On the basis of nature of transactions market can be classified as:
(a) Wholesale market and retail market.
(b) Future market and spot market.
(c) Regulated market and unregulated market.
(d) Money market and future market. (1 mark)

Answer:

(b) On the basis of Nature of Transactions:
(a) Spot or cash market
(b) Forward or future market

2022 - June

[56] Demand Curve is also known as:
(a) MR Curve
(b) AR Curve
(c) MC Curve
(d) MR Reserve (1 mark)

Answer:

(a) Demand curve is also known as Marginal revenue curve in a market.

[57] Prices in monopoly are higher than price under:
(a) Oligopoly
(b) Duopoly
(c) Monopoly
(d) Perfect Competition (1 mark)

Answer:

(d) Prices in monopoly are most high as compared to prices in perfect competition. Monopolies being price makers and charging prices to increase there revenues more as compared to other market forms.

[58] In Oligopoly upper part shows which elasticity:
(a) Less than
(b) Greater than
(c) Zero
(d) Negative (1 mark)

Answer:

(b) In oligopoly the kinked demand curve has two parts the upper part being relatively more elastic and the lower part being less elastic then the upper part.

[59] Which of the following is closely related to perfect competition?
(a) Mobiles
(b) Cars
(c) Utensils
(d) Agricultural Products (1 mark)

Answer:

(d) Agricultural products are not highly perfect competitive market but are closely related to perfect competitive market.

[60] If the price of good is ₹ 100 per unit & quantity demanded is 900 units. If the price decreased to ₹ 90 per unit then the demand increases to 100 units calculate marginal revenue.

(a) 0
(b) ₹ 10
(c) ₹ 90
(d) ₹ 100 (1 mark)

Answer:

(a)

Price	**Quantity**	**Total Revenue**	**Marginal revenue**
100	900	90,000	—
90	1,000	90,000	0

Marginal Revenue is 0.

$$\left[\begin{array}{l}\text{Total Revenue} = \text{Price} \times \text{Quantity} \\ \text{Marginal Revenue} = TR_n - TR_{n-1}\end{array}\right]$$

[61] No substitution are found in which form of Market:
(a) Perfect competition
(b) Oligopoly
(c) Monopoly
(d) Monopolistic Competition (1 mark)

Answer:

(c) No substitutes are found in monopoly form of market. Oligopoly has less substitutes as compared to monopoly, but in perfect competition every product is a substitute of each other.

[62] The market is the direct relationship between-
(a) Buyer and seller
(b) Whole seller and retailer
(c) Consumer and manufactures
(d) None of the above (1 mark)

Answer:

(a) The market is the direct relationship between a buyer and seller. Where the buyer and seller are the essential elements of market and they influence the price.

[63] Which commodity is best for the short term period market?
(a) Fruits and Vegetables
(b) Automobiles
(c) Electronic goods
(d) All of the above (1 mark)

Answer:

(a) For short term period market is best for perishable goods like fruits and vegetables that are needed in day to day life.

[64] Demand for a firm's product when express as in percentage of an industry demand it signifies the ____ of firm.
(a) Product share
(b) Market share
(c) Demand
(d) Supply (1 mark)

Answer:

(b) Demand for a firms product when express as in percentage of an industry demand it signifies the market share of the firm.

[65] Which of the following is true?
(a) Perfect competition sells heterogenous product
(b) Oligopolistic incurs a good amount of selling cost.
(c) Monopolist always earns super normal profit .
(d) Oligopolistic economy do not get hike in their normal profit. (1 mark)

Answer:

(b) In an oligopolistic market, advertising & selling and have great importance. Therefore, oligopolistic incurs a good amount of selling cost.

[66] Which of the following is correct?
(a) Total revenue is equal to price x Quantity
(b) Sum of Average Revenue
(c) Sum of Quantity sold X marginal revenue
(d) All of the above

Answer:

(a) The formula for the total revenue (TR) is
$TR = P \times Q$, where P is price and Q is quantity sold.

2022 - DECEMBER

[67] Who introduced the 'time element' in economics?
(a) Adam Smith
(b) Alfred Marshall
(c) Robert Malthus
(d) J. M. Keynes (1 mark)

Answer:

(b) Alfred Marshall introduced the time element in economics. In the parts of very short period, short period, long period & very long period.

[68] Which of the following is not a characteristic of market?
(a) Advertisement and awareness
(b) Buyer and seller
(c) Bargaining power
(d) Product or service (1 mark)

Answer:

(a) The main characteristic of a market in the buyer and seller, they have the bargaining power and they have product or service.

[69] In the initial stage, total revenue is increasing at a decreasing rate due to:
(a) Diminishing marginal revenue
(b) Negative marginal revenue
(c) Multi level marginal revenue
(d) None of the above (1 mark)

Answer:

(a) TR increases as long as MR is positive and declines (has a negative slope) when MR is negative. TR curve initially increases at a diminishing rate due to diminishing MR and reaches maximum and then it falls when MR becomes zero, the TR is maximum and the slope of TR is zero.

[70] When MR = MC the firm will incur:

(a) maximum profits
(b) minimum profits
(c) maximum losses
(d) minimum losses (1 mark)

Answer:

(a) Profits are maximum when MR = MC and MC curve cuts MR curve from below.

2023 - June

[71] Price of goods expresses _____ value.

(a) Exchange (b) Cost
(c) Demand (d) Fair (1 mark)

Answer:

(a) **Exchange**

Price of Good expresses its exchange value in the market.

[72] Which one of the following is not element of market?

(a) Buyer
(b) Service
(c) Firm
(d) Bargaining for Price (1 mark)

Answer:

(c) **Firm**

The elements of market are-buyers and sellers, goods or service, bargaining for price, knowledge about the market conditions, a price for good or service at given time.

[73] On the basis of nature of transaction, a market can be classified into which of the following?

(a) Cash and Forward Market
(b) National and International Market
(c) Organized and unorganized Market
(d) Retail and Wholesale Market (1 mark)

Answer:

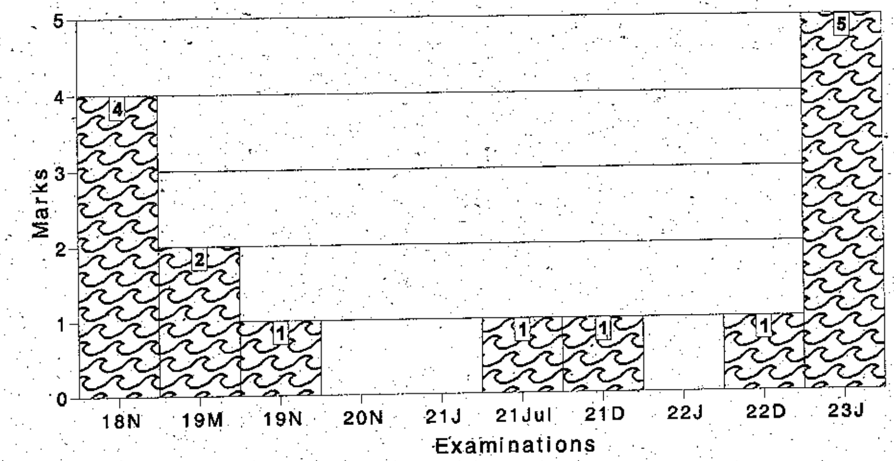
(a) **Cash and Forward Market**

On the basis of nature of transactions, market has been classified into cash and forward market.

4 PRICE DETERMINATION IN DIFFERENT MARKETS

Unit:2 **Determination of Prices**

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



PAST YEAR QUESTIONS AND ANSWERS

2006 - NOVEMBER

[1] For maximum profit, the condition is :

(a) AR = AC (b) MR = MC

(c) MR = AR (d) MC = AR (1 mark)

Answer:

(b) Profit maximization level of a firm is the level at which its marginal revenue is equal to marginal cost. The condition for maximum profit is: MC = MR.

2007 - MAY

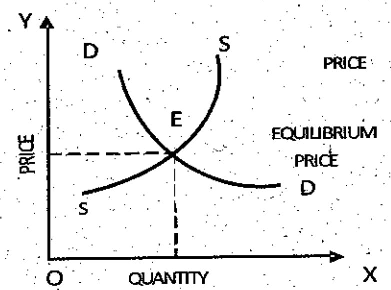
[2] Equilibrium price may be determined through:

(a) Only demand (b) Only supply

(c) Both demand & supply (d) None (1 mark)

Answer:

(c) Equilibrium price is the price of a product when its demand equals supply. The point of intersection of demand and supply curves is the equilibrium price.



Equilibrium price involves both demand and supply.

2007 - AUGUST

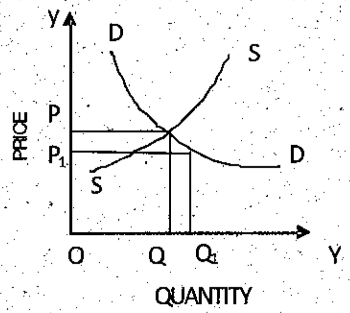
[3] If price is forced to stay below equilibrium price then consequently it can be said that:

(a) Excess supply exists.   (b) Excess demand exists

(c) Either (a) or (b)   (d) Neither (a) nor (b)   (1 mark)

Answer:

(b) If the price is below equilibrium price, supply remaining the same, the demand of the commodity increases.



2007 - NOVEMBER

[4] An increase in supply with unchanged demand leads to :

(a) Rise in price and fall in quantity

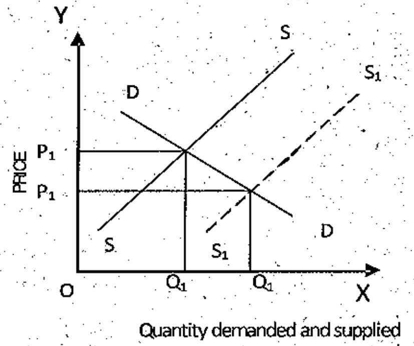
(b) Fall in both price and quantity

(c) Rise in both price and quantity

(d) Fall in price and rise in quantity   (1 mark)

Answer:

(d) When there is an increase in supply, demand remaining the same, the price of the good decreases and quantity demanded increases. It is evident from the following diagram:



2008 - FEBRUARY

[5] In the long run :

(a) Only demand can change

(b) Only supply can change

(c) Both demand and supply can change

(d) None of these   (1 mark)

Answer:

(c) Long run is the period when both buyers and sellers get sufficient time to adjust their demand and supply. Hence, both demand and supply can change in long run.

2008 - JUNE

[6] Condition for producer equilibrium is :

(a) TR = TVC   (b) MC = MR

(c) TC = TAC   (d) None of these   (1 mark)

Answer:

(b) Conditions for producer's equilibrium are :

a. MC = MR

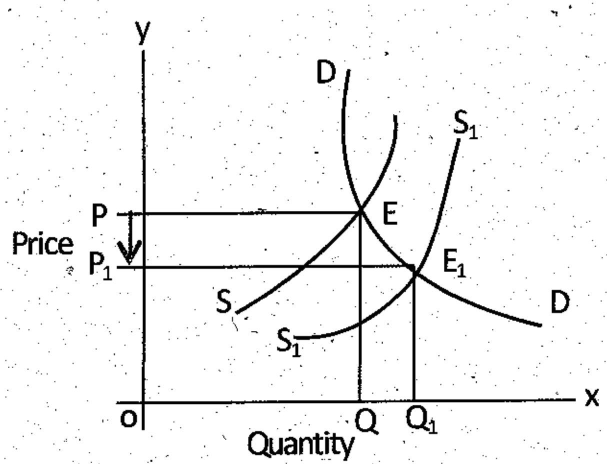
b. MC should cut MR from below.

2010 - June

[7] An increase in supply with demand remaining the same, brings about.
(a) An increase in equilibrium quantity and decrease in equilibrium price.
(b) An increase in equilibrium price and decrease in equilibrium quantity.
(c) Decrease in both equilibrium price and quantity .
(d) None of these. (1 mark)

Answer:

(a) When there is an increase in supply, demand remaining the same, the equilibrium price of good decreases and equilibrium quantity increases. It is evident from the following diagram.



2014 - December

[8] When the price of a commodity is ₹ 20, the quantity demanded is 9 units and when its price is ₹ 19, the Quantity demanded is 10 units. Based on this information what will be the marginal revenue resulting from an increase in output from 9 units to 10 units?
(a) ₹ 20 (b) ₹ 19
(c) ₹ 10 (d) ₹ 01 (1 mark)

Answer:

(c) The marginal revenue resulting from an increase in output from 9 units to 10 units is ₹ 10.

Price	Quantity	Revenue
20	9	180
19	10	190

Marginal Revenue is [190 - 180] ⇒ ₹ 10.

2016 - November

[9] From the following table, what will be equilibrium market price?

Price (in ₹)	Demand (Tonnes per annum)	Supply (Tonner per annum)
1	500	200
2	450	250
3	400	300
4	350	350
5	300	400
6	250	450
7	200	500
8	150	550

(a) ₹ 2
(b) ₹ 3
(c) ₹ 4
(d) ₹ 5 (1 mark)

Answer:

(c) Equilibrium Market price is ₹ 4 because at this price demand and price are equal so market price will tend to settle at this figure.

2017 - DECEMBER

[10] If the price of a commodity is fixed, then with every increase in its sold quantity the total revenue will ________ and the marginal revenue will ________.

(a) increase, also increase
(b) increase, remain unchanged
(c) increase, decline
(d) remain fixed, increase. (1 mark)

Answer:

(b) If the price of a commodity is fixed, then with every increase in its sold quantity the total revenue will increase and the marginal revenue will remain unchanged. As marginal revenue is the change in total revenue. Resulting from the sale of an additional unit of the commodity.

2018 - NOVEMBER

[11] If supply decreases and demand remains constant, then equilibrium price will be?

(a) Increases
(b) Decreases
(c) No change
(d) Become Negative (1 mark)

Answer:

(a) When supply falls and demand remains constant, then there will be excess demand in the economy and in order to meet the demand the price of the commodity will rise (Increase).

[12] According to pigou, first degree price discrimination charges price to;

(a) Individual capacity
(b) Quantities sold
(c) Location
(d) None of the above (1 mark)

Answer:

(a) Under first degree price discrimination, the monopolist separates the market into each individual consumer and charges them the price they are willing and able to pay and thereby extract the entire consumer surplus.

Therefore, **(a)** is the correct option, individual capacity.

[13] What is the shape of monopolist Average Revenue Curve?

(a) Falls from left to right
(b) Is parallel to X – axis
(c) Is parallel to Y – axis
(d) Rise from left to right (1 mark)

Answer:

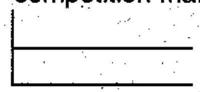
(a) The shape of monopolist average revenue curve falls from left to right.

[14] What is the shape of perfectly competitive Average Revenue Curve?

(a) Parallel to X axis
(b) Parallel to Y axis
(c) Fall from left to right
(d) Rise from left to right (1 mark)

Answer:

(a) Curve of average revenue is parallel to X axis as per perfect competition market.



AR

2019 - May

[15] Monopsony means
- (a) Where there are large firms
- (b) There is a single buyer
- (c) Small number of large buyers
- (d) Single seller and single buyer (1 mark)

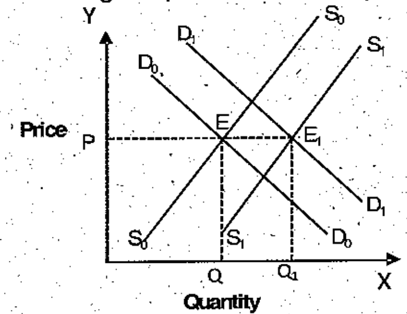
Answer :

(b) A monopsony is a market condition in which there is only a single buyer - A single buyer dominates the market.

[16] When increase in demand is equal to increase in supply and equilibrium price remains constant, then what about equilibrium quantity?
- (a) Increases
- (b) Decreases
- (c) Remains Constant
- (d) None of the above (1 mark)

Answer:

(a) In case there is a simultaneous increase in demand as well as supply without change in price, the new equilibrium point will be



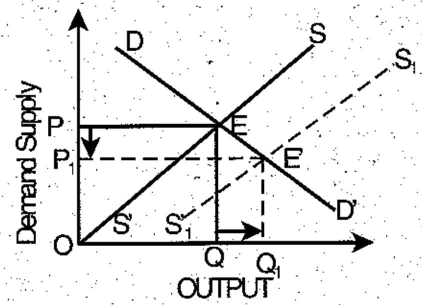
It can be observed that the quantity has moved from Q to Q_1, changing the equilibrium point from E to E_1, i.e. if the equilibrium price remains unchanged/constant, the equilibrium quantity will increase.

2019 - November

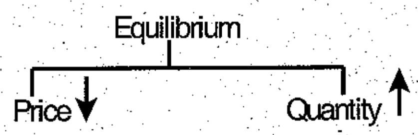
[17] An increase in supply with demand remaining the same, brings about
- (a) An increase in equilibrium quantity and decrease in equilibrium price.
- (b) An increase in equilibrium price and decrease in equilibrium quantity.
- (c) Decrease in both equilibrium price and quantity.
- (d) None of these (1 mark)

Answer:

(a) An increase in supply with demand remaining the same brings about.



In the above diagram we can see that when there is increase in supply curve i.e. from SS' to $S_1S'_1$ where demand curve remaining the same i.e. DD' with price 'P' and quantity 'Q'. Then as a result the there is an increase in equilibrium quantity i.e., from Q to Q_1 and price decreased i.e., from P to P_1. And equilibrium point shifted down - wards i.e. from E to E'.



2021 - July

[18] The equilibrium quantity increases but the charges in equilibrium price is uncertain when,
(a) Both demand and supply decreases
(b) Demand increases and supply decreases
(c) Both demand and supply increase
(d) Demand decreases and supply increases (1 mark)

Answer:

(c) Two possible outcomes when supply and demand curve shift in same direction:
- when both demand and supply increases the equilibrium quantity increases but the change in equilibrium price uncertain.
- when both demand & supply decrease the equilibrium quantity decrease but the change in equilibrium price is uncertain.

2021 - December

[19] When both demand and supply increase, how does it effect the equilibrium quantity and equilibrium price?
(a) The equilibrium quantity increases but the change in equilibrium price is uncertain.
(b) The equilibrium quantity decreases but change in equilibrium price is uncertain.
(c) Equilibrium price increases but the change in equilibrium quantity is uncertain
(d) Equilibrium price decreases but the change in equilibrium quantity is uncertain. (1 mark)

Answer

(a) When both demand and supply increase, the equilibrium quantity increases but the change in equilibrium price is uncertain.

2022 - December

[20] When there is a change in demand and change in supply, what will be the net influence on price if the change in supply is greater than change in demand.
(a) Increase
(b) Decrease
(c) No effect
(d) uncertain change (1 mark)

Answer:

(a) When the supply increases, it results in an excess supply at the earlier equilibrium price. So there will be competition among sellers, which reduces the price. Price fall leads to a rise in demand and fall in supply.

2023 - June

[21] Under which of the following market condition both average and marginal revenue are same?
(a) Perfect competition
(b) Monopolistic competition
(c) Monopoly
(d) Oligopoly (1 mark)

Answer:

(a) **Perfect competition**
Average Revenue = Marginal Revenue = Price, it happens under Perfect competition only.

[22] 'Average revenue curve' is also known as:
(a) Production possibility curve
(b) Supply curve
(c) Demand curve
(d) Indifference curve (1 mark)

Answer:

(c) **Demand Curve**

Another name for Average Revenue Curve is Demand Curve.

[23] When demand for commodity is decreasing as a result of fall in income and its supply remains constant, what will be impact on its price?

(a) Price increases

(b) Price decreases

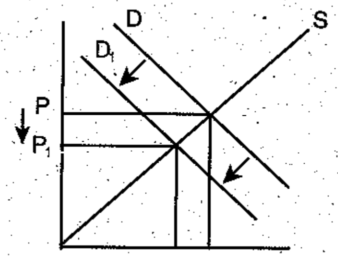
(c) No change

(d) Uncertain change (1 mark)

Answer:

(b) **Price Decrease**

If supply is constant and demand decrease, equilibrium price decrease.



[24] In which of the following, prices are determined by market forces of demand and supply?

(a) Duopoly Competition

(b) Perfect Competition

(c) Monopolistic Competition

(d) Natural Market (1 mark)

Answer:

(b) **Perfect Competition**

Under Perfect Competition, market forces of demand and supply determines the prices and all sellers and buyers individually are price takens.

[25] Suppose a seller realises ₹ 100 by selling 10^{th} unit of commodity and ₹ 120 by selling 11^{th} unit. What is the MR of 11^{th} unit ?

(a) 100

(b) 120

(c) 20

(d) 10 (1 mark)

Answer:

(c) **20**

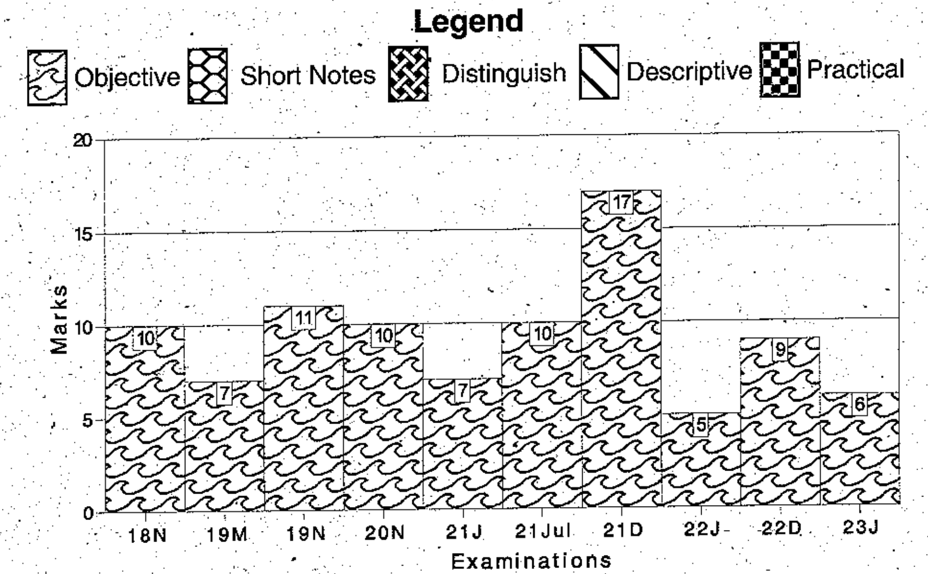
$MR_n = TR_n - TR_{n-1}$

$MR_{11} = TR_{11} - TR_{10} = 120 - 100 = 20.$

4 PRICE DETERMINATION IN DIFFERENT MARKETS

Unit:3 Price Output Determination Under Different Market Forms

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



PAST YEAR QUESTIONS AND ANSWERS

2006 - NOVEMBER

[1] A competitive firm in the short run incur losses. The firm continues production, if:
(a) P > AVC
(b) P = AVC
(c) P < AVC
(d) P >= AVC (1 mark)

Answer:

(d) In short run if the competitive firm is incurring losses then it will continue production only if its price is greater or equal to average variable cost. If price is less than variable cost it means neither the fixed cost nor the variable cost can be covered. In such a situation, the producer shall stop production.

[2] Under _______ market condition, firms make normal profits in the long run:
(a) perfect competition
(b) monopoly
(c) oligopoly
(d) none (1 mark)

Answer:

(a) Perfect competitive market is characterized by free entry and exit of firms. In the long run if the firm makes profit, more seller enter the industry and hence the profits are reduced to the equilibrium level. If there are losses, then and more firms leave the industry resulting into increase in profits to the equilibrium level. Hence, competitive firms always incur normal profits.

2007 - February

[3] A monopolist is able to maximize his profits when :
(a) His output is maximum
(b) He charges a high price
(c) His average cost is minimum
(d) His marginal cost is equal to marginal revenue (1 mark)

Answer:

(d) Profit maximization level is the level at which :
MC = MR

[4] Under which of the following market structure AR of the firm will be equal to MR?
(a) Monopoly
(b) Monopolistic Competition
(c) Oligopoly
(d) Perfect Competition (1 mark)

Answer:

(d) In perfect competition firms are price taker. Hence they offer same price i.e. the prices are same throughout the market. Since the prices are same or the AR and MR are also equal.

2007 - May

[5] Under Monopolistic competition the cross elasticity of demand for the product of a single firm would be :
(a) Infinite (b) Highly elastic
(c) Highly inelastic (d) Zero (1 mark)

Answer:

(b) In case of monopolistic competition, the products are less differentiated and all the brands are close substitutes of one another hence it has highly elastic of cross elasticity.

[6] When AR = ₹ 10 and AC = ₹ 8 the firm makes______ :
(a) normal profit (b) net profit
(c) gross profit (d) supernormal profit (1 mark)

Answer:

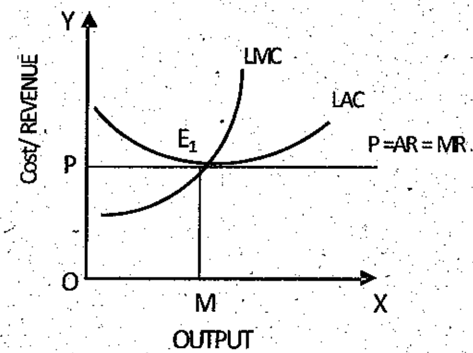
(d) A firm makes normal profit when AC = AR .
In the given question AR = 10 and AC = 8 i.e. average revenue is greater than average cost. So the firm makes super normal profit. (Profit above normal profit is super normal profit).

2007 - August

[7] What are the conditions for the long run equilibrium of the competitive firm?
(a) LMC = LAC = P (b) SMC = SAC = LMC
(c) P = MR (d) All of these (1 mark)

Answer:

(d) In the long run, a competitive will be at equilibrium at
LMC = LAC = P
(When long run marginal cost, long run average cost and price are equal)
Also in long run in the firms operating under perfect competition is efficient at point E' where P = MR
and SMC = SAC = LMC.



[8] Kinked demand curve hypothesis is given by:
(a) Alfred marshal
(b) A.C Pigou
(c) Sweezy
(d) Hicks & Allen (1 mark)

Answer:

(c) Kinked Demand hypothesis was given by Sweezy, an American economist.

2007 - NOVEMBER

[9] Supernormal profits occur, when :
(a) Total revenue is equal to total cost
(b) Total revenue is equal to variable cost
(c) Average revenue is more than average cost
(d) Average revenue is equal to average cost (1 mark)

Answer:

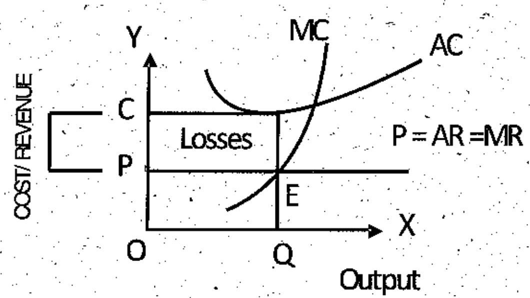
(c) Super normal profits are the profits over and above the normal profit. Normal profit is included in the cost of the product (This profit is for recovering the fixed cost). If the product is sold above its cost supernormal profits occurs. In other words, when AR > AC, supernormal profits occurs.

[10] If under perfect competition, the price line lies below the average cost curve, the firm would :
(a) Make only Normal profits
(b) Incur losses
(c) Make abnormal profit
(d) Profit cannot be determined

(1 mark)

Answer:

(b) In the perfect competition if the price line (AR and MR curve) are below AC curve so the firm incurs losses i.e. AR or MR is less than AC.

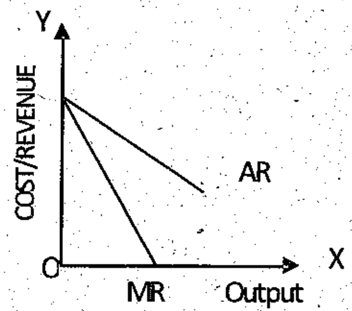


2008 - FEBRUARY

[11] The MR curve cuts the horizontal line between Y axis and demand curve into:
(a) Two unequal parts
(b) Two equal parts
(c) May be equal or unequal parts
(d) None of these (1 mark)

Answer:

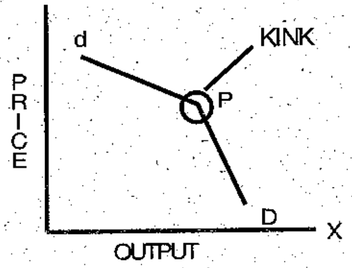
(b) The slope of average revenue curve is twice the slope of marginal revenue curve hence MR curve units it into two equal parts.



[12] Kinked demand curve is observed in ______.
(a) duopoly market (b) monopoly market
(c) competitive market (d) oligopoly market. (1 mark)

Answer:

(d) In oligopolistic industries prices remain sticky or inflexible for a long time. They tend to change infrequently even if in the face of declining cost. These inflexibilities lead to kink shape of the demand curve. Therefore, oligopolistic markets have kinked demand curve.



[13] Competitive firms in the long run earn:
(a) Super normal profit (b) Normal profit
(c) Losses (d) None (1 mark)

Answer:

(b) Same as Ans. 2

2008 - June

[14] For a monopolist, the necessary condition for equilibrium is:
(a) P = MC (b) P = MR = AR
(c) MR = MC (d) None (1 mark)

Answer:

(c) A firm is in equilibrium when:
MC = MR

[15] A firm will shut down in the short run if :
(a) It is suffering a loss
(b) Fixed costs exceeds revenue
(c) Variable costs exceed revenues
(d) Total costs exceed revenues (1 mark)

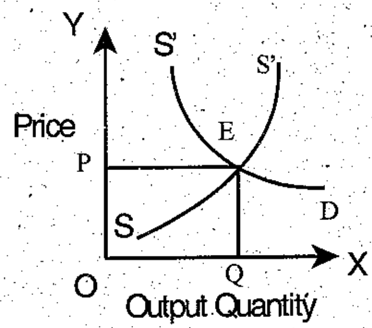
Answer:

(c) In the short run if the firms will be in break even point when variable cost = revenues. When variable cost is above revenues it means that the firm can neither recover its variable cost nor fixed cost. With this situation, the producer cannot survive for a long so he may shut down.

[16] __________ is the price at which demand for a commodity is equal to its supply :
(a) Normal Price (b) Equilibrium Price
(c) Short run Price (d) Secular Price (1 mark)

Answer:

(b) Equilibrium price is the price at which demand of a commodity is equal to its supply.



Point E is the equilibrium price.

2008 - December

[17] OPEC is an example of :
(a) Monopolistic competition
(b) Monopoly
(c) Oligopoly
(d) Duopoly (1 mark)

Answer:

(c) OPEC [Organisation for Petroleum Exporting Countries] is an example of oligopoly market because there are few seller for petroleum in the world.

[18] __________ is a ideal Market.
(a) Monopoly
(b) Monopolistic
(c) Perfect Competition
(d) Oligopoly (1 mark)

Answer:

(c) Perfectly Competitive Market is an ideal Market because it is characterized by many sellers selling identical products to many buyers and there is a freedom of entry and exit.

[19] Under which Market Situation demand curve is linear and parallel to X axis :
(a) Perfect Competition (b) Monopoly
(c) Monopolistic Competition (d) Oligopoly (1 mark)

Answer:

(a) Under Perfect competition demand curve is Linear and parallel to X axis because there are huge number of buyers selling the same commodity at a particular price and as a result each buyer and seller makes transactions in the market at a prevailing price.

[20] Which market have characteristic of product differentiation?
(a) Perfect Competition (b) Monopoly
(c) Monopolistic Competition (d) Oligopoly (1 mark)

Answer:

(c) Monopolistic markets have a characteristic of product differentiation which is the most prominent feature of such a form of market where firms do not produce identical goods. They rather produce different varieties of a commodity which are close substitutes of each other.

[21] Which of these are characteristics of Perfect Competition.
(a) Many Sellers & Buyers (b) Homogeneous Product
(c) Free Entry and Exit (d) All of the above (1 mark)

Answer:

(d) Under perfect competition there are large number of buyers and sellers. A particular buyer has a negligible role to determine the price.

The product sold under this type of market structure is a homogenous product i.e. all units of a good are identical colour, shape, size or packing of the product of each seller. Lastly, there is no legal or social restriction upon the entry of new firms into the industry. The choice of entering or leaving an industry lies on individual firms.

[22] The demand curve of oligopoly is :
(a) Horizontal (b) Vertical
(c) Kinked (d) Rising left to right (1 mark)

Answer:

(c) In many oligopolistic industries, prices remain sticky or inflexible for a long time. This price rigidity has been clearly explained by the kinked demand curve hypothesis. The demand curve of an oligopoly market has a 'Kink' at the level of the prevailing prices. The kink is formed at the prevailing price level. It is because the segment of the demand curve above the prevailing price level is highly elastic and the segment of the demand curve below the prevailing price level is inelastic.

Therefore, the demand curve formed under an oligopolistic market is kinked.

[23] MR Curve = AR = Demand Curve is a feature of which kind of Market?
(a) Perfect Competition (b) Monopoly
(c) Monopolistic (d) Oligopoly (1 mark)

Answer:

(a) In perfect competition, all the goods are sold at a single price, by which average revenue (AR) equals marginal revenue (MR). This price is determined by the industry through the forces of demand and supply and this price is adopted by the firms. All the goods are sold at a prevailing price in the market by which AR equals MR at each level of quantity sold.

2009 - JUNE

[24] In the long-run monopolist can:
(a) Incur losses (b) Must earn super normal profits
(c) Wants to shut-down (d) Earns only normal profits.
(1 mark)

Answer:

(b) Long run is a period long enough to allow the monopolist to adjust his plant size or use his existing plant at any level that maximizes his profit. In the absence of competition the monopolist need not produce at the optimum level.
Therefore, the monopolist will not continue if he makes losses in the long run. He will continue to make super normal profits even in the long run as entry of outside firm is blocked.

[25] The demand curve of the firm and industry will be same in which form of market :
(a) Monopolistic Competition (b) Perfect Competition
(c) Monopoly (d) Oligopoly. (1 mark)

Answer:

(c) In case of monopoly market, the firm and the industry are same as there is only one seller in the market. Hence the demand curve of the firm and industry are same.

[26] Oligopoly having identical products is:
(a) Pure oligopoly (b) Imperfect oligopoly
(c) Price leadership (d) Collusion. (1 mark)

Answer:

(a) Oligopoly is a market situation when there are few sellers in the market. When the sellers in the market sell homogeneous products, such oligopoly is termed as pure oligopoly.

2009 - DECEMBER

[27] The demand curve of oligopoly is :
(a) Horizontal (b) Vertical
(c) Kinked (d) Rising left to right

Answer:

(c) Same as Ans. 22

[28] Demand curve is equal to M. R. curve in which market?
(a) Oligopoly (b) Monopoly
(c) Monopolistic Competition (d) Perfect Competition (1 mark)

Answer:

(d) In a perfectly competitive market, all units are priced at the same level.
Therefore, P = MR = AR. Since every demand curve is the average revenue curve, so in a perfectly competitive market, the demand curve is a straight line parallel to X axis, i.e. demand is perfectly elastic.

[29] Kinked demand hypothesis is designed to explain ______ in context of oligopoly.
(a) price and output determination
(b) price rigidity
(c) collusion between firm
(d) all of the above (1 mark)

Answer:

(b) Kinked demand hypothesis is designed to explain the rigidity of price under oligopolistic market. It helps to determine the price and output of the firm.

[30] Price discrimination can take place only in_______.
(a) monopolistic competition
(b) oligopoly
(c) perfect competition
(d) monopoly (1 mark)

Answer:

(d) Price discrimination refers to charging different prices from different customers. This is a feature of monopoly, as this situation is possible only in case of monopoly as there is only one seller in the market and there is no competition.

2010 - JUNE

[31] In oligopoly, the kink on the demand curve is more due to_____.
(a) discontinuity in MR.
(b) discontinuity in AR.
(c) Fulfillment of the assumption that a price cut is followed by others and a price increase by a firm is not followed by others.
(d) price war amongst the firms. (1 mark)

Answer:

(c) In case of oligopoly there is a 'kink' on the demand curve because the Segment of demand curve above prevailing price is highly elastic and segment of the demand curve below prevailing price level is inelastic.

The reason for the above is that the oligopolist believes if he lowers the price below prevailing level its competitors will follow him but if he raises the price above the prevailing level, its competitors will not follow him.

[32] Price Discrimination is possible only when.
(a) Seller is alone.
(b) Goods are homogeneous.
(c) Market is controlled by the government.
(d) None of the above. (1 mark)

Answer:

(a) In case of price discrimination there is a condition that the seller should have some control over the supply of his product i.e. monopoly power in some form is necessary (not sufficient) to discriminate price.

So it can be said that in order to have monopoly power the seller should be alone to exercise price discrimination.

[33] Which of the following is not the feature of an imperfect competition?
(a) Product differentiation.
(b) Few sellers.
(c) Homogeneous products.
(d) Price wars. (1 mark)

Answer:

(c) Features of imperfect competition are:
(i) Large number of sellers.
(ii) Product differentiation
(iii) Freedom of Entry or Exit
(iv) Non-price competition.

[34] Price taker firms_________.
(a) do not advertise their product because it misleads the customers.
(b) advertise their products to boost the level of demand.
(c) do not advertise but give gifts along with the sold items to attract customers.
(d) do not advertise because they can sell as much as they wish at the prevailing price. (1 mark)

Answer:

(d) In case of perfect competition firms are price takers which need not advertise their products because they can sell as much as they wish at the prevailing prices.

[35] Price rigidity is a situation found in which of the following market forms?
(a) Perfect competition.
(b) Monopoly.
(c) Monopolistic competition.
(d) Oligopoly. (1 mark)

Answer:

(d) Oligopoly is a market structure having few sellers characterized by price rigidity which helps to determine the price and output of the firm.

2010 - DECEMBER

[36] When elasticity of demand is Equal to one in monopoly, marginal Revenue will be________.
(a) equal to one. (b) greater than one.
(c) less than one. (d) zero. (1 mark)

Answer:

(d) $MR = AR\left[\frac{e-1}{e}\right]$

Where, e =1

$\therefore MR = AR\left[\frac{1-1}{1}\right] = AR\left[\frac{0}{1}\right]$

MR = 0

[37] Which one of the following statement is Incorrect?
(a) Competitive firms are price takers and not price makers.
(b) Price discrimination is possible in monopoly only.
(c) Duopoly may lead to monopoly.
(d) Competitive firm always seeks to discriminate prices. (1 mark)

Answer:

(d) Monopoly control over the product gives rise to price-discrimination, hence it can take place only in monopoly and not in competitive firms.

[38] Under which of the following market structure AR of the firm will be equal to MR?
(a) Monopoly (b) Monopolistic Competition
(c) Oligopoly (d) Perfect Competition (1 mark)

Answer:

Same as Ans. 4

[39] Tooth paste industry is an example of ________.
(a) monopoly (b) monopolistic competition
(c) oligopoly (d) perfect competition. (1 mark)

Answer:

(b) Monopolistic competition is a market in which many sellers offering differentiated products to many buyers Example- Toothpaste industry where product differential is only slight, and the degree of control over price is only some.

[40] OPEC is an example of :
(a) Monopolistic competition (b) Monopoly
(c) Oligopoly (d) Duopoly (1 mark)

Answer:

(c) Same as Ans. 17

[41] Monopolistic Competitive firms ________.
(a) are small in size
(b) have small share in total market
(c) are very large in size
(d) both (A) and (B) (1 mark)

Answer:

(d) Monopolistic competitive firms are small in size as compared to monopolies and every monopolistic competitive firms have small share in the total market Example – Soap industry

[42] The price discrimination under monopoly will be possible under which of the following conditions?
(a) The seller has no control over the supply of his product
(b) The market has the same condition all over
(c) The price elasticity of demand is different in different markets
(d) The price elasticity of demand is uniform. (1 mark)

Answer:

(c) Conditions for price discrimination under monopoly are:

(i) seller should have control over the supply of his product

(ii) seller should be able to divide his market into sub-markets

(iii) price elasticity of product should be different in different markets

(iv) not possible for buyers of low-priced market to resell the product to the buyers of high priced market.

2011 - JUNE

[43] Oligopoly having identical products is known as__________.

(a) pure oligopoly (b) collusive oligopoly

(c) independent oligopoly (d) none of these. (1 mark)

Answer:

(a) Oligopoly having identical products is known as pure oligopoly. For example-aluminium industry.

[44] Which of these is the best example of oligopoly?

(a) OPEC (b) SAARC

(c) WTO (d) GATT. (1 mark)

Answer:

(a) Oligopoly is defined as 'competition among few'. In other words when there are few sellers in the market selling homogeneous or differentiated products, oligopoly is said to exist.

OPEC (Oil and Petroleum Exporting Countries) is the best example of oligopoly.

[45] Monopolist can fix him price of goods whose elasticity is _______.

(a) less than 1 (b) more than 1

(c) elastic (d) inelastic. (1 mark)

Answer:

(a) Monopoly is a situation when there is a single seller in the market. Here the firm is the price maker. The price elasticity demand for monopolist is less than one hence he can fix price of the goods whose elasticity is less than one.

[46] Kinked demand curve is observed in ______.

(a) duopoly market (b) monopoly market

(c) competitive market (d) oligopoly market. (1 mark)

Answer:

(d) Same as Ans. 12

[47] Perfectly competitive firm faces:

(a) Perfectly elastic demand curve

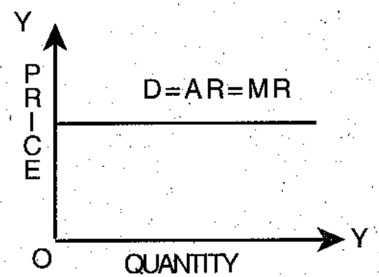
(b) Perfectly inelastic demand curve

(c) Zero

(d) Negative. (1 mark)

Answer:

(a) Firms in a competitive market are price takers. This is because there are a large number of firms in the market who are producing identical or homogeneous products. As such these firms cannot influence the price of their products and hence they have a perfectly elastic demand curve.



2011 - DECEMBER

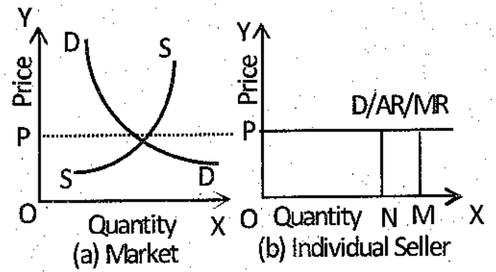
[48] In perfect Competition when the firm is a price taker, which curve among the following will be a straight line?

(a) Marginal Cost (b) Average Cost

(c) Total Cost (d) Marginal Revenue (1 mark)

Answer:

(d) In a perfect competitive market the firms are price-takers and the marginal revenue curve is a straight line.



Firm's Demand Curve Under Perfect Competition

[49] "Price Discrimination" can be best exercised by the Seller in________.

(a) oligopoly

(b) monopoly

(c) monopolistic competition

(d) perfect competition (1 mark)

Answer:

(b) Price discrimination cannot persists under perfect competition because the seller has no influence over market determined rate. Price Discrimination requires an element of monopoly so that the seller can influence the price of his product.

[50] In Oligopoly the kink in the demand curve is more due to__________.

(a) discontinuity in MR

(b) discontinuity in AR

(c) fulfillment of the assumption that a price fall is followed by the other and a price increase by a firm is not followed by the other

(d) price war among the firms (1 mark)

Answer:

(c) In oligopoly, the kinked demand curve is based on the assumption that:

Each oligopolist believes that if he lowers the price below the prevailing level, its competitors will follow him and will accordingly lower the prices, whereas if he raises the price above the prevailing level, its competitors will not follow its increase in price. This feature gives a kink shape to the demand curve.

[51] A firm encounters "shut down" point when__________.

(a) marginal cost equals the price of the profit maximising level of output

(b) average fixed cost equals the price at the profit maximising level of output

(c) average variable cost equals the price at the profit maximising level of output

(d) average total cost equals the price at the profit maximising level of output (1 mark)

Answer:

(c) A firm reaches a shutdown level when it is not being able to meet its variable cost. This means that the firm will not be able to make payment to labour, raw material suppliers etc. In such a situation, the firm will not be able to recover its variable cost even in the long run. Hence at this stage the firm should stop production and shut down.

[52] Under which market Condition firms make only normal profits in the long run?

(a) Oligopoly (b) Monopoly

(c) Monopolistic competition (d) Duopoly (1 mark)

Answer:

(c) In short-run, firm earn super-normal profits in the monopolistic competition thus giving incentives to new firms to enter the industry. As more firms enter, profits per firm will go on decreasing as the total demand will be shared among large number of firms. This will happen till all the profits are wiped away and all the firms earn only normal profits.

[53] In monopolistic competition excess capacity in the firm______.

(a) always exists (b) sometimes exists

(c) never exists (d) none of the above (1 mark)

Answer:

(a) An individual firm in the long run is in equilibrium position at a position where it has excess capacity. Thus, the firms in monopolistic competition are not of optimum size and there exists excess capacity of production with each firm.

2012 - JUNE

[54] Selling costs have to be incurred in case of:

(a) Perfect Competition (b) Monopolistic Competition

(c) Monopoly (d) None of these. (1 mark)

Answer:

(b) Non price competition is an essential feature of monopolistic competition. Here the firms compete not on basis of price but on other factors such as aggressive marketing, product development, after sale services etc.. Hence incurring of selling cost is an essential feature of monopolistic competition.

[55] In market, the price and output equilibrium is determined on the basis of:

(a) Total revenue and total cost

(b) Total cost and marginal cost

(c) Marginal revenue and marginal cost

(d) Only marginal cost. (1 mark)

Answer:

(c) For the condition of equilibrium two conditions are necessary –

(i) Marginal revenue should be equal to marginal cost.

(ii) Marginal cost curve should cut MR from below.

Hence, equilibrium is determined on the basis of marginal cost and marginal revenue.

2012 - DECEMBER

[56] A perfect market is characterised by :-

(a) Existence of large number of buyers and sellers

(b) Homogenous products

(c) Perfect knowledge of the market

(d) All of the above. (1 mark)

Answer:

(d) A perfect market has following characteristics :

1. Large number of buyers and sellers
2. Homogeneous products
3. Free entry and exit Perfect knowledge of the market
5. Movement of goods from one centre to another
6. Uniform price.

[57] Which of the following is not a feature of oligopoly market?

(a) Interdependence of the firms in decision making

(b) Price rigidity

(c) Group behaviour

(d) Existence of large number of firms. (1 mark)

Answer:

(d) Oligopoly is described as 'competition among the few'. It has the following characteristics:

1. Interdependence of few firms in decision making
2. Great importance of advertising and selling cost, firms compete on non-price basis.
3. Group behaviour.

[58] A monopolist can fix:

(a) Both price and output (b) Either price or output

(c) Neither price nor output (d) None of the above. (1 mark)

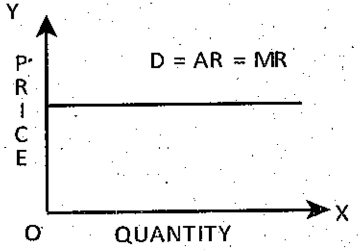
Answer:

(a) The term 'monopoly' means 'alone to sell'. In a monopoly market there is only one firm producing or supplying a product. Thus, the monopolist is free to determine both his price and output.

[59] In a perfectly competitive market, the demand curve of a firm is:-
(a) Elastic (b) Perfectly elastic
(c) Inelastic (d) Perfectly inelastic (1 mark)

Answer:

(b) Firms in a competitive market are price takers. This is because there are a large number of firms in the market who are producing identical or homogeneous products. As such these firms cannot influence the price of their products and hence, they have a perfectly elastic demand curve.



[60] In a competitive market, if price exceeds Average Variable Cost (AVC) but remains less than Average Cost (AC) at the equilibrium, the firm is:
(a) Making a profit
(b) Planning to quit
(c) Experiencing loss but should continue production
(d) Experiencing loss but should discontinue production. (1 mark)

Answer:

(c) The firm can be in an equilibrium position and still make losses. When the firm is able to meet its VC and a part of FC, it will try to continue production in short run. If it recovers a part of FC, it will be beneficial for it to continue production because FC are already incurred and in such a case, it will be able to recover a part of them.

Thus, if price exceeds the AVC but remains less than AC at equilibrium in a competitive market, the firm is experiencing loss but should continue production.

2013 - JUNE

[61] Price under perfect competition is determined by the ______.
(a) firm (b) industry
(c) government (d) society. (1 mark)

Answer:

(b) An industry consist of a large number of independent firms, having a number of factories, firms or mines under its control. Each such unit in the industry produces a homogeneous product so that there is competition amongst goods produced by different units called firms. When the total output of the industry is equal to the total demand, we say the industry is in equilibrium, the price prevailing is equilibrium price. Thus it can be said that price under perfect competition is determined by industry.

[62] Under monopoly, which of the following is correct:
(a) AR and MR both are downward sloping
(b) MR lies halfway between AR and Y-axis.
(c) MR can be zero or even negative
(d) All of the above. (1 mark)

Answer:

(d) The relationship between AR and MR of a monopoly firm can be stated as follows:
(i) AR and MR are both negative sloped (downward sloping) curves.
(ii) MR curve lies half way between the AR curve and Y axis, i.e. it cuts the horizontal line between Y axis and AR into two equal parts.
(iii) AR cannot be zero, but MR can be zero or even negative.
Thus, all of the above statements are correct under monopoly.

[63] Non-price competition is very popular in:
(a) Monopoly market
(b) Monopolistic competition
(c) Oligopolistic market
(d) Perfect competition. (1 mark)

Answer:

(b) In a monopolistically competitive market, seller try to compete on basis other than price, as for example aggressive advertising, product development, better distribution arrangements, efficient after-sale service, and so on. A key base of non-price competition is a deliberate policy of product differentiation.

[64] In the 'kinked-demand' curve model, the upper portion of the demand curve is:
(a) Elastic
(b) Inelastic
(c) Perfectly Elastic
(d) Unitary Elastic. (1 mark)

Answer:

(a) The demand curve faced by an oligopolist according to kinked demand curve hypothesis, has a 'kink' at the level of prevailing price. It is because the segment of the demand curve above the prevailing price level is highly elastic and the segment of the demand curve below the prevailing price level is inelastic.

[65] Equilibrium price for an industry in perfect competition is fixed through.
(a) Input and Output
(b) Market demand and market Supply
(c) Market demand and firms supply
(d) None of the above. (1 mark)

Answer:

(b) Firms in a competitive market are price takers. This is because there are a large number of firms in the market who are producing identical or homogeneous products. As such these firms cannot influence the price in their individual capacities. They have to accept the price fixed (through interaction of market demand and supply) by the industry as a whole.

2013 - DECEMBER

[66] In a perfectly competitive market, if MR is greater than MC, then a firm should—
(a) Increase its production (b) Decrease its production
(c) Decrease its sales (d) Increase its sales (1 mark)

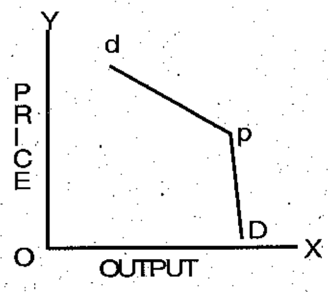
Answer:

(a) In a perfectly competitive market, if MR is greater than MC, there is always an incentive for the firm to expand its production further and gain by sale additional units.
Thus, the firm should increase its production if MR is greater than MC.

[67] Kinked demand curve is related to which market structure
(a) Oligopoly (b) Monopoly
(c) Monopsony (d) Monopolistic competition.
(1 mark)

Answer:

(a) In oligopolistic industries prices remain sticky or inflexible for a long time. They tend to change infrequently even if in the face of declining cost. These inflexibilities lead to kink shape of the demand curve.
Therefore, oligopolistic markets have kinked demand curve.



Thus, option a is correct.

[68] In the long run a monopolist always earns
(a) Normal profit (b) Abnormal profit
(c) Zero profit (d) Loss (1 mark)

Answer:

(b) Long run is a period long enough to allow the monopolist to adjust his plant size or use his existing plant at any level that maximizes his profit. In the absence of competition the monopolist need not produce at the optimum level.
Therefore, the monopolist will not continue if he makes losses in the long run.
He will continue to make super normal profits abnormal even in the long run as entry of outside firm is blocked.
Thus, option b is correct.

[69] Under which of the following forms of market structure does a firm has a very considerable control over the price of its product?
(a) Monopoly
(b) Monopolistic Competition
(c) Oligopoly
(d) Perfect Competition (1 mark)

Answer:

(a) In monopoly since there is a single seller and there is only one firm producing and supplying a product. Each firm is a price maker and is in a position to determine price of its own product.

2014 - JUNE

[70] One of the essential conditions of Perfect Competition is :
(a) Product differentiation
(b) Many sellers and few buyers
(c) Only one price for identical goods at any one time
(d) Multiplicity of prices for identical product at any one time (1 mark)

Answer:

(c) In case of perfect competition, the commodity or the goods are sold at uniform price throughout the market at any given point of time. In other words, all firms individually are price takers; they have to accept the price determined by the market forces of demand and supply.

[71] The demand curve of an oligopolist is :
(a) Determinate (b) Indeterminate
(c) Circular (d) Vertical (1 mark)

Answer:

(b) When an oligopolistic firm changes its price, its rival firms will retaliate or react and change their prices which in turn would affect the demand of the former firm. Therefore, an oligopolistic firm cannot have sure and definite demand curve, since it keeps shifting as the rivals changes their prices in reaction to the price changes made by it.
Hence, option (b) is correct.

[72] Abnormal profits exist in the long run only under_____
(a) perfect competition (b) monopoly
(c) monopolistic competition (d) oligopoly (1 mark)

Answer:

(b) Abnormal profits exist in the long run only under monopoly. He will continue to make supernormal profits even in the long run as entry of outside firms is blocked.
Thus, option (b) is correct.

[73] The distinction between a single firm and an Industry vanishes in which of the following market conditions?
(a) Perfect Competition (b) Imperfect Competition
(c) Pure Competition (d) Monopoly (1 mark)

Answer:

(d) In a monopoly market, there is only one firm producing or supplying a product. This single firm constitutes the industry and as such there is no distinction between firm and industry in a monopolistic market or monopoly.

[74] Selling outlay is an essential part of which of the following market situations?

(a) Perfect Competition (b) Monopoly
(c) Monopolistic Competition (d) Pure Competition. (1 mark)

Answer:

(c) In a monopolistically competitive market, sellers try to compete on bases of selling cost/outlay. Sellers attempt to promote their product not by cutting prices but by incurring high expenditure on publicity and advertisement and sales promoting techniques. Thus, selling outlay is an essential part of monopolistic competitive market.

[75] The Kinked demand curve model explains the market situation

(a) Pure Oligopoly (b) Differentiated Oligopoly
(c) Collusive Oligopoly (d) Price Rigidity (1 mark)

Answer:

(d) In many oligopolistic industries prices remain sticky or inflexible for a long time. They tend to change infrequently, even in the face of declining costs. The most popular explanation given for this price rigidity is the kinked demand curve hypothesis given by Paul A. Sweezy.

[76] For price discrimination to be successful, the elasticity of demand for the commodity in the two markets should be :

(a) Same
(b) Different
(c) Constant
(d) Zero (1 mark)

Answer:

(b) Conditions for price discrimination:

(i) Seller should have some control over the supply of his product.
(ii) Seller should be able to divide his market into two or more sub-markets.
(iii) Price-elasticity of the product should be different in different sub-market.
(iv) It should not be possible for buyers of low-priced market to resell the product to buyers of high-priced market.

2014 - DECEMBER

[77] The firm in a perfectly competitive market is a price taker. This designation as a price taker is based on the assumption that:

(a) The firm has some but not complete control over its product price
(b) There are so many buyers and sellers in the market that any one buyer or seller cannot affect the market
(c) Each firm produces a homogeneous product
(d) There is easy entry into or exit from the market place. (1 mark)

Answer:

(b) The firm in a perfectly competitive market is a price taker. The designation as a price taker is based on the assumption that there are large number of buyers and sellers who compete among themselves and their number is so large that no buyer or seller is in a position to influence the demand or supply in the market.

[78] A market structure in which many firms sell products that are similar and identical is known as __________.

(a) monopolistic competition (b) monopoly
(c) perfect competition (d) oligopoly (1 mark)

Answer:

(c) Perfect competition is a market where firm sells homogenous product that are similar and identical in nature.

[79] A firm having kinked demand curve indicates that:

(i) If the firm reduces the price, competitive firms also reduce the price
(ii) If the firm increases the price, competitive firms also increases the price
(iii) If the firm reduces the price, competitive firms do not reduce the price
(iv) If the firm increases the price, competitive firms do not increase the price

(a) Only (i) above (b) Both (i) and (iv) above
(c) Both (ii) and (iv) above (d) Both (ii) and (iii) above (1 mark)

Answer:

(b) In a firm having kinked demand curve indicates that, the firm has reduces, the price and the competitive firm also reduces the price but if the firm increases the price, competitive firms do not increase the price.

So, option B is correct answer i.e. Both (i) and (iv) above.

[80] Price discrimination will not be profitable, if the elasticity of demand is ________ in different markets

(a) uniform
(b) different
(c) less
(d) zero (1 mark)

Answer:

(a) Price discrimination is a method of pricing adopted by the monopolist in order to earn abnormal profits. It refers to the practices of charging different prices for different units of the same commodity. Thus, it will not be profitable, if the elasticity of demand is uniform in different market.

[81] In the long run, which of the following statement is true for a firm in a perfectly competitive industry?

(a) It operates at its minimum average cost
(b) The price is more than the average fixed cost
(c) The marginal cost is greatest than marginal revenue
(d) The fixed cost is lower than the total variable cost (1 mark)

Answer:

(a) In the long run, plants are used at full capacity, so that there is no wastage of resources i.e. MC = AC. The firm adjusts its plant size so as to produce that level of output at which the LAC is the minimum.

Thus, we can say that a firm in a perfectly competitive industry operates at its minimum average cost.

2015 - JUNE

[82] The firm will attain equilibrium at a point where MC curve cuts ________ from below.

(a) AR curve (b) MR curve
(c) AC curve (d) AVC curve. (1 mark)

Answer:

(b) The MC curve cuts MR curve from below. In other words, MC should have a positive slope.

[83] In a monopoly market, a producer has control only over:

(a) Price of the commodity (b) Demand of the commodity
(c) Both (a) and (b) (d) Utility of the product. (1 mark)

Answer:

(a) The monopolist or the producers in a monopoly market may use their monopolistic power to realize maximum revenue and may also adopt price discrimination. Therefore they have control only over price of the commodity.

[84] One of the following is not correct about perfect competition:

(a) Purchase and Sale of homogeneous goods
(b) Existence of marketing costs
(c) Absence of transportation costs
(d) Perfect mobility of factors of production. (1 mark)

Answer:

(b) Perfect competition has following features:

- Large number of buyers and sellers of a commodity
- Homogeneous Product
- Perfect Knowledge
- Freedom of Entry and Exit
- No Extra Transport Cost
- Independent Decision Making
- Perfect Mobility

[85] Kinked demand curve under oligopoly is designed to show:
(a) Price and output determination
(b) Price rigidity
(c) Price leadership
(d) Collusion among rivals. (1 mark)

Answer:

(b) Kinked demand curve hypothesis has a 'kink' at the level of the prevailing price. This kink is formed to show price rigidity.

2015 - DECEMBER

[86] "I am making a loss, but with the rent I have to pay, I can't afford to shut down at this point of time." If this entrepreneur is attempting to maximize profits or minimize losses.
(a) Rational, if the firm is covering its variable cost
(b) Rational, if the firm is covering its fixed cost
(c) Irrational, since plant closing is necessary to eliminate losses
(d) Irrational, since fixed costs are eliminated if a firm shut down. (1 mark)

Answer:

(a) A point of operation where a firm is indifferent between continuing operation and shutting down temporarily. The shutdown point is the combination of output and price where a firm earns just enough revenue to cover its total variable costs.

[87] Kinked demand curve is the demand curve of
(a) Perfect Competition (b) Monopoly
(c) Monopolistic Competition (d) None of the above. (1 mark)

Answer:

(d) Kinked demand curve is the demand curve of oligopoly.

[88] Price discrimination will be profitable only if the elasticity of demand in different markets is
(a) Uniform (b) Different
(c) Less (d) Zero (1 mark)

Answer:

(b) Price discrimination will be profitable only if the elasticity of demand in different markets is different because Monopolist fixes a high price for his product for those buyers whose price Elasticity of demand for a product is less than one. This implies that when the monopolist charges a higher price from them, they do not significantly reduce their purchases in response to high price.

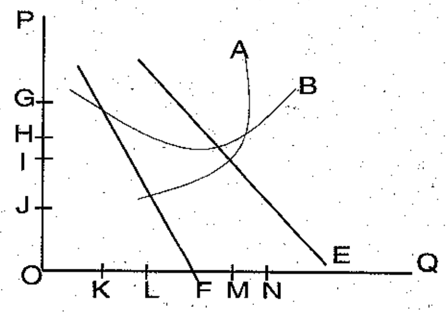
[89] Under which of the following form of market structure does a firm have no control over the price of its production?
(a) Monopoly (b) Monopolistic Competition
(c) Oligopoly (d) Perfect Competition. (1 mark)

Answer:

(d) In perfect competition, a firm has no control over the price of its product because there are large number of sellers and each seller produces such a small share of the total output so that any change in his output will not have a significant effect on the market price and there are large number of buyers so that no buyer can change its output by its individual action. The firms are said to be 'price takers'.

[90] ____________ is that situation in which a firm bases its market policy, in part on the expected behaviour of a few close rivals.
(a) Oligopoly (b) Monopolistic Competition
(c) Monopoly (d) Perfect Competition. (1 mark)

Solve the question No. 91, 92 and 93 on the base of following figure:



Answer:

(a) Oligopoly is a market structure in which there is interdependence of firms in decision making. This is because when the number of competitors are few any change in price, output or product by a firm will have a direct effect on the fortunes of the rivals, who will then retaliate by changing their own price.

[91] In the above figure, curve E is the firm's
(a) Marginal Cost Curve
(b) Average Cost Curve
(c) Demand Curve
(d) Marginal revenue Curve. (1 mark)

Answer:

(c) Curve-E is Average Revenue curve which is also known as Demand Curve.

[92] Above figure represents a
(a) Monopolist
(b) Perfectly competition industry
(c) Perfectly competitive firm
(d) None of the above. (1 mark)

Answer:

(a) Given curve is Monopolist curve because:
(i) AR and MR are both negatively sloped
(ii) MR curve lies half-way between the AR curve and the Y-axis. i.e. it cuts the Horizontal line between Y-axis and AR into two equal parts.
(iii) AR cannot be zero, but MR can be zero or negative.

[93] In above figure, firms marginal revenue curve is curve
(a) E (b) A
(c) F (d) B (1 mark)

Answer:

(c) Marginal revenue curve is curve F because it lies half-way between the AR curve and the Y-axis.

2016 - JUNE

[94] The price elasticity of demand for a product is infinite under:
(a) Perfect competition (b) Monopolistic competition
(c) Monopoly (d) Oligopoly. (1 mark)

Answer:

(a) The price elasticity of demand for a product is infinite under perfect competition as there are large number of buyers and sellers who compete among themselves and their number is so large that no buyer or seller is in a position to influence the demand or supply in the market.

[95] Comparing a Monopoly and Competitive firm the Monopolist will:
(a) Produce less and sell at a lower price
(b) Produce more and sell at a lower price
(c) Produce less and sell at a higher price
(d) Produce zero and sell at a lower price. (1 mark)

Answer:

(c) Monopoly is an extreme form of imperfect competition with a single seller of a product which has no close substitute as compared with the perfectly competitive market. In perfect competition, average and marginal revenue are identical but this is not the case in monopoly as monopolist knows that if he wishes to increase his sales he will have to reduce the price of a product. Thus, produce less at a higher price at times.

[96] The reason for the kinked demand curve is that:
(a) the oligopolist believe that competitors will follow output increases but not output reductions.
(b) the oligopolist believe that competitors will follow price increases but not output reductions.
(c) the oligopolist believe that competitors will follow price cuts but not price rises.
(d) the oligopolist believe that competitors will follow price increases but not output increases. (1 mark)

Answer:

(c) The reason for the Kinked Demand curve is that the oligopolist believe that competitors will follow price cuts but not price rises. This kink is formed at a prevailing price level. This is because the segment of the demand curve above the prevailing price level is highly elastic and the segment of the demand curve below the prevailing price level is inelastic.

[97] A discriminating monopolist will charge a higher price in the market in which the demand for its product is ___________.

(a) highly elastic (b) relatively elastic
(c) relatively inelastic (d) perfectly elastic. (1 mark)

Answer:

(c) A discriminating monopolist charge a higher price in a market which has a relatively in elastic demand. The market which is highly responsive to price changes is charged less. On the whole, the monopolist benefits from such discrimination.

[98] If a firm under monopoly wants to sell more, its average revenue curve will be a _________ line.

(a) horizontal (b) vertical
(c) downward sloping (d) upward sloping (1 mark)

Answer:

(c) If a firm under monopoly wants to sell more, its average revenue curve will be a downward sloping line because the seller charges a single price for all units he sells, average revenue per unit is identical with price, and thus the market demand curve is the average revenue curve for the monopolist.

2016 - DECEMBER

[99] Who sets the price of the product under perfect competition?

(a) Government (b) Consumers
(c) Sellers (d) Both buyers and sellers (1 mark)

Answer:

(d) Price of the product under perfect competition is set by both buyers and sellers.

[100] Which is the first order condition for the firm to maximise the profit.

(a) AC = MR (b) AC = AR
(c) MC = MR (d) MR = AR (1 mark)

Answer:

(c) The first order condition for the firm to maximise the profits is when marginal cost is equal to the marginal revenue.

[101] Which market has the concept of 'group' equilibrium in the long run?

(a) Oligopoly (b) Monopoly
(c) Monopolistic competition (d) Perfect competition. (1 mark)

Answer:

(c) In the long run monopolistic competition has the concept of group equilibrium. Group equilibrium represents the price and output of organizations having close substitutes.

[102] Which of the following is incorrect?

(a) Even monopolistic can earn losses.
(b) Firms in perfect competitive market is price taker.
(c) It is always beneficial for a firm in a perfectly competitive market to discriminative prices.
(d) Kinked demand curve is related to an oligopolistic market. (1 mark)

Answer:

(c) It is always beneficial for a firm in a perfectly competitive market to discriminate prices. This statement is incorrect.

[103] Average revenue curve is also known as:

(a) Profit Curve
(b) Demand Curve
(c) Average Cost Curve
(d) Indifference Curve (1 mark)

Answer:

(b) Average Revenue curve is also known as Demand Curve.

[104] Which is not characteristic of monopoly?
(a) The firm is price taker
(b) There is a single firm
(c) The firm produces a unique product
(d) The existence of some advertising. (1 mark)

Answer:

(a) A monopoly is not a price taker but a price maker.

[105] Price discrimination is profitable only when:
(a) Different markets are kept separate
(b) Distance between the consumer and the market is more
(c) Elasticity of demand in different markets is different
(d) The consumers are segregated on the basis of their purpose of use of the commodity. (1 mark)

Answer:

(c) Price discrimination is profitable only when elasticity of demand in different markets is different.

2017 - JUNE

[106] When the industry is dominated by one large firm which is considered as the leader of the group, the market is described as:
(a) Open oligopoly
(b) Perfect oligopoly
(c) Partial oligopoly
(d) Organised oligopoly. (1 mark)

Answer:

(c) Oligopoly is partial when the industry is dominated by one large firm which is considered or looked upon as the leader of the group. The dominating firm will be the price leader. In partial oligopoly. The market will be conspicuous by the absence of price leadership.

[107] Which amongst the following is not an objective of price discrimination?
(a) To hold the extra stocks
(b) To earn maximum profits
(c) To enjoy economies of scale
(d) To secure equity through pricing. (1 mark)

Answer:

(a) The objectives of price discrimination are here under:
1. to earn maximum profit
2. to dispose off surplus stock
3. to enjoy economies of scale
4. to capture foreign market
5. to secure equity through pricing

Thus, option (a) is the correct answer.

[108] Which of the following statement is not correct?
(a) Under monopoly there is no difference between a firm and industry.
(b) A monopolist may restrict the output and raise the price.
(c) Commodities offered for sale under a perfect competition will be heterogeneous.
(d) Product differentiation is peculiar to monopolistic competition. (1 mark)

Answer:

(c) Commodities offered for sale under a perfect competition will be homogenous. There are large number of buyers and sellers who compete among themselves and their number is so large that no buyer or seller is in a position to influence the demand and supply in the market being the commodity dealt in it is homogeneous, in the sense that the goods produced by different firms are identical in nature.

[109] Under perfect competition firm is described as:
(a) price taker and not price maker
(b) price maker and not price taker
(c) neither price maker nor price taker
(d) none of the above. (1 mark)

Answer:

(a) Under perfect competition firm is described as price takers and not price makers. This is because there are large number of firms in the market who are producing identical or homogenous products. As such these firms cannot influence the price in their individual capacities. They have to accept the price fixed (through interaction of total demand and total supply) by the industry as a whole.

[110] Under which of the following forms of market structure does a firm have no control over the price of its product?

(a) Monopoly (b) Monopolistic Competition
(c) Oligopoly (d) Perfect Competition. (1 mark)

Answer:

(d) Under perfect competition, a firm have no control over the price of its product. Firm have to accept the price as given and as such they are price takers rather than price makers. They cannot increase the price individually because of the fear of losing the customer to other firms.

Thus, option (d) is correct.

2018 - MAY

[111] Condition for equilibrium of firm:

(a) MR = MC
(b) AR = AC
(c) MC curve cuts MR curve from below
(d) Both (a) and (c) (1 mark)

Answer:

(d) Conditions for Equilibrium of firm are:

(i) Marginal revenue should be equal to marginal cost i.e. MR = MC
(ii) MC curve should cut MR curve from below i.e. MC should have positive slope. Hence both conditions.

[112] What is/ are feature (s) of oligopoly

(a) Kinked Demand curve
(b) Cartel
(c) Downward sloping demand curve
(d) Both (a) and (b) are correct (1 mark)

Answer:

(d) Oligopoly is type of market in which there are only few buyers and sellers (generally 2 to 10) and it was so many features also and these are as follows:

(a) Cartel
(b) Kinked Demand Curve
(c) Interdepence
(d) Group Behaviour
(e) Importance of advertising and selling costs

[113] Monopoly is undesirable due to:

(a) It has prices higher than competitive firms
(b) It produces less output than competitive firms
(c) It discriminates on prices
(d) All of the above. (1 mark)

Answer:

(d) Monopoly means where only one seller exist and take all the profits. It has some features from his point of view and undesirable also from public point of view these are:

(a) Price Discrimination
(b) Produced less output than competitive firms
(c) Prices higher, than competitive firm

[114] In long run equilibrium undue perfect competition is/are satisfied by which condition

(a) MC = MR
(b) AC = AR
(c) CMC = LAC = P
(d) All of the above. (1 mark)

Answer:

(d) Equilibrium point is judged in long run when there is/are following conditions given

(a) Marginal Cost = Marginal Revenue or MC = MR

(b) Average Cost = Average Revenue or AC = AR

(c) Long run Marginal Cost = Long Run Average Cost = Price or LMC = LAC = P

[115] In the long run monopolist

(a) Incur losses (b) Must earn super normal profits

(c) Wants to shut down (d) Earns only normal profits. (1 mark)

Answer:

(b) Monopoly means one seller and many buyers. Monopoly is kind of market in which seller is known as monopolist and as his business gross for long time then he not only earns normal profits but also abnormal profits and which is known as super profits. So, the must earn super normal profits in long run.

[116] The demand curve of the firm and industry will be same in which form of market:

(a) Monopolistic competition (b) Perfect competition

(c) Monopoly (d) Oligopoly (1 mark)

Answer:

(c) Demand curve of firm and industry will same in monopoly market as price set by industry and firm have to choose that level of output which yields maximum profits.

[117] Which of these is the best example of oligopoly?

(a) OPEC (b) SAARC

(c) WTO (d) GATT (1 mark)

Answer:

(a) Oligopoly market is type of market in which there are only 2 to 10 sellers.

For Ex: OPEC, cold-drink seller, water supplier etc.

[118] In a perfectly competitive market, if MR is greater than MC, then a firm should:

(a) Increase its production (b) Decrease its production

(c) Decrease its sales (d) Increase its sales (1 mark)

Answer:

(a) In a perfect competition market, when firm increase its output or production then the reason is its Marginal Revenue/Average Revenue is greater than Marginal Cost/Average Cost.

[119] Equilibrium price for an industry in prefect competition is fixed through

(a) Input and output

(b) Market demand and market supply

(c) Market demand and firms supply

(d) None of the above. (1 mark)

Answer:

(b) Equilibrium is that price at which both demand and supply are equal and therefore, no buyer who wanted to buy at that price goes dissatisfied and none of the seller is dissatisfied that he could not sell his goods at that price. Equilibrium price in perfect competition is fixed through Market Supply and Market Demand.

[120] A competitive firm in the short rum insure losses. The firm continues production, if:

(a) $P > AVC$ (b) $P = AVC$

(c) $P < AVC$ (d) $P \geq AVC$ (1 mark)

Answer:

(d) Firm continues production if price is greater than or equal to average variable cost but price is less than average variable cost then firm will incur definitely losses which leads to closure of firm.

[121] Market form in which there is only one buyer and one seller is:

(a) Oligopoly (b) Duopoly

(c) Bilateral Monopoly (d) Monopsony (1 mark)

Answer:

(c) Bilateral Monopoly is type of market in which there are only one seller and one buyer.

2018 - November

[122] The structure of the Toothpaste Industry in India is best described as:
(a) Perfectly competitive
(b) Monopolistic
(c) Monopolistically competitive
(d) Oligopolistic (1 mark)

Answer:

(b) Monopolistic market has differentiated products with close substitutes just like Toothpaste Industries.

[123] Product differentiation is the main features of which market?
(a) Oligopoly
(b) Monopolistic
(c) Discriminating Monopoly
(d) Perfect competition (1 mark)

Answer:

(b) In monopolistic competitive market there are large number of buyers and seller each selling differentiated product.

[124] Which market is having a single seller and single Buyer?
(a) Duopoly
(b) Monopsony
(c) Bilateral Monopoly
(d) None of the above (1 mark)

Answer:

(c) Bilateral Monopoly is a market structure in which there is only a single buyer and a single seller i.e. it is a combination of monopoly market and a monopsony market.

[125] In Long run perfect competitive market incurs
(a) Normal profit
(b) Supernormal profit
(c) Losses
(d) Constant Returns (1 mark)

Answer:

(a) In long run, firms will 'just be earning normal profit because if in short run they earning supernormal profit new firms will be attracted and supply will rise which lead to fall in prices and *vice versa*.

[126] Which one of the following is not the feature of Oligopoly?
(a) Interdependency
(b) Selling cost
(c) Free Entry
(d) None of the above/ group behaviour (1 mark)

Answer:

(c) Feature of oligopoly are:
1. Strategic Interdepence
2. Importance of advertising and selling cost
3. Group behaviour.

Therefore, free entry is not a feature of oligopoly market.

[127] Price leadership is the characteristic of
(a) Oligopoly
(b) Monopoly
(c) Perfect competition
(d) Discriminating Monopoly (1 mark)

Answer:

(a) Price leadership can be by dominant firm, a low cost firm or it can be barometric price leadership.

[128] MR Curve in perfect competition is
(a) Parallel to X- axis
(b) Parallel to Y- axis
(c) Fall from left to right
(d) Rise from left to right (1 mark)

Answer:

(a) MR curve in perfect competition is parallel to x-axis. Because a perfectly competitive firm is a price taker and faces a horizontal demand curve, its MC curve is also horizontal and coincides with its AC curve.

[129] Which of the following is not the characteristic of MR?
(a) When TR is maximum, then MR is zero
(b) MR cannot be negative
(c) MR slopes downward from left to right
(d) MR Curve is below AR Curve (1 mark)

Answer:

(b) Properties of MR is:
(i) When TR is maximum, then MR is zero
(ii) MR can be negative
(iii) MR slopes downward
(iv) MR curve is below AR curve
Therefore, (b) is the correct option, because MR can be negative.

[130] Which out of these are not a feature of perfect competition?
(a) Homogeneous
(b) Large number of buyer and sellers
(c) Free entry and exit
(d) Selling cost. (1 mark)

Answer:

(d) Feature of perfectly competitive market
1. Large number of buyers and sellers
2. Products are homogenous in nature
3. Firms are free to center and exit
4. Consumer have perfect knowledge.

Therefore selling cost is not included in perfectly competitive market

2019 - MAY

[131] Which is the characteristic feature of monopoly ?
(a) Homogeneous goods
(b) Strong barriers to entry
(c) Perfect competition
(d) Perfectly elastic demand curve (1 mark)

Answer :

(b) Monopoly is a market situation in which there is a single seller and large number of buyers. Its features are:
(i) Single seller of the product
(ii) Barriers to entry
(iii) No close-substitute of product
(iv) Market power.

[132] A discriminating monopolist to reach equilibrium position, his decision on total output depends upon
(a) How much total output should be produce ?
(b) How the total output should be distributed between the two sub-market ?
(c) Both (a) and (b)
(d) None (1 mark)

Answer:

(c) In order to attain equilibrium position, a discriminating monopolist has to make three main decisions regarding his output.
1. How much total output should be produce?
2. How the total output should be distributed between the two sub-markets? and.
3. What price he should change in the two sub-markets?

Thus, **option (c)** is correct.

[133] Price discrimination is possible only in __________
(a) Monopoly
(b) Perfect Competition
(c) Oligopoly
(d) Monopolistic Competition (1 mark)

Answer:

(a) Price discrimination is a method of pricing which is adopted by a monopolist in order to earn abnormal profits. It is a method in which different prices are charged for different units of same commodity. Thus, this method is only possible in monopoly market situation.

[134] Kinked demand curve is

(a) Highly elastic at above the prevailing price

(b) Inelastic at below the prevailing price

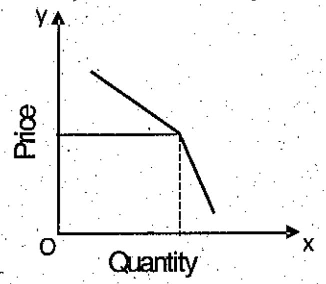
(c) Both (a) and (b)

(d) None of the above (1 mark)

Answer:

(c) In oligopoly market, the demand curve is kinked shaped at the level of the prevailing price. The reason behind this is that the demand curve above prevailing price level is highly elastic and the segment below the prevailing price level is inelastic.

In other words, a high prices, the firm faces the relatively elastic demand and at low prices, relatively inelastic demand.



[135] Demand curve is horizontal in the case of ________

(a) Monopoly

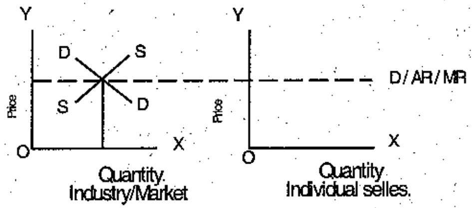
(b) Perfect Competition

(c) Imperfect Competition

(d) Monopolistic Competition (1 mark)

Answer:

(b) In perfect competitive market firms are price taker i.e. the cannot influence the price in their individual capacity. Price is determined by the industry. Thus, the demand curve of this market is horizontal i.e. parallel to x-axis.



[136] What is the characteristic of monopolistic competition?

(a) Price elasticity is low for the product concerned

(b) Large number of sellers

(c) No degree of control over price

(d) One buyer (1 mark)

Answer:

(b) Monopolistic competition is an imperfect market where many produces sell differentiated products. Its characteristics are

1. Large number of sellers.
2. Product differentiation
3. Freedom of entry and exit
4. Non-price competition

[137] If a perfectly competitive firm earns super normal profits then ______

(a) AR > MR

(b) AR < MR

(c) AR = MR

(d) None of the above (1 mark)

Answer:

(c) In case of perfect competition super normal profit arises when its average revenue is more than its average total cost. There is no change in Demand curve, i.e.

AR = MR = Demand.

2019 - NOVEMBER

[138] Live and let live is characteristics of which of the following market?

(a) Perfect Competition
(b) Monopoly Competition
(c) Imperfect Competition
(d) Oligopoly Competition (1 mark)

Answer:

(d) Oligopoly market which forms cartels because there are a few firms, all of which are similar in size. One strategy is to adopt a 'live and let live philosophy'. Specifically the dominant firm accepts the presence of fringe firms and sets the price to maximize its profit, taking into account the fringe firms' behaviour. This is called price leadership by dominant firm.

[139] In which of the following market there are only two sellers?

(a) Duopoly Competition
(b) Perfect Competition
(c) Monopoly Competition
(d) Perfect Competition and Duopoly (1 mark)

Answer:

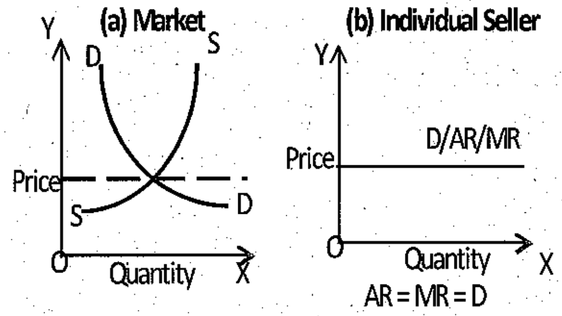
(a) Duopoly is a subset of oligopoly, is a market situation in which there are only two firm in the market.
Where as in oligopoly market there are few firms and large number of buyers with some degree of control our its price.

[140] The degree of elasticity in perfect competition market.

(a) Perfectly elastic (b) Inelastic
(c) Perfectly inelastic (d) Elastic (1 mark)

Answer:

(a) The degree of elasticity in perfect competition market is perfectly elastic because firm is a price taker, the demand curve 'D' facing an individual competitive firm is given by a horizontal line at the level of market price set by the industry. In other words the demand curve of each firm is perfectly (or infinitely) elastic.

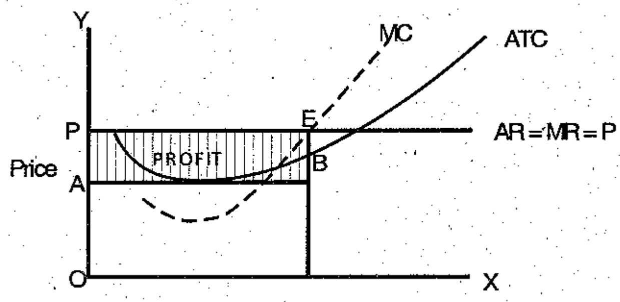


[141] A perfect competitive firm earns super-normal profits when

(a) ATC < MC
(b) ATC > MC
(c) MR < AR
(d) MR > AR (1 mark)

Answer:

(a) When a firm earns supernormal profits its average revenues are more than its average total cost. Thus, in addition to normal rate of profit the firm earns some additional profits.
Therein short run perfect competitive firm earns super normal profits. But in long run it earns normal profits only.



[142] A firm is said to earn normal profit when
(a) AC = AR
(b) MC = MR
(c) AR = NR
(d) MC > MR (1 mark)

Answer:

(a) When the average revenue of a firm is just equal to its average cost, a firm earns normal profits or zero economic profits. i.e.
AC = AR
It is to be noted that here a normal profit percentage for entrepreneur for his managerial services is already included in the cost of production.

[143] Two firms are selling cold- drinks and competing with some identical characteristics, This is an example of
(a) Duopoly
(b) Monopoly
(c) Oligopoly
(d) Monopolistic (1 mark)

Answer:

(a) Duopoly market is the subset of oligopoly market where two and only two firms are there in the market.
Therefore, when there are two firms of cold- drink are selling cold-drink and competing with some identical characteristics . This is an example of Duopoly market.

[144] Group Behaviour is a characteristics of _____.
(a) Oligopoly
(b) Monopoly
(c) Perfect Competition
(d) Nanopolistic Competition (1 mark)

Answer:

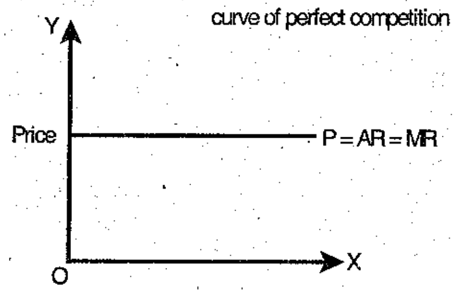
(a) Group behaviour is a characteristics of oligopoly market. The theory of oligopoly is a theory of group behaviour, not mass or individual behaviour and to assume profit maximising behaviour on the oligopolists' part may not be very valid. The firms may agree to

pull together as a group in promotion of their common interest. And each oligopolist closely watches the business behaviour of the other oligopolists in the industry and designs his moves on the basis of some assumptions of how they behave are likely to behave.

[145] Myth in Real world
(a) Oligopoly
(b) Duopoly
(c) Perfect Competition
(d) Monopoly (1 mark)

Answer:

(c) Myth in Real world is perfect competition market as in this market there are large number of buyers and sellers but they sell all homogenous goods which is not possible in real situation. And here all firms are price-takers.



[146] _______ oligopoly refers to that situation where the firms sell their products through a centralized body
(a) Syndicate oligopoly
(b) Organized oligopoly
(c) Collusive oligopoly
(d) Partial oligopoly (1 mark)

Answer:

(a) Syndicated oligopoly refers to that situation where the firms sell their products through a centralized body.

Organized oligopoly refers to the situation where the firms organize themselves into a central association for fixing prices, output, quotas, etc.

[147] The similarity between monopolistic and perfect competition is ____

(a) In short run both earn super normal profit

(b) In long term both earn normal profit

(c) In short run their prices remain constant

(d) None (1 mark)

Answer:

(b) The similarity between monopolistic and perfect competition is in long run both earn normal profits.

As long run is a period long enough to allow monopolistic to adjust his plant size or use his existing plant at any level that maximizes his profit. In the absence of competition the monopolist need not produce at optimum level.

Therefore, the monopolistic will not continue if he makes losses in the long run. He will continue to make normal profits even in long run.

[148] Which Market has a downward demand curve?

(a) Monopolistic competition

(b) Monopoly

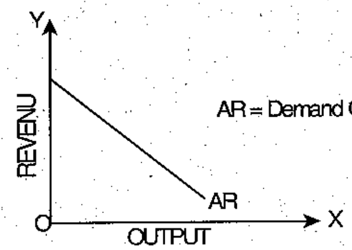
(c) Perfect competition

(d) Both (a) and (b) (1 mark)

Answer:

(d) Monopolistic Competition and Perfect Monopoly competition market both have downward sloping demand curve.

In all forms of imperfect competition, the average revenue curve of an individual firm slopes downwards as in these market forms when a firm increase the price of its product, its quantity demanded decreases and *vice versa*.



2020 - NOVEMBER

[149] Kinked demand hypothesis is designed to explain the under oligopolistic market.

(a) Collusion between firms

(b) Price and output determination

(c) Rigidity of price

(d) Price leadership (1 mark)

Answer:

(c) In the context of oligopoly, the kinked demand curve hypothesis is designed to explain price rigidity. The curve is more elastic above the kink and less elastic below it. This means that the response to a price increase is less than the response to a price decrease.

[150] ______ is the best example of oligopoly.

(a) SAARC

(b) WTO

(c) GATT

(d) OPEC (1 mark)

Answer:

(d) An oligopoly is a market form wherein a market or industry is...A prime example of such a cartel is OPEC, which has a profound influence on the international price of oil.

[151] Aluminum industry is the example of which type of oligopoly.

(a) Open oligopoly
(b) Full oligopoly
(c) Pure oligopoly
(d) Syndicated oligopoly (1 mark)

Answer:

(c) In the case of pure oligopoly, the product of different firms in the industry is identical or homogeneous like- Alluminium industry.

[152] In which market price are determined by the market forces of demand and supply?

(a) Pure competition
(b) Perfect competition
(c) Monopolistic competition
(d) Oligopoly (1 mark)

Answer:

(b) Perfect competition is a form of market in which there are a large number of buyers and sellers competing with, each other in the purchase and sale of goods, respectively and no individual buyer or seller has any influence over the price. Thus, perfect competition is an ideal form of market structure in which there is the greatest degree of competition.

[153] Railways charges comparatively cheaper fores from senior citizens. These an example of:

(a) Price discrimination
(b) Market analysis
(c) Profit discrimination
(d) Demand forecasting (1 mark)

Answer:

(a) Railway charges comparatively cheaper fores from senior citizens because it has monopoly power and can practice price discrimination i.e. charging different prices from different customers.

[154] Smart Phones market is an example of:

(a) Monopoly
(b) Monopolistic Competition
(c) Oligopoly
(d) Perfect Competition (1 mark)

Answer:

(c) The cell phone industry is on oligopoly because, there are four large firms that are competing to produce 70 to 80% of the output.

[155] Collusion is impossible if an industry has:

(a) large number of firms
(b) only few number of firms
(c) only two firms
(d) limited number of firms (1 mark)

Answer:

(a) Collusion is a non-competitive, secret, and sometimes illegal agreement between rivals which attempts to disrupt the market's equilibrium. The act of collusion involves people or companies which would typically compete against one another, but who conspire to work together to gain an unfair market advantage. Collusion is generally seen in Oligopoly market hence is not possible in case of large number of firms.

[156] When the industry is dominated by one large firm it is called:

(a) Partial oligopoly
(b) Full oligopoly
(c) Organised oligopoly
(d) Closed oligopoly (1 mark)

Answer:

(a) Partial oligopoly refers to that market situation where the industry is dominated by one large firm and the other firms of the industry follow the price policy determined by their leader.

[157] Choose the incorrect statement regarding the barometric price leadership.

(a) Live and let live philosophy is followed
(b) Old and experienced firm act as a leader

(c) Price decided by assessing market conditions
(d) Price decided by leader is generally accepted by the rest of all (1 mark)

Answer:

(a) Barometric price leadership refers to situations in which a price leader acts as a barometer of prevailing market conditions for other firms in the industry.

[158] Competition among few is described in:
(a) Monopoly
(b) Oligopoly
(c) Duopoly
(d) Monopsony (1 mark)

Answer:

(b) There is no certainty in how firms will compete in oligopoly, it depends upon the objectives of the firm and the nature of the product.

2021 - JANUARY

[159] Which of the following is not a coalition of perfect competition?
(a) A large number of firms
(b) Perfect mobility of factors
(c) Informative advertising to ensure that consumers have good information
(d) Freedom of entry and exit into and out of the market (1 mark)

Answer:

(c) Informative advertising to ensure that consumers have good information

The conditions of perfect competitive market are as follows:
(a) Large no of buyers and sellers
(b) Free entry & exist
(c) Perfect Substitutes etc.

[160] Oligopoly industries are characterized by
(a) A few dominant firms and substantial barriers to entry
(b) A few large firms and no entry barriers
(c) A large number of small firms and no entry barriers
(d) One dominant firm and low entry barriers (1 mark)

Answer:

(a) A few dominant firms and substantial barriers to entry
Oligopoly industries are characterized by a few dominant firms and substantial barriers to entry.

[161] The long run equilibrium outcomes in monopolistic competition and perfect competition are similar, because in both market structures:
(a) The efficient output level will be produced on the long run
(b) Firms will be producing at minimum average cost
(c) Firms realize all economies of scale
(d) Firms will only earn normal profit (1 mark)

Answer:

(d) Firms will only earn normal profit
The long run equilibrium outcomes in monopolistic competition and perfect competition are similar, because in both market structures firms will only normal profits.

[162] Pure oligopoly is based on the ______ production
(a) Homogeneous
(b) Differential
(c) Unrelated
(d) Related (1 mark)

Answer:

(a) Homogeneous
Pure oligopoly is based on the Homogeneous production.

[163] In the competition of oligopoly, the kinked demand curve hypothesis is designed to explain
(a) Price rigidity
(b) Price and output determination
(c) Price leadership
(d) Collusion (1 mark)

Answer:

(a) Price Rigidity

In the oligopoly market, the linked demand curve hypothesis is designed to explain price rigidity.

[164] Given AR = 5 and elasticity of demand = 2 find MR.

(a) + 2.5

(b) – 2.5

(c) + 1.5

(d) + 2.0 (1 mark)

Answer:

(a) + 2.5

$$MR = AR \times \frac{e-1}{e}$$

$$= 5 \times \frac{2-1}{2}$$

= (2.5+)

[165] When TR is max, then MR is

(a) Zero

(b) One

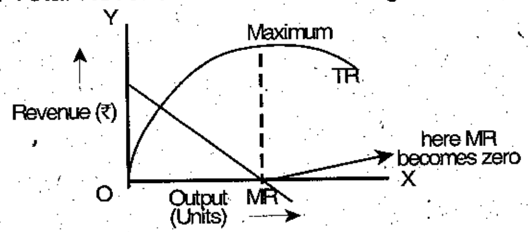
(c) Both (a) and (b)

(d) None (1 mark)

Answer:

(a) Zero

When Total Revenue is max then marginal revenue is Zero.



2021 - JULY

[166] A firm to attain the equilibrium position under perfect competition has to satisfy which of the following conditions?

(a) MR > MC

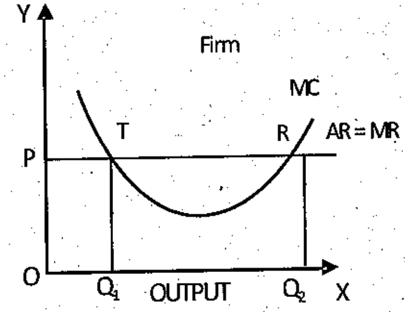
(b) MR = MC

(c) MR curve should cut MC curve from below

(d) MC curve should cut MR curve from below (1 mark)

Answer:

(d)



At R, the MC curve is cutting MR curve from below. Hence, R is the point of equilibrium T, MC curve is cutting MR curve from above. Hence, T is not the point of equilibrium.

[167] Electricity companies sell electricity as a cheaper rate for power consumption in rural areas than for industrial consumption. This is an example of:

(a) Product discrimination

(b) Perfect competition

(c) Price discrimination

(d) Price taker (1 mark)

Answer:

(c) Price discrimination is a method of pricing which is adopted by a Monopolist in order to earn abnormal profit. It is a method in which different prices are charged for different units of same commodity.

[168] Which of the following is an example of monopolistic competition?

(a) De Beers and Diamonds
(b) Hotel and Pubs
(c) Microsoft and window
(d) Dell and Lenovo (1 mark)

Answer:

(b) In Monopolistic competition, large number of buyers and large number of firms in the industry. Differentiated product which are close substitutes but not perfect substitute Example: Hotels and Pubs.

[169] Who propounded the price rigidity under kinked demand curve model of oligopoly?

(a) Adam Smith
(b) Karl Marx
(c) Keynes
(d) Paul A. Sweezy (1 mark)

Answer:

(d) American economist Paul A. Sweezy propounded the price rigidity under kinked demand curve model of oligopoly.

[170] The demand for generic good like soap is _______ the demand for Lux soap is _________.

(a) Inelastic, elastic
(b) Elastic, inelastic
(c) Inelastic, inelastic
(d) Elastic, elastic (1 mark)

Answer:

(d) The demand for generic good like soap is elastic the demand for LUX soap is elastic.

[171] Zero economic profit emerges due to which of the following conditions?

(a) Average revenue is more than average total cost.
(b) Marginal revenue is just equal to marginal cost.
(c) Marginal revenue is just not equal to marginal cost.
(d) Average revenue is just equal to average total cost. (1 mark)

Answer:

(d) Zero economic profit emerges due to average revenue is just equal to average total cost.

[172] Non - Price competition is observed in which type of following market?

(a) Monopoly
(b) Monopolistic competition
(c) Duopoly
(d) Oligopoly (1 mark)

Answer:

(b) Non-price competition is observed in Monopolistic competition market. Features of monopolistic competition are:

(i) Product differentiation
(ii) Freedom of entry and exit
(iii) Large numbers of buyers and sellers
(iv) Non-price competition

[173] A group of firm that explicitly agree (collude) to coordinate their activities is called a/an __________.

(a) Oligopoly
(b) Duopoly
(c) Monopoly
(d) Cartel (1 mark)

Answer:

(d) Cartels are often formed in industries where there are a few firms all of which are similar in size. A group of firms that explicitly agree to co-ordinate their activities is known as cartel.

[174] Which one of the following is not a characteristics of oligopoly?
(a) Strategic interdependence
(b) Large number of firms selling close substitutes.
(c) Importance of selling cost
(d) Group behaviour (1 mark)

Answer:

(b) Large numbers of firms selling close substitutes is not feature of oligopoly. Feature of oligopoly are:
(i) Few firms or sellers
(ii) **Example:** cold drinks

[175] Which of the following is not a features of the monopoly market?
(a) Large seller of the product
(b) No close - substitutes
(c) Market power
(d) Single seller of the product (1 mark)

Answer:

(a) Features of monopoly market are:
- Single seller of the product
- Barriers to Entry
- No close substitutes
- Market power

2021 - DECEMBER

[176] Price discrimination refers to charging ________ prices for _______ units of ________ commodity.
(a) different, different, same
(b) different, same, same
(c) same, different, same
(d) same, same, different (1 mark)

Answer

(a) Price discrimination is a method of pricing adopted by a monopolist in order to earn abnormal profits. It refers to the

practices of charging different prices for different units of the same commodity. Price discrimination is a selling strategy that charges customers different prices for the same product or service based on what the seller thinks they can get the customer to agree to. In pure price discrimination, the seller charges each customer the maximum price they will pay.

[177] There are 4 firms in a market.

Firms	Market Share
A	39.4%
B	19.6%
C	0.4%
D	0.6%

Which type of Market structure can be most suitable here?
(a) Oligopoly
(b) Monopoly
(c) Monopolistic
(d) Perfect Competition (1 mark)

Answer

(a) Oligopoly is often described as 'competition among the few'. Prof. Stigler defines oligopoly as that "situation in which a firm bases its market policy, in part, on the expected behaviour of a few close rivals". In other words, when there are few (two to ten) sellers in a market selling homogeneous or differentiated products, oligopoly is said to exist. Oligopolies mostly arise due to those factors which are responsible for the emergence of monopolies. Unlike monopoly where a single firm enjoys absolute market power, under oligopoly a few firms exercise their power to keep possible competitors out.

[178] A market condition in which there is only a single seller and a single buyer
(a) Monopsony
(b) Bilateral Monopoly
(c) Monopolistic Competition
(d) Oligopoly. (1 mark)

Answer

(b) A bilateral monopoly exists when a market has only one supplier and one buyer. The one supplier will tend to act as a monopoly power and look to charge high prices to the one buyer. The lone buyer will look towards paying a price that is as low as possible.

[179] Charging lower price from senior citizens for railway tickets is an example of ____
(a) Subsidized pricing
(b) Concessional pricing
(c) Price discrimination
(d) Product pricing (1 mark)

Answer

(c) Under the third degree price discrimination, price varies by attributes such as location or by customer segment. Here the monopolist will divide the consumers into separate sub-markets and charge different prices in different sub-markets. **Examples**: Dumping, charging different prices for domestic and commercial uses, lower prices in railways for senior citizens, etc.

[180] Which of the following is not a characteristic of perfect competition–
(a) large no. of sellers and buyers
(b) freedom of entry and exit
(c) Inefficient allocation of resources
(d) Homogeneous Product. (1 mark)

Answer

(c) Inefficient allocation of resources is not a characteristic of perfect competition. A market is said to be perfectly competitive if it has large number of buyers and sellers, homogeneous product, free

entry and exit, perfect mobility of factors of production, perfect knowledge about the market conditions, insignificant transaction costs, no government interference and absence of collusion.

[181] When the industry is dominated by one large firm, then it is _______.
(a) Full oligopoly (b) Syndicated oligopoly
(c) Organised oligopoly (d) Partial oligopoly (1 mark)

Answer

(d) When the industry is dominated by one large firm, then it is partial oligopoly. Oligopoly is a form of imperfect competition and is usually described as the competition among a few. Hence, Oligopoly exists when there are two to ten sellers in a market selling homogeneous or differentiated products. These firms sell homogeneous as well as differentiated products in the market.

[182] In oligopoly, sellers try to act as _________.
(a) Price taker (b) Price maker
(c) Price indicators (d) Price barriers (1 mark)

Answer

(a) Oligopolies are price setters (makers) rather than price takers. Barriers to entry are high. The most important barriers are government licenses, economies of scale, patents, access to expensive and complex technology, and strategic actions by incumbent firms designed to discourage or destroy nascent firms.

[183] The kinked demand curve is designed to explain ________
(a) Price and output determination
(b) Price rigidity
(c) Price leadership
(d) Collusion among rivals (1 mark)

Answer

(b) In the context of oligopoly, the kinked demand curve hypothesis is designed to explain Price rigidity. The curve is more elastic above the kink and less elastic below it. This means that the response to a price increase is less than the response to a price decrease.

[184] In case of monopoly, the price elasticity of demand is ______

(a) elastic (b) more elastic
(c) negative (d) infinite (1 mark)

Answer

(c) Monopoly power, also called market power, is the ability to set price. Firms with market power face a downward sloping demand curve. Hence, negative.

[185] The kinked demand curve model of oligopoly assumes that ______

(a) the response (of consumers) to a price increase is less than the response to a price decrease
(b) the response (of consumers) to a price increase is more than the response to a price decrease
(c) elasticity of Demand is constant
(d) demand is perfectly elastic. (1 mark)

Answer

(a) The kinked demand curve model of oligopoly assumes that response to a price increase is less than the response to a price decrease, response to a price increase is more than the response to a price decrease. Elasticity of demand is constant regardless of whether price increases or decreases.

[186] In which form of the market structure is the degree of control over price of its product by a firm is very large?

(a) Monopoly
(b) Imperfect competition
(c) Oligopoly
(d) Perfect competition (1 mark)

Answer

(a) In monopolistic market structure the degree of control over price of its product by a firm is very large.

[187] Under perfect competition in the long-run there will be ______

(a) Normal profit
(b) Supernormal profit
(c) Production
(d) Cost

Answer

(a) In perfect competition, in the long run, there will be Normal profits. Perfect Competition Long Run equilibrium results in all firms receiving normal profits or zero economic profits.

[188] Degree of control over price is very considerable in ______

(a) Monopoly
(b) Perfect competition
(c) Oligopoly
(d) Monopolistic competition (1 mark)

Answer

(a) In Monopoly market structure the degree of control over the price of its product by a firm very large. In a monopoly type of market structure, there is only one seller, so a single firm will control the entire market. It can set any price it wishes since it has all the market powers. Consumers do not have any alternative and must pay the price set by the seller.

[189] In which of the market firm price discrimination cannot persist.

(a) Monopoly
(b) Oligopoly
(c) Monopolistic Competition
(d) Perfect Competition. (1 mark)

Answer

(d) In a monopoly, the seller adopts this method of pricing to earn abnormal profits. It is important to remember that price discrimination cannot persist under perfect competition since the seller has no control over the market price of the product/service.

[190] Nuclear Power represents which type of market structure:

(a) Government Monopoly
(b) Perfect Competition
(c) Monopolistic Competition
(d) Oligopoly (1 mark)

Answer

(a) Nuclear power represents government monopoly type of market structure.

[191] Monopoly market and Monopsony market combination is called:
(a) Duopoly Market
(b) Oligopoly Market
(c) Bilateral Monopoly Market
(d) Monopolistic Market (1 mark)

Answer

(c) Monopoly market and monopsony market combination is called as bilateral monopoly market.

[192] Marginal revenue curve lies _______ its demand curve in monopolistic competition due to _________
(a) Below; product differentiation
(b) Above; Barriers to entry
(c) Above; Product-differentiation
(d) None of these (1 mark)

Answer

(a) Marginal revenue curve lies **below** its demand curve in monopolistic competition due to **product differentiation**.

2022 - JUNE

[193] In monopoly MR is ____ AR.
(a) Less than
(b) Greater than
(c) Equal
(d) Any of the above (1 mark)

Answer:

(a) In monopoly MR is always less than AR, as AR i.e prices are always greater then marginal revenue to earn economic profit.

[194] Non- Price competition typically occurs with in:
(a) Monopoly
(b) Perfect Competition
(c) Monopolistic
(d) Oligopoly (1 mark)

Answer:

(c) A monopolistic competition has non-price competition. In non price competition all firms are safe and they don't need to reduce the profit margins.
Sellers attempt to provide and promote their products not by cutting prices but by incurring expenditure on publicity and advertisement.

[195] On the upper side of kinked demand curve what is elasticity of demand-
(a) Less elastic
(b) Inelastic
(c) Relatively elastic
(d) Infinite (1 mark)

Answer:

(c) On the upper side of kinked demand curve elasticity of demand is relatively more elastic then elasticity on the lower side of demand curve.

[196] Price rigidity is a concept of -
(a) Perfect competition
(b) Monopoly
(c) Monopolistic
(d) Oligopoly (1 mark)

Answer:

(d) Price rigidity is feature of oligopoly as price does not change easily in response to change in demand. If an firm raises price others keep constant. Hence, it is not rational to keep prices increases, so prices are rigid.

[197] A firm should produce fill MC ____ MR
(a) Greater
(b) Less
(c) Equal
(d) All of the above

Answer:

(c) According to the economic theory, a firm should expand production until the point where marginal cost is equal to marginal revenue.

2022 - DECEMBER

[198] Which of the following statement is correct?

(a) Price rigidity is an important feature of monopoly
(b) Selling Cost are possible under perfect condition
(c) Under perfect competition factor of production do not move freely as there are legal restrictions
(d) An industry consist of many firms (1 mark)

Answer:

(d) Price rigidity is the important feature of oligopoly and not monopoly.

Selling costs are not possible under perfect competition as well as monopoly market. Under perfect competition, there is freedom of entry and exit.

An industry consists of various firms. Hence, **option (d)** is correct.

[199] In which type of market there are large number of buyer and seller with identical produces:

(a) Imperfect competition
(b) Oligopoly
(c) Perfect competition
(d) Monopolistic competition (1 mark)

Answer:

(c) Features of perfect competition:

1. Large number of buyers and sellers.
2. Homogenous / identical products.
3. Free entry and exit.
4. Perfect knowledge of the market conditions on the part of buyers and sellers.
5. Negligible transaction costs.
6. All firms are individual price takers.

[200] Kinked demand curve is also known as:

(a) Sweezy's model
(b) Adam's model
(c) Revisionary model
(d) Economic trade model (1 mark)

Answer:

(a) The kinked demand curve hypothesis given by an American economist Paul A Sweezy. Hence, this is called Sweezy's model.

[201] On the upper part of kinked demand curve the demand is:

(a) Elastic
(b) Inelastic
(c) Neutral
(d) None of the above (1 mark)

Answer:

(a) The upper segment of the kinked demand curve is relatively elastic and the lower segment is relatively inelastic. The difference in elasticities is due to the particular competitive reaction pattern assumed by the kinked demand curve hypothesis.

[202] The long run equilibrium of a competitive firm is achieved at:

(a) LAR = LMR = P = LMC = LAC
(b) LMR = LAR = LMC +1 = LAC
(c) LAR = LMR +1 = P+1 = LAC
(d) P = LMC = LAC - LMR + LAR (1 mark)

Answer:

(a) In the long run, under perfect competition, the market mechanism leads to optimal allocation of resources. The optimality is shown by the following outcomes associated with the long run equilibrium of the industry.

(a) The output is produced at the minimum feasible cost
(b) Consumer pay the minimum possible price which just covers the marginal cost i.e. MC = AR. (P = MC)
(c) Plant are used to fully capacity in the long run, so that there is no wastage of resources i.e. (MC = AC)
(d) Firm earn only normal profits i.e. AC = MR

(e) Firm maximize profits (i.e. MC = MR), but the level of profits will be just normal

(f) There is optimum number of firm in the industry.
LAR = LMR = P = LMC = LAC

[203] The producer is an oligopolistic market fixes its price at:
(a) A price less than the price charged by a monopoly as well as a perfectly competitive market
(b) A price more than the price charged by a perfectly competitive market as well as a monopoly
(c) A price higher than the one charged by a monopoly and less than that of a perfectly competitive market
(d) A price higher than that charged by a perfectly competitive market and less than that of a monopoly. (1 mark)

Answer:
(d) The producer in an oligopolistic market fixes its price at a price higher than that charged by a perfectly competitive market and less than that of a monopoly.

[204] Which of the following is a behaviour of oligopoly?
(a) Group behaviour
(b) Individual behaviour
(c) Relative behaviour
(d) None of the above (1 mark)

Answer:
(a) The theory of oligopoly is a theory of group behaviour, not of mass or individual behaviour and to assume profit maximising behaviour.

[205] Where there are large number of letters in a market and there is very high degree of competition between them, the elasticity of supply is:
(a) infinite
(b) zero
(c) more than one
(d) less than one (1 mark)

Answer:
(b) Where there are large number of sellers in a market, and there is very high degree of competition between them, the elasticity of supply is zero.

[206] Which of the following market may earn supernormal profit in the long run:
(a) Perfect competition
(b) Monopoly
(c) Monopolistic
(d) None of these (1 mark)

Answer:
(b) Monopoly being only single seller in the market can earn supernormal profits in the long run.

2023 - JUNE

[207] "Product differentiation" is characteristic of:
(a) Perfect competition
(b) Oligopoly competition
(c) Monopolistic competition
(d) Duopoly competition (1 mark)

Answer:
(b) **Monopolistic Competition**
Product Differentiation is essential feature of Monopolistic competition.

[208] "Kinked demand curve" hypothesis explains which of the following concept?
(a) Price leadership
(b) Price rigidity
(c) Group behaviour
(d) Independent pricing (1 mark)

Answer:

(b) **Price Rigidity**

"Kinked Demand Curve" in Oligopoly explains the concept of Price rigidity.

[209] In which type of Market, product is homogeneous in nature?

(a) Pure Oligopoly
(b) Pure Monopoly
(c) Pure Duopoly
(d) Pure Competition (1 mark)

Answer:

(d) **Pure Competition**

Pure Competition is a market where there are large number of buyers and sellers dealing with same homogeneous good and there is free to entry and free exit.

[210] When new firm enter into market and compete with existing firm is a situation called?

(a) Open Oligopoly
(b) Open Dligopoly
(c) Collusive Ougopoly
(d) Competitive Oligopoly (1 mark)

Answer:

(a) **Open Oligopoly**

On the basis of entry and exit, oligopoly is classified as open oligopoly and close oligopoly. Here, new firms are entering and competing with existing firm. It is open oligopoly.

[211] Which of the following is characteristics of Monopoly ?

(a) Industry is dominating by larger no. of firms
(b) Freedom to entry and exit
(c) No close substitutes
(d) Only two firms in the market (1 mark)

Answer:

(c) **No Close Substitutes**

Monopoly is characterised by No close substitutes and Single seller.

[212] Not an objective of Price Discrimination?

(a) To enjoy Economics of scale
(b) To dispose off surplus stock
(c) To escape foreign market
(d) To secure equity through pricing (1 mark)

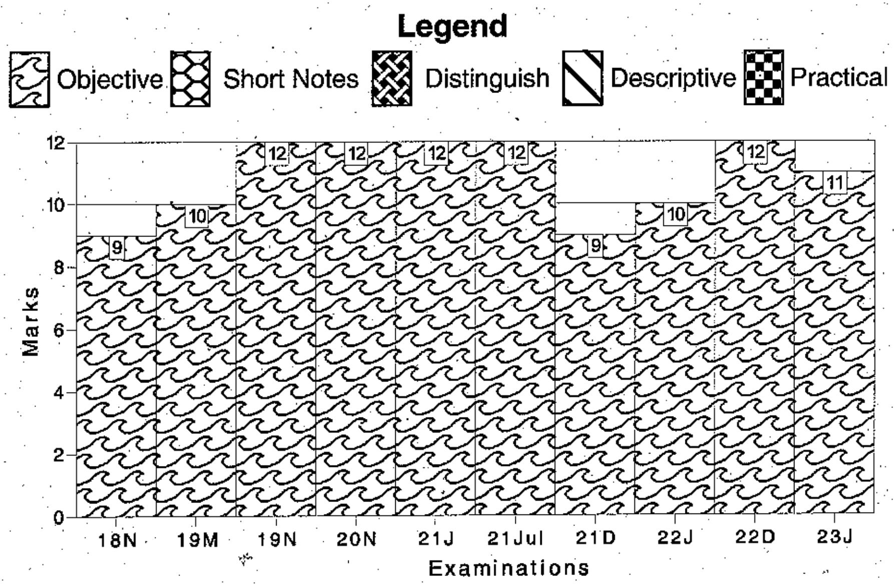
Answer:

(c) **To Escape Foreign Market**

To escape foreign market is not an objective of price discrimination.

5 BUSINESS CYCLES

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



PAST YEAR QUESTIONS AND ANSWERS

2018 - MAY

[1] Rampant unemployment is found in:
(a) Boom
(b) Recovery
(c) Contraction
(d) Depression (1 mark)

Answer:

(d) Because very much unemployment is seen in depression.

[2] According to which economist trade cycle is a purely monetary phenomenon
(a) Schumpeter (b) Pigou
(c) Hawtrey (d) Marshall (1 mark)

Answer:

(c) 'Trade cycle is purely Monetary phenomenon' is said by one and only Hawtrey

[3] Greatest depression suffered by economy in which year.
(a) 1924 (b) 1930
(c) 2008 (d) 2009 (1 mark)

Answer

(b) 1930 is a year in which greatest depression suffered by economy

[4] Last stage of recession is called:
(a) Depression
(b) Recovery
(c) Slowdown
(d) All of these. (1 mark)

Answer:

(a) Depression is the last stage of recession and not slowdown and recovery

[5] In the long run, a reduction in labour supply would cause output to ____ and the aggregate price level to ______.

(a) fall; rise (b) fall, fall
(c) rise, fall (d) rise, rise. (1 mark)

Answer:

(a) If firm in long run, reduce supply of labour then it will cause fall in output whereas rise in aggregate price.

[6] Which of the following macro economic variables would you include in an index of leading economic indicators?

(a) Employment (b) Inflation
(c) Real interest rates (d) Residential investment (1 mark)

Answer:

(d) The variables that change before the real output changes are called' leading indicators'. They often change prior to large economic adjustment. It will include residential investment as one of its variables.

[7] Industries that are extremely sensitive to the business cycle are the

(a) durable goods and service sectors
(b) non durable goods and service sectors
(c) capital goods and non-durable goods sectors
(d) capital goods and durable goods sectors (1 mark)

Answer:

(d) Capital goods and durable goods both are of same nature i.e. long term period. These both goods are extremely sensitive to the business cycle. Without these business can not go smooth by.

[8] An economic variable that moves in the opposite direction as aggregate economic activity down in expansions, up in contractions is called.

(a) procyclical (b) counter cyclical
(c) a cyclical (d) a leading variable (1 mark)

Answer:

(b) An economic variable that moves in the opposite direction as aggregate economic activity (down in expansion and up in contraction) is called counter cyclical

2018 - November

[9] How many phases are their in business cycle?

(a) Four
(b) Five
(c) One
(d) Many (1 mark)

Answer:

(a) Business cycle has 4 Phases; expansion, peak contraction, trough.

[10] The world economy suffered the longest, deepest and most widespread depression of the 20^{th} century during?

(a) 1934
(b) 1928
(c) 1930
(d) 1932 (1 mark)

Answer:

(c) The world economy suffered most widespread depression of the 20^{th} Century during 1930s. It started in US.

[11] Business cycle is contagious and _______ in character?

(a) Local
(b) Regional
(c) National
(d) International (1 mark)

Answer:

(d) Business cycle is International in character as it effects all over the world.

[12] Which External Factor affect the business cycle?

(a) Population growth
(b) Variation in government spending
(c) Money supply
(d) Macro economic policies (1 mark)

Answer:

(a) Population growth is the factor which affects business cycle.

[13] Which internal factor affect the Business cycle?
(a) Fluctuations in investment
(b) Natural factors
(c) Technology shocks
(d) Population growth (1 mark)

Answer:

(a) Fluctuations in Investment is the Internal factor which affect business cycle.

[14] Whose statement out of these is false?
(a) Hawtrey – "Trade cycle is purely Monetary phenomena"
(b) Keynes – "Fluctuations in aggregate Demand"
(c) Pigou – "Fluctuations in investment"
(d) Schumpeter – "Innovations" (1 mark)

Answer:

(c) According to Pigou, modern business activities are based on anticipation of business community and are affected by waves of optimism or pessimism.

[15] When once peak is reached, increase in demand is halted, then _____ phase begins?
(a) Trough
(b) Contraction
(c) Expansion
(d) Trend (1 mark)

Answer:

(b) Once peak is reached, increase in demand is halted and start decreasing in certain sectors and therefore, phase of contraction begins.

[16] Fashion Retailer is business of?
(a) Cyclical business
(b) Sun rise business
(c) Sluggish business
(d) None of these (1 mark)

Answer:

(a) Business whose fortunes are closely by related to the rates of economic growth are referred to as cyclical business.

[17] Features of business cycles include?
(a) Occurs periodically
(b) Have four different phases
(c) Originate in free Market Economy
(d) All of the above. (1 mark)

Answer:

(d) Feature of business cycle are:
1. It occurs periodically although they do not exhibit same regularity
2. They have four distinction phases.
3. It occurs in free market economy.
4. It is pervasive in nature

Therefore, **(d)** is the right option all of the above.

2019 - MAY

[18] Which of the following is true about leading indicators?
(a) Measurable economic factors
(b) Changes after real output
(c) Both (a) and (b)
(d) None (1 mark)

Answer :

(a) A leading indicator is a measurable economic factor that changes before the economy starts following a particular trend/pattern.

[19] The internal causes of business cycle is
(a) Fluctuation in effective demand
(b) Technology shocks
(c) Both (a) and (b)
(d) None (1 mark)

Answer :

(a) Business Cycle is the downward and upward movement of Gross Domestic Product (GDP) around its long term growth trend. The internal causes of such movement includes:

(i) Fluctuations in effective demand
(ii) Fluctuations in investment
(iii) Variation in government spending
(iv) Macro economic policies
(v) Money supply
(vi) Psychological factors

The external causes are:
(i) Post war reconstruction
(ii) Technology shocks
(iii) Natural factors
(iv) Population growth.

[20] Economics activities will be declining in the phase of ________
(a) Expansion
(b) Depression
(c) Contraction
(d) Peak (1 mark)

Answer :

(c) An expansion is characterised by increasing employment, economic growth and upward pressure on prices. A peak is the highest point when the economy is at maximum allowable output, full employment.

Contraction is characterised where growth slows, economic activities declines pricing pressure subside.

Depression is the point where the economy has hit a bottom from which next phase of expansion and contraction will emerge.

[21] Business Cycle occurs
(a) Periodically
(b) In different phases
(c) Both (a) and (b)
(d) None of the above (1 mark)

Answer :

(c) Business cycle have certain features such as:
- It occurs periodically although they do not exhibit the same regularity. Its duration and intensity varies.

- It have distinct phases of expansion, peak, contraction and trough with indefinite length.

Thus, **option (c)** is correct.

[22] According to some economists,____________are the prime causes of business cycles.
(a) Fluctuations in effective demand
(b) Fluctuations in investments
(c) Macroeconomic policies
(d) All of the above (1 mark)

Answer :

(b) Business cycles occur due to various causes which can be both external or internal. These includes:
- Fluctuations in effective demand
- Fluctuations in investment (Prime Cause)
- Variation in Government spending
- Macro economic policies
- Money supply.

Hence, **option (b)** is correct.

[23] Which is not related to great depression of 1930?
(a) It started in USA
(b) John Maynard Keynes regarded lower aggregate expenditure as the cause
(c) Excess Money Supply
(d) Both (a) and (b) (1 mark)

Answer :

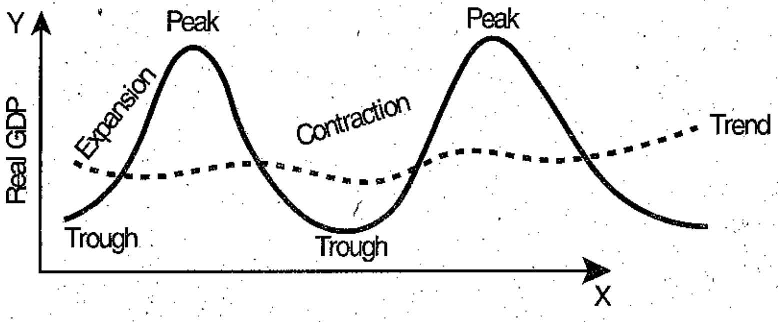
(c) The Great Depression of 1930 was started in US and became worldwide. The British economist John Maynard Keynes regarded lower aggregate expenditures in the economy to be a cause of massive decline in employment and income. The economies of the world came out of recession and entered the expansion phase due to increase in money supply, international inflow of gold, rise in government spending etc.

Thus, **option (c)** is not related to great depression of 1930.

[24] Which of the following is not the phase of business cycles?
(a) Prosperity
(b) Upswing
(c) Reconstruction
(d) Depression (1 mark)

Answer :

(c) A typical business cycle has 4 distinct phases
1. Expansion/upswing
2. Peak/Prosperity
3. Contraction/Downswing/Recession
4. Trough/Depression



[25] Boom and depression in business cycle are
(a) Turning points
(b) Equilibrium points
(c) Both (a) and (b)
(d) None of the above (1 mark)

Answer :

(a) Boom and depression are the turning points. Boom or Peak is the highest point where economic growth stabilises for short time and then moves in reverse direction and same is with trough or depression.

[26] Which is not the characteristic feature of expansion phase in business cycle ?
(a) Increase in national output
(b) Unemployment
(c) Rise in price and costs
(d) Boost in business confidence (1 mark)

Answer: (b)

(b) Expansion phase in business cycle is characterised by increase in national output, more employment opportunities, sales, profits, rising stock prices. Prices and costs also tend to rise faster. There is an increase in prosperity, high standard of living, business confidence. The growth rate slowly reaches to the peak. Thus, unemployment is not the characteristic feature of this phase

[27] "Modern business activities are based on the anticipations of business community and are affected by waves of optimism or pessimism, according to ____
(a) Pigou
(b) Keynes
(c) Hawtrey
(d) Schumpeter (1 mark)

Answer:

(a) According to Pigou, "Modern business activities are based on the anticipations of business community and are affected by waves of optimistic or pessimism".

2019 - NOVEMBER

[28] Find the odd man out:
Which of these is not a coincident factor?
(a) Retail sale
(b) Industrial production
(c) Inflation
(d) New orders for plant & machine (1 mark)

Answer:

(d) Coincident indicator are also called concurrent indicators, coincide or occur simultaneously with the business - cycle movements.

For Example: (GDP) Gross domestic product

- Industrial production
- Inflation
- Personal income
- Retail sale
- Financial market trends.

But new orders for plant and machine is a leading indicator.

[29] Excess capacity in capital industries leads to

(a) Peak
(b) Trough
(c) Expansion
(d) Recovery (1 mark)

Answer:

(b) Excess capacity in capital industries leads to trough a typical feature of depression is the fall in the interest rate. With lower interest rate, the demand for holding liquid money (i.e. in cash) increases. Industries, especially capital and consumer durable goods industry, suffer from excess capacity.

[30] Here, growth moves in reverse direction

(a) Peak
(b) Expansion
(c) Contraction
(d) Recovery (1 mark)

Answer:

(a) The term peak refers to the top or the highest point of the business cycle. In the later stages of expansion, inputs are difficult to find as they are short of their demand and therefore input prices increases. This is the end of expansion and it occurs when economic growth has reached a point where it will stabilize for a short time and then move in the reverse direction.

[31] Frictional unemployment exists in

(a) Peak
(b) Contraction
(c) Expansion
(d) Recovery (1 mark)

Answer:

(c) Frictional unemployment exists in expansion phase i.e., there is increase in national output there is involuntary unemployment is almost zero and whatever unemployment is there is either frictional (i.e. due to change of jobs, or suspend word due to strikes or due to imperfect mobility of labour etc.

[32] In which stage maximum production occurs.

(a) Peak
(b) Expansion
(c) Boom or Expansion
(d) Trough or boom (1 mark)

Answer:

(a) The term peak refers to the top or highest point of the business cycle. Here in this stage maximum production occurs. Inputs are difficult to find as they are short of their demand and therefore input prices increases. This stage is the end of expansion and it occurs when economic growth has reached a point where it will stabilize for short period of time.

[33] Unemployment is caused due to structural changes is known as?

(a) Ethnic unemployment
(b) Involuntary unemployment
(c) Structural
(d) None (1 mark)

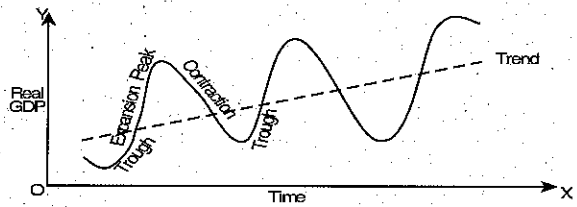
Answer:

(c) Unemployment is caused due to structural changes is known as structural unemployment. It is almost zero and whatever unemployment is there is either fictional (i.e. due to change of jobs, strike) or structural unemployment caused due to structural changes in the economy. And all these types of unemployment occur in expansion phase.

[34] At trough production is?
(a) High
(b) Low
(c) Negative
(d) None (1 mark)

Answer:

(b) At trough production is low. It is a situation where there is lower rate of interest people's demand for holding liquid money (i.e. in cash) increases.
Despite lower interest rates, the demand for credit declines because investors confidence has fallen. At the depth of depression all economic activities touch the bottom and the phase of trough is reached. It is a very agonizing period causing lots of distress for all.



[35] Stage at which actual demand is stagnated?
(a) Peak
(b) Boom or Peak
(c) Contraction
(d) Tough (1 mark)

Answer:

(b) Peak is a stage at which actual demand is stagnates. As peak refers to the top or highest point of the business cycle. Output prices also rise rapidly leading to increased cost of living and greater strain on fixed income earners. Consumers begin to review their consumption expenditure on housing, durable goods etc. Actual demand stagnates. This is the end of expansion and it occurs when economic growth has reached a point where it will stabilize for a short time and then move in the reverse direction.

[36] A change of reaction producer cancel their order in which, stage?
(a) Peak
(b) Contraction
(c) Trough
(d) None (1 mark)

Answer:

(b) Contraction is a stage where economy cannot endless by grow. During contraction, there is fall in the levels of investment and employment. Producers being aware of the fact that they have indulged in excessive investment and over production, respond by holding back future investment plans, cancellation and stoppage of orders for equipments and all types of inputs including labour.

[37] Which of the following is true:
(a) Depression is severe form of trough
(b) Depreciation causes fall in interest rate.
(c) Both (a) and (b)
(d) None (1 mark)

Answer:

(a) Depression is the severe form of trough. During this phase of business cycle growth rate becomes negative and the level of national income and expenditure declines rapidly. Demand for products and services decreases, prices are at their lowest and decline rapidly forcing firms to shutdown several production facilities decreases, prices are at their lowest.
It is a very agonizing period causing lots of distress for all.

[38] China's recent slowdown caused
(a) Cycle of decline and panic across the world.
(b) Countries across the globe were able to insulate themselves from the crisis.
(c) Stock Markets in the emerging economics largely remained unaffected
(d) Old technology fueled the economic decline. (1 mark)

Answer:

(a) A decline in China's economy had caused adverse affect on other countries. It causes decline and panic across the world.

Business cycles are contagious and are international in character. They begin in one country and mostly spread to other countries through trade relations. For example, the great depression of 1930s in the USA and Great Britain affected almost all the countries, especially the capitalist countries of the world.

[39] What of the following are not external causes?
(a) Past war reconstruction
(b) Population growth
(c) Technology factors
(d) Fluctuation in effective demand (1 mark)

Answer:

(d) External cause or exogenous factors which may lead to boom or bust are :
(a) Wars
(b) Post war Reconstruction
(c) Technology shocks
(d) Natural shocks
(e) Population growth
∴ Illustration in effective demand is a internal cause.

2020 - November

[40] Modern business activities are based on the anticipations of business community and are affected by waves of optimism (or) Pessimism is said by:
(a) Hawtrey
(b) Pigou
(c) Keynes
(d) Schumpeter (1 mark)

Answer:

(b) The famous author Pigou said Modern business activities are based on the anticipations of business community and are affected by waves of optimism (or) pessimism.

[41] Which of the following phase occurs after threat and before peak?
(a) Expansion
(b) Depression
(c) Boom
(d) Recession (1 mark)

Answer:

(a) Expansion is the phase which occurs after trough and before peak. Expansion is characterized by increase in national output and an other economic variables.

[42] Which indicators coincide as occur simultaneously with the business cycle movements?
(a) Lagging
(b) Leading
(c) Concurrent
(d) Legal. (1 mark)

Answer:

(c) Coincident economic indicators also called as concurrent indicators coincide or occurs simultaneously with the business cycle movements.

[43] What is the most visible sign of recession in an economy?
(a) Fall in the level of employment
(b) Rise in the inventory cost
(c) Full in price level
(d) Weakening stock market (1 mark)

Answer:

(c) Falls in the price level is the most appropriate and visible sign of recession in an economy.

[44] Taxation policy of government is the part of:
(a) Monetary Policy
(b) Fiscal Policy
(c) Exim Policy
(d) Industry Policy (1 mark)

Answer:

(b) Taxation policy of government comes under fiscal policies of the government.

[45] During the phase of tough of business cycle, the growth rate become:
(a) High
(b) Low
(c) Negative
(d) Zero (1 mark)

Answer:

(c) During the phase of trough of business cycle the growth rate becomes negative.

[46] ______ is measurable economics factor that changes before economy starts to follow a particulars pattern of trend.
(a) Leading indicator
(b) Coincident indicator
(c) Heading indicator
(d) Concurrent indicator (1 mark)

Answer:

(a) A Leading indicator is a measurable economic factor that changes before the economy starts to follow a particular pattern or trend i.e. they change before the real output changes.

[47] Which of the following is an internal cause of business cycles?
(a) Wars
(b) Natural factors
(c) Fluctuation in effective demand
(d) Population growth (1 mark)

Answer:

(c) Fluctuation in effective demand are the internal causes of business cycle rest are the external causes of business cycle.

[48] Phases of business cycles are:
(a) Expansion, peak, contraction and trough
(b) Bottom, recession, tough and boom
(c) Peak, depression, trough and boom
(d) Peak, depression, bust and boom (1 mark)

Answer:

(a) Phases of business cycles are:
Expansion, peak, contraction and trough.

[49] Which is not an example of coincident indicator?
(a) Inflation
(b) GDP
(c) Interest rate
(d) Financial market trend (1 mark)

Answer:

(c) Interest rate is not the example of coincident indicators rest are the examples of coincident indicators.

[50] During the phase___there is fall in level of investment and employment.
(a) contraction
(b) depression
(c) boom
(d) recovery (1 mark)

Answer:

(a) During the phase of contraction there is fall in the level of investment and employment.

[51] The most important feature of business cycle is:
(a) Persuasive nature
(b) Regular length
(c) Periodic intensity
(d) None (1 mark)

Answer:

(a) Persuasive nature is the most important feature of a business cycle.

2021 - JANUARY

[52] Feature of ______ is fall in interest rates and people's demand for holding liquid money.
(a) Contraction
(b) Peak
(c) Trough & Depression
(d) Recovery (1 mark)

Answer:

(c) Trough and Depression

Feature of Trough and depression is fall in interest rates and people demand for holding liquid money.

[53] Business that are more vulnerable to charges in business cycle and whose fortunes are closely linked to rate of economic growth are called as _________.

(a) Vulnerable Business
(b) Cyclical Business
(c) Leading Business
(d) Lagging Business (1 mark)

Answer:

(b) Cyclical business

Business that are more vulnerable to changes in business cycle and whose features are closely linked to rate of economic growth are called as cyclical business.

[54] Optimistic and Pessimistic mood of business community also affects the economic activities is view of _________.

(a) Hawtrey
(b) Schumpeter
(c) Pigou
(d) Marshall (1 mark)

Answer:

(c) Pigou

Optimistic and Pessimistic mode of business community also effects the economic activities in view of Pigou.

[55] According to hawtrey, which of the following is correct?

(a) Trade Cycle occurs as a result of innovation
(b) Trade Cycle is purely monetary phenomenon
(c) Fluctuation in economy activity is due to fluctuation in demand
(d) Fluctuation in government expenditure (1 mark)

Answer:

(b) Trade cycle is purely monetary phenomenon

According to Hawtrey, Trade cycle is purely monetary phenomenon.

[56] The term business cycle refers to

(a) The ups and downs in production of commodities
(b) The fluctuation levels of economic activity over a period of time
(c) Decline in economic activities over prolonged period of time
(d) Increasing unemployment rate and diminishing rate of savings (1 mark)

Answer:

(b) The fluctuating levels of economic activity over a period of time

The term business cycle refers to fluctuating level of economic activity over a period of time.

[57] During recession, the unemployment rate _____ and output _____.

(a) Rises; Falls
(b) Rises; Rises
(c) Falls; Rises
(d) Falls; Falls (1 mark)

Answer:

(a) Rises; falls

During recession, the unemployment rate rises and output falls.

[58] Which of the following is not a characteristic of business cycles?

(a) Business cycles have serious consequences on the well being of the society
(b) Business cycles occur periodically, although they do not exhibit the same regularity
(c) Business cycles have uniform characteristics and causes
(d) Business cycles are contagious and un predictable (1 mark)

Answer:

(c) Business cycle have uniform characteristics and causes.

Business cycle do not have uniform characteristics and causes.

[59] According to ______ trade cycles occurs due onset of innovations.

(a) Hawtrey
(b) Adam Smith
(c) J. M. Keynes
(d) Schumpeter (1 mark)

Answer:

(d) Schumpeter

According to Schumpeter trade cycle occur due to onset of innovations.

[60] A measurable economic factor that changes before the economy starts follows particulars pattern/trend is:

(a) Leading Factor
(b) Lagging Factor
(c) Coincident Factor
(d) Concurrent Factor (1 mark)

Answer:

(a) Leading Factor

A measurable economic factor that changes before the economy starts follows particular trend is leading factors.

[61] Coincident indicators are also known as____

(a) logging indicators
(b) Concurrent indicators
(c) Effective indicators
(d) Leading indicators (1 mark)

Answer:

(b) Concurrent indicators

Coincident Indicators are known as concurrent indicators.

[62] Business cycle is contagious and ______ in character?

(a) Local
(b) Regional
(c) National
(d) International (1 mark)

Answer:

(d) International

Business cycle is international in character as it effects all over the world.

[63] The world economy suffered the longest deepest and most widespread depression of the 20th century during:

(a) 1934
(b) 1928
(c) 1930
(d) 1932 (1 mark)

Answer:

(c) 1930

The world economy suffered most widespread depression of the 20th century during 1930's. It started in US.

2021 - JULY

[64] Variable that change before the real output change are called as:

(a) Leading indicators
(b) Trade cycle
(c) Lagging indicators
(d) Business cycle (1 mark)

Answer:

(a) Leading Indicator

A measurable economic factor that changes before the economy starts follows particular trend is known as leading factor.

[65] Which business cycle phases are known as Turning point?

(a) Trough and Depression
(b) Peak and Trough
(c) Expansion and contraction
(d) Peak and Boom (1 mark)

Answer:

(b) Peak and troughs of business cycle are known as collectively Turning points.

[66] Variables that change after real output changes are known as:
(a) Leading indicators
(b) Cyclical indicators
(c) Lagging indicators
(d) Coincident indicators (1 mark)

Answer:

(c) Variables that changes after real output changes are known as lagging indicators.

[67] In which of the following phase of a business cycle, actual demand stagnates?
(a) Expansion
(b) Peak
(c) Contraction
(d) Recovery (1 mark)

Answer:

(b) This is the end of expansion and it occur when economic growth has reached a point where it will be stabilize for short time "Actual demand stagnates." In peak of business cycle where actual demand stagnates.

[68] In a typical business cycle, in which phase supply exceeds demand:
(a) Expansion
(b) Peak
(c) Contraction
(d) Recovery (1 mark)

Answer:

(c) In a Contraction of business cycle where "Supply exceeds demand". The consequences is mismatch between demand and supply.

[69] The rhythmic Fluctuations in aggregate economic activity that an economy experiences over a period of time is called:
(a) Business cycle
(b) Recession
(c) Contraction phase
(d) Recovery (1 mark)

Answer:

(a) The rhythmic fluctuations is aggregate economic activities that an economy experiences over a period of time are called "Business Cycle".

[70] Which phase of business cycle is characterised by increase in national output, employment, aggregate demand, capital and consumer expenditure sales, profits etc.?
(a) Depression
(b) Contraction
(c) Trough
(d) Expansion (1 mark)

Answer:

(d) The expansion phase is characterised by increase in National output, employment, aggregate demand, sales, profit, rising stock prices. This states continue till there is full employment of resources and production is at maximum.

[71] Coincident economic indicators are also called as:
(a) Leading indicators
(b) Headed indicators
(c) Concurrent indicators
(d) Capacity indicators (1 mark)

Answer:

(c) Coincident economic indicator also called concurrent indicators, coincide or occur simultaneously with the business cycle movement.

[72] Which of the following is not a features of business cycle?
(a) Business cycle are contagious and are international in character
(b) Business cycle have uniform characteristics and causes
(c) Business cycle have serious consequences on the well being of the society
(d) Business cycle generally original in free market economics (1 mark)

Answer:

(b) Business cycle have uniform characteristics and cause. It is not a feature of Business Cycle.

Features of Business Cycle:
- Business cycle occur periodically.
- Business cycles have distinct phases expansion peak, contraction and trough.
- Business cycle do not have uniform characteristics and causes.

[73] Internal cause of Business cycle is:
(a) Fluctuations in investment
(b) Natural factors
(c) Technology shocks
(d) Population growth (1 mark)

Answer:
(a) Internal cause of Business Cycle are:
(i) Fluctuations in Effective demand
(ii) Fluctuations in Investment
(iii) Variations in government spending
(iv) Macro Policies
(v) Money Supply

[74] Excess capacity in capital industries leads to
(a) Peak
(b) Trough
(c) Expansion
(d) Recovery (1 mark)

Answer:
(b) Excess capacity in capital industries leads to trough a typical feature of depression is the fall in the interest rate. With lower interest rate, the demand for holding liquid money (i.e. in cash) increases. Industries, especially capital and consumer durable goods industry, suffer from excess capacity.

[75] According to whom "Business Fluctuation are the outcome of some Psychological states of mind of business community":
(a) Marshall
(b) A. C. Pigou
(c) J. K. Hicks
(d) Schumpeter (1 mark)

Answer:
(b) According to Pigou, Modern business cycle activities are based on the anticipation of business community and are affected by waves of optimism or pessimism. Business fluctuation are the outcome of these psychological state of mind of businessmen.

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[76] ________ is when economic activity is increasing?
(a) Peak
(b) Depression
(c) Expansion
(d) Contraction. (1 mark)

Answer
(c) The economy is moving out of recession. Money is cheap to borrow, businesses build up **inventories** again and consumers start spending. GDP rises, **per capita income** grows, unemployment declines, and equity markets generally perform well.

[77] According to which economist, trade cycle is a purely monetary phenomenon
(a) Schumpeter
(b) Pigou
(c) Hawtrey
(d) Marshall (1 mark)

Answer
(c) According to Hawtrey, trade cycle is a purely monetary phenomenon. Unplanned changes in the supply of money may cause business fluctuation in an economy.

[78] ________ is a measurable economic factor that changes at the same time when economy starts to follow a particular pattern of trend.
(a) Leading Indicators (b) Coincident Indicator
(c) Lagging Indicator (d) Heading Indicator.
(1 mark)

Answer

(b) A third type of indicator is coincident indicator. Coincident economic indicators, also called concurrent indicators, coincide or occur simultaneously with the business-cycle movements. Since they coincide fairly closely with changes in the cycle of economic activity, they describe the current state of the business cycle. In other words, these indicators give information about the rate of change of the expansion or contraction of an economy more or less at the same point of time it happens. A few examples of coincident indicators are Gross Domestic Product, industrial production, inflation, personal income, retail sales and financial market trends such as stock market prices.

[79] According to _____ fluctuations in economic activities are due to fluctuations in aggregated effective demand.

(a) Keynes
(b) Hawtrey
(c) Pigou
(d) Marshall (1 mark)

Answer

(a) According to Keynes, fluctuations in economic activities are due to fluctuations in aggregate effective demand (Effective demand refers to the willingness and ability of consumers to purchase goods at different prices). In a free market economy, where maximization of profits is the aim of businesses, a higher level of aggregate demand will induce businessmen to produce more. As a result, there will be more output, income and employment. However, if aggregate demand outstrips aggregate supply, it causes inflation.

[80] ________ phase is categorized by increase in national output, employment, aggregate demand, capital & consumer expenditure.

(a) Expansion
(b) Contraction
(c) Peak
(d) Trough (1 mark)

Answer

(a) The expansion phase is characterised by increase in national output, employment, aggregate demand, capital and consumer expenditure, sales, profits, rising stock prices and bank credit. This state continues till there is full employment of resources and production is at its maximum possible level using the available productive resources. Involuntary unemployment is almost zero and whatever unemployment is there is either frictional (i.e. due to change of jobs, or suspended work due to strikes or due to imperfect mobility of labour) or structural (i.e. unemployment caused due to structural changes in the economy). Prices and costs also tend to rise faster. Good amounts of net investment occur, and demand for all types of goods and services rises. There is altogether increasing prosperity and people enjoy high standard of living due to high levels of consumer spending, business confidence, production, factor incomes, profits and investment. The growth rate eventually slows down and reaches its peak.

[81] In India, Monetary policy is implemented by _____.

(a) RBI
(b) SEBI
(c) SBI
(d) ICICI (1 mark)

Answer

(a) The Reserve Bank of India (RBI) is vested with the responsibility of conducting monetary policy. This responsibility is explicitly mandated under the Reserve Bank of India Act, 1934.

[82] Highest point of business cycle is known as ______

(a) Peak
(b) Expansion
(c) Contraction
(d) Trough (1 mark)

Answer

(a) The term peak refers to the top or the highest point of the business cycle. In the later stages of expansion, inputs are difficult to find as they are short of their demand and therefore, input prices increase. Output prices also rise rapidly leading to increased cost of living and greater strain on fixed income earners. Consumers begin to review their consumption expenditure on housing, durable goods etc. Actual demand stagnates. This is the end of expansion and it occurs when economic growth has reached a point where it will stabilize for a short time and then move in the reverse direction.

[83] Which of the following is the characteristic of business cycle?

(a) It is sporadic in nature
(b) It is contagious
(c) It is complex in nature
(d) They have uniform characteristics (1 mark)

Answer

(b) Business cycles are contagious and are international in character. They begin in one country and mostly spread to other countries through trade relations. **For example,** the great depression of 1930s in the USA and Great Britain affected almost all the countries, especially the capitalist countries of the world.

[84] Economic indicator required to predict the turning point of business cycle is:

(a) Leading Indicator
(b) Lagging Indicator
(c) Coincident
(d) All of the above (1 mark)

Answer

(d) Economic indicator required to predict the turning point of business cycle is:
(a) Leading indicator
(b) Lagging indicator
(c) Coincident

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[85] Involuntary unemployment is zero in:

(a) Expansion
(b) Peak
(c) Contraction
(d) Trough (1 mark)

Answer

(a) In expansion, involuntary unemployment is almost zero and whatever unemployment is there is either frictional or structural.

[86] Actual Demand Stagnates in:

(a) Expansion
(b) Contraction
(c) Peak
(d) Trough (1 mark)

Answer

(c) Actual Demand Stagnates when there is a end in expansion and beginning of peak.
So demand stagnates at "peak". Here, consumers begin to review there expenditure.

[87] Typical feature of depression is ________ in the interest rate:

(a) Fall
(b) Rise
(c) Constant
(d) None of the above (1 mark)

Answer

(a) Depression is the severe form of recession people; demand for liquid money increase resulting in decrease/fall in interest rates. Fall in interest rate is a typical feature of depression.

[88] Indicator which changes after the real output changes?

(a) Lagging Indicator (b) Coincident indicator
(c) Leading Indicator (d) Concurrent Indicator
(1 mark)

Answer

(a) Lagging indicators reflect the economies historical performance they are observable after an economic trend or pattern already occurred.
Variables that change after real output changes are "Lagging indicators".

[89] Coincident indicator is also known as:
(a) Concurrent Indicator
(b) Lagging Indicator
(c) Leading Indicator
(d) None of the above (1 mark)

Answer

(a) Coincident indicator is also known as concurrent indicator as these are occurring simultaneously with the business cycle movements.

[90] What is leading indicator in the following?
(a) Change in GDP
(b) Change in Stock
(c) Unemployment
(d) Commercial leading Activity (1 mark)

Answer

(b) Leading indicators are:
(i) Changes in stock price.
(ii) New orders for capital goods.
(iii) New orders for consumer goods.

[91] ________sector can not be a cyclical business.
(a) Electric goods
(b) House building
(c) Agriculture
(d) Restaurant (1 mark)

Answer

(c) Business whose fortunes are closely linked to the rate of economic growth are cyclical businesses.
Ex- Fashion Retailers, electric goods, restaurants, house building.

[92] Which of the following is correct?
(a) Recession is severe form of depression
(b) Depression in a severe form of recession
(c) In case of depression interest rates rises
(d) All of the above (1 mark)

Answer

(b) Depression is severe form of recession.
Recession when is complete and severe contraction in the economic activities pushes economy into phases of depression.

[93] The lowest point in the business cycle is referred to as -
(a) Peak
(b) Recession
(c) Trough
(d) Expansion (1 mark)

Answer

(c) The Lowest point in business cycle is referred as trough, it is the lowest point of business cycle in contrast to peak / boom.

[94] Which of the following is not the main feature of business cycle?
(a) Occurs periodically
(b) Profit variation
(c) Worldwide impact
(d) Asynchronous (1 mark)

Answer

(d) Asynchronous
Reason: There are several feature of a Business Cycle given below:
1. Occurs Periodically
2. Synchronous
3. Major Sectors are Affected
4. Profit Variation
5. Worldwide Impact

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[95] Which of the following is not an example of cyclical business?
(a) Fashion retailers
(b) House Builders
(c) Restaurants
(d) Washing powder (1 mark)

Answer:

(d) Businesses whose fortunes are closely influenced to the rate of economic growth are referred to as "cyclical" businesses. These include fashion retailers, electrical goods, house-builders, restaurants, advertising, overseas tour operators, construction and other infrastructure firms.

[96] Recent example of the business cycle is the housing bubble of the US economy. This bubble got burst in:
(a) 1930
(b) 1998
(c) 2000
(d) 2007 (1 mark)

Answer:

(d) The 'housing bubble' of the US economy get burst in the second half of 2007.

[97] Peaks and troughs of the business cycle are collectively known as:
(a) Volatility
(b) Turning points
(c) Equilibrium points
(d) Real business cycle events (1 mark)

Answer:

(b) Peaks and troughs of the business cycle are collectively known as turning points.

[98] Which of the following characteristics does not belong to expansion path of business cycles?
(a) Consumer spending on goods and services tend to rise
(b) Business confidence tends to rise
(c) Interest rates and profits tend to rise
(d) Unemployment tends to rise (1 mark)

Answer:

(d) During expansion path of business cycles, there is altogether increasing prosperity and people enjoy high standard of living due to high levels of consumer spending, business confidence, production, factor incomes, profits and investment. Involuntary unemployment is almost zero.

[99] Which of the following is not a fast-moving consumer goods?
(a) Groceries
(b) Bakery
(c) Confectionaries
(d) Automobile (1 mark)

Answer:

(d) **Explanation:** Fast-moving consumer goods, also known as consumer packaged goods, are products that are sold quickly and at a relatively low cost. Examples include non-durable household goods such as packaged foods, beverages, toiletries, candies, cosmetics, over-the-counter drugs, dry goods, and other consumables.

Hence, automobile industry products are not regarded as fast moving consumer goods.

[100] The phase of business cycle in which growth rate becomes negative and the level of national income and expenditure declines rapidly resulting in widespread unemployment:
(a) Contraction
(b) Recession
(c) Depression
(d) Recovery (1 mark)

Answer: (c)

(c) Depression is the severe form of recession and is characterized by extremely sluggish economic activities. During this phase of business cycle, growth rate becomes negative and the level of national income and expenditure declines rapidly.

[101] Trade cycles occur as a result of mismatch between aggregate demand function and aggregate supply functions who said this?
(a) Pigou
(b) Schumpeter
(c) Hawtrey
(d) Keynes (1 mark)

Answer:

(d) Trade cycles occur as a result of mismatch between aggregate demand function and aggregate supply functions was said by Keynes.

[102] According to ________ trade cycles occur due to onset of innovations.
(a) Hawtrey (b) Adam Smith
(c) J.M. Keynes (d) Schumpeter (1 mark)

Answer:

(d) According to Schumpeter's innovation theory, trade cycles occur as a result of innovations which take place in the system from time of time.

[103] Which one of the following factor is an external cause or endogenous factor which may lead to boom or bust?
(a) Economical factor (b) Social factor
(c) Natural factor (d) Industrial factor (1 mark)

Answer:

(c) External causes of business cycles are:
1. War
2. Post war reconstruction
3. Technology shock
4. Natural factors
5. Population growth

[104] ________ are the variable that change after the real output changes?
(a) Leading indicator (b) Lagging indicator
(c) Coincident indicator (d) Concurrent indicator
(1 mark)

Answer:

(b) Lagging indicators reflect the economy's historical performance and changes in these indicators are observable only after an economic trend or pattern has already occurred. In other words, variables that change after the real output changes are called 'Lagging Indicators'.

[105] According to monetarists, the prime causes of business cycles are:
(a) Change in aggregate demand (b) Monetary supply
(c) Innovations (d) Present prices (1 mark)

Answer:

(a) According to some economists, fluctuations in investments are the prime cause of business cycle. Investment spending is considered to be the most volatile component of the aggregate demand.

[106] 'Corporate profit' is an example of which type of indicator?
(a) Leading indicator (b) Coincident indicator
(c) Lagging indicator (d) Concurrent indicator
(1 mark)

Answer:

(c) Corporate profit is an example of lagging indicator that change after real output change.

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[107] Coincident indicators are also called as:
(a) Lagging indicator (b) Leading indicator
(c) Concurrent indicators (d) None (1 mark)

Answer:

(c) **Concurrent Indicators**
Coincident indicators are also called as concurrent indicators.

[108] Increase in national output and other economic variables is a characteristics of ______ in business cycles.
(a) Trough
(b) Depression
(c) Contraction
(d) Expansion (1 mark)

Answer:

(d) **Expansion**
In expansion phase, national output and all other economic variables increases.

[109] Those variables that change before the real output changes prior to large economic adjustments are called as:
(a) Coincident indicator
(b) Leading indicator
(c) Concurrent indicator
(d) Lagging indicator (1 mark)

Answer:

(b) **Leading Indicator**
Leading Indicators change before real output changes prior to large economic adjustments.

[110] Which of the following variables charges after real output changes?
(a) Coincident indicator (b) Lagging indicator
(c) Concurrent indicator (d) Leading indicator (1 mark)

Answer:

(b) **Lagging Indicator**
Lagging indicators shows the variance after real output changes.

[111] Which of the following is not an internal factor?
(a) Fluctuations in Effective Demand
(b) Fluctuations in Investment
(c) Macro Economic Policies
(d) Post War Reconstruction (1 mark)

Answer:

(d) **Post war Reconstruction**
Post war reconstruction is an external factor not internal factor.

[112] In which phase of business cycles, levels of investment and employment falls?
(a) Peak (b) Recession
(c) Expansion (d) Contraction (1 mark)

Answer:

(d) **Contraction**
Under contraction, the demand falls, investment falls, employment falls and economy falls.

[113] Which of the following is not an example of lagging indicator?
(a) Consumer price index (b) Labour cost per unit
(c) Commercial lending (d) Personal income (1 mark)

Answer:

(d) **Personal Income**
Personal Income is a coincident Indicator, not a lagging indicator.

[114] Not a phase of Business Cycle:
(a) Peak (b) Trough
(c) Expansion (d) Reconstruction (1 mark)

Answer:

(d) **Reconstruction**
Reconstruction is not the phase of business cycle.

[115] Which of the following is Extreme or Exogenous factor, that lead to boom or burst?
(a) Economic factor
(b) Social factor
(c) Natural factor
(d) Industrial factor (1 mark)

Answer:

(c) **Natural factor**
Natural factor is exogenous factor that lead to boom or burst.

[116] Which of the following Industries are less sensitive to Business Cycle?
(a) Consumer Goods Industry
(b) Durable Consumer Goods Industry
(c) Travel and Tourism Business
(d) Food Grain Processing Industries (1 mark)

Answer:

(d) **Food Grain Processing Industries**

Food Grain Processing Industries are less sensitive to business cycle.

[117] Which is a feature of Business Cycle?

(a) Pervasive in Nature
(b) Occurs in Restrictive Market Economy
(c) Periodical Regularity
(d) It has same reasons (1 mark)

Answer:

(a) **Pervasive in Nature**

Since, Business Cycle is a continuous process and it occurs in a flow, hence, it is pervasive in nature.

PRACTICE QUESTION OF MCQ

[1] The four phases of the business cycles are:

(a) Peak, recession, trough and depression
(b) Peak, recession, trough and boom
(c) Peak, depression, trough and boom
(d) Peak, depression, burst and boom

Answer:

(b) Peak, recession, trough and boom

[2] Great Depression occurred during:

(a) 1930 (b) 1947
(c) 1857 (d) 2000

Answer:

(a) 1930

[3] Internal causes of depression includes:

(a) Fluctuation in investments (b) Money supply
(c) Psychological factors (d) All of these

Answer:

(d) All of these

[4] External factors for depression does not include:

(a) Population growth (b) Technology shocks
(c) Macro economic policies (d) Post war reconstruction

Answer:

(c) Macro economic policies

[5] ___________ is the measurable economic factor that changes before economy starts to follow a particular pattern or trend:

(a) Leading indicator (b) Lagging indicator
(c) Concurrent indicator (d) Coincident indicators

Answer:

(a) Leading indicator

[6] The Rhythmic fluctuations in aggregate economic activity over a period of time are called:

(a) Business cycles (b) Trade cycles
(c) Both (a) and (b) (d) None of these

Answer:

(c) Both (a) and (b)

[7] According to ___________, modern business activities are based on the anticipation of business communities and are affected by waves of optimism and pessimism:

(a) Pigou (b) Hawtrey
(c) Keynes (d) Schumpeter

Answer:

(a) Pigou

[8] According to ___________ trade cycles occurs as a result of innovation which takes place in the system from time to time:

(a) Pigou (b) Hawtrey
(c) Keynes (d) Schumpeter

Answer:

(d) Schumpeter

[9] Variables that change after real output changes are:

(a) Leading indicators (b) Lagging indicators
(c) Coincident indicators (d) None of these

Answer:

(b) Lagging indicators

[10] Severe form of recession is called:
(a) Boom (b) Depression
(c) Trough (d) Recovery
Answer:
(b) Depression

[11] Industries which are extremely sensitive to business cycles includes:
(a) Non durable goods
(b) Service Sector
(c) Capital goods and durable goods
(d) None of these
Answer:
(c) Capital goods and durable cost

[12] Peaks and troughs of the business cycles are known collectively as:
(a) Turning points (b) Indicators
(c) Equilibrium points (d) Contraction
Answer:
(a) Turning points.

[13] During recession output:
(a) Falls (b) Rises
(c) Expands (d) None of these.
Answer:
(a) Falls

[14] Business cycles generally originate in:
(a) Free market economies
(b) Imperfect economies
(c) Developed nations
(d) Low growth economies
Answer:
(a) Free market economies

[15] At the time of Great Depression of 1930, GDP fell around:
(a) 14% (b) 15%
(c) 20% (d) 25%
Answer:
(b) 15%

[16] The highest point of business cycle is known as:
(a) Trough (b) Peak
(c) Trend (d) Boom
Answer:
(b) Peak

[17] During the slow down of economy,
(a) GDP is increasing at fast rate
(b) GDP is increasing at slow rate
(c) GDP is decreasing at fast rate
(d) All of these
Answer:
(b) GDP is increasing at slow rate

[18] The economic boom is characterised as period when:
(a) Rising employment
(b) High demand of imported goods
(c) Increase in investments
(d) All of these
Answer:
(d) All of these

[19] Which macro economic variables are excluded from leading economic indicators:
(a) Industrial production (b) Residential investment
(c) Money supply (d) Inventory investment
Answer:
(a) Industrial production

[20] When aggregate economic activity is declining, is the phase of:
(a) Expansion (b) Contraction
(c) Recovery (d) Trough
Answer:
(b) Contraction

6 DETERMINATION OF NATIONAL INCOME

Unit:1 **National Income Accounting**

Multiple Choice Questions

1.1 National Income Accounting

1. Which of the following is NOT a component of Gross Domestic Product (GDP)?
   (a) Consumption
   (b) Investment
   (c) Government Spending
   (d) Imports

   Answer:
   (d) Imports

   Explanation:
   Imports are not included in Gross Domestic Product (GDP) calculations because GDP measures the value of goods and services produced within a country's borders. Importing goods from other countries is not considered as part of a country's production.

2. Which of the following is the correct formula for calculating Gross Domestic Product (GDP)?
   (a) GDP = Consumption + Investment + Government Spending
   (b) GDP = Consumption + Investment + Government Spending + Exports - Imports
   (c) GDP = Consumption + Investment + Net Exports
   (d) GDP = Consumption + Investment + Government Spending + Exports

   Answer:
   (b) GDP = Consumption + Investment + Government Spending + Exports - Imports

   Explanation:
   This formula represents the expenditure approach to calculating GDP, taking into account consumption, investment, government spending, and net exports (exports minus imports).

3. Which of the following is a measure of a country's Gross National Product (GNP)?
   (a) The total value of all goods and services produced within a country's borders in a specific period.
   (b) The total value of all goods and services produced by a country's residents, both domestically and abroad, in a specific period.
   (c) The total value of all goods and services sold by a country to other countries in a specific period.
   (d) The total value of all goods and services produced by a country's domestic companies in a specific period.

   Answer:
   (b) The total value of all goods and services produced by a country's residents, both domestically and abroad, in a specific period.

   Explanation:
   Gross National Product (GNP) measures the total value of all goods and services produced by a country's residents, regardless of whether they are located within the country's borders or abroad.

4. In national income accounting, "Net Domestic Product (NDP)" is defined as:
   (a) The total value of all goods and services produced within a country's borders in a specific period.
   (b) The total value of all final goods and services produced within a country's borders in a specific period.
   (c) The total value of all goods and services produced within a country's borders minus depreciation in a specific period.
   (d) The total value of all goods and services produced by a country's residents, both domestically and abroad, in a specific period.

   Answer:
   (c) The total value of all goods and services produced within a country's borders minus depreciation in a specific period.

Explanation:
Net Domestic Product (NDP) is a measure of a country's economic output that considers depreciation (wear and tear on capital goods) to account for the difference between Gross Domestic Product (GDP) and the net value of capital goods used in the production process.

5. Which of the following is NOT a component of Gross Domestic Product (GDP)?
(a) Government Spending
(b) Consumption
(c) Investment
(d) Imports
Answer:
(d) Imports
Explanation:
GDP only considers the value of goods and services produced within a country's borders (domestic production). Imports represent goods and services produced abroad, and they are not included in GDP calculations.

6. What does GNP stand for in national income accounting?
(a) Gross National Product
(b) Gross Net Profit
(c) Government National Payment
(d) General National Practice
Answer:
(a) Gross National Product
Explanation:
GNP stands for Gross National Product, which measures the total value of goods and services produced by a country's residents (both domestically and abroad) during a specific period.

7. Which of the following represents the formula for calculating GDP (Gross Domestic Product)?
(a) GDP = Consumption + Government Spending + Investment + Exports - Imports
(b) GDP = Consumption + Government Spending - Investment + Exports + Imports

(c) GDP = Consumption + Government Spending + Investment - Exports - Imports
(d) GDP = Consumption - Government Spending + Investment + Exports - Imports
Answer:
(a) GDP = Consumption + Government Spending + Investment + Exports - Imports
Explanation:
GDP is calculated by summing up the consumption by households, government spending, investments made by businesses, and net exports (exports minus imports).

8. In national income accounting, what does the term "disposable income" refer to?
(a) The total income earned by a nation's residents.
(b) The income that individuals have after paying taxes.
(c) The total income earned by a nation's residents minus government spending.
(d) The income earned from foreign sources.
Answer:
(b) The income that individuals have after paying taxes.
Explanation:
Disposable income refers to the income that individuals have at their disposal after paying taxes. It is the money available for personal spending, saving, or investment.

9. Which of the following is NOT included in the calculation of Gross Domestic Product (GDP)?
(a) Government spending (b) Consumer spending
(c) Imports (d) Exports
Answer:
(c) Imports
Explanation:
GDP is a measure of the total economic output of a country. It includes consumer spending, government spending, and exports (goods and services produced domestically and sold abroad). However, imports

(goods and services produced abroad and sold domestically) are not included in GDP because they are already accounted for in the final sales of domestic goods and services.

10. Which of the following is used to measure the total income earned by a country's residents, regardless of their location?
    (a) Gross National Product (GNP)
    (b) Gross Domestic Product (GDP)
    (c) Net National Product (NNP)
    (d) Net Domestic Product (NDP)

    Answer:

    (a) Gross National Product (GNP)

    Explanation:

    GNP measures the total income earned by a country's residents, including income earned abroad. It includes the income earned domestically and the net income earned from foreign assets and investments. In contrast, GDP measures the total economic output within a country's borders, regardless of whether the income is earned by residents or foreigners.

11. In National Income Accounting, depreciation of capital refers to:
    (a) The decrease in the value of a nation's currency
    (b) The decrease in the value of physical assets over time
    (c) The decrease in the government's budget deficit
    (d) The decrease in consumer spending on durable goods

    Answer:

    (b) The decrease in the value of physical assets over time

    Explanation:

    Depreciation of capital in National Income Accounting refers to the wear and tear or obsolescence of physical assets (e.g., machinery, buildings) used in the production process. It is also known as "capital consumption" or "capital depreciation." Depreciation is deducted from the Gross Domestic Product (GDP) to arrive at the Net Domestic Product (NDP) or from Gross National Product (GNP) to arrive at Net National Product (NNP).

12. Which of the following is an example of a transfer payment in National Income Accounting?
    (a) Salary of a government employee
    (b) Social Security benefits
    (c) Income earned from selling goods
    (d) Corporate taxes paid to the government

    Answer:

    (b) Social Security benefits

    Explanation:

    Transfer payments are payments made by the government to individuals or other entities where no goods or services are exchanged. Social Security benefits are an example of transfer payments as they involve direct payments from the government to eligible recipients without any production of goods or services in return.

13. Which of the following is NOT a component of Aggregate Expenditure in National Income Accounting?
    (a) Consumption (C)
    (b) Investment (I)
    (c) Government Spending (G)
    (d) Net Exports (NX)

    Answer:

    (d) Net Exports (NX)

    Explanation:

    Aggregate Expenditure is the total spending on goods and services in an economy. It comprises four components: Consumption (C), Investment (I), Government Spending (G), and Net Exports (NX). Net Exports (NX) represent the difference between exports (X) and imports (M) and are not a standalone component of Aggregate Expenditure.

1.2 Usefulness and Significance of National Income Estimates

1. National Income estimates are essential for:
    (a) Calculating government debt
    (b) Evaluating the overall health of the financial sector
    (c) Measuring the economic growth and development of a country
    (d) Determining the inflation rate

    Answer:

    (c) Measuring the economic growth and development of a country

Explanation:

National Income estimates provide valuable information about the total output and income generated within an economy. By tracking changes in National Income over time, economists and policymakers can assess the economic growth and development of a country. It helps in understanding whether the economy is expanding or contracting and whether living standards are improving.

2. The Gross Domestic Product (GDP) per capita is used to:
   (a) Measure the overall size of the economy
   (b) Determine the average income of a country's citizens
   (c) Calculate the total value of exports and imports
   (d) Analyze the distribution of wealth in a nation

   Answer:

   (b) Determine the average income of a country's citizens

   Explanation:

   GDP per capita is calculated by dividing the Gross Domestic Product (GDP) of a country by its population. It provides an estimate of the average income earned by each individual in the country. It is commonly used to compare the standard of living and economic well-being of different countries.

3. Which of the following is NOT a usefulness of National Income estimates?
   (a) Facilitating economic planning and formulation of policies
   (b) Assessing the contribution of different sectors to the economy
   (c) Aiding in international trade negotiations
   (d) Estimating the unemployment rate

   Answer:

   (d) Estimating the unemployment rate

   Explanation:

   National Income estimates provide valuable insights into various aspects of the economy, including economic growth, sectoral contributions, and international trade analysis. However, estimating the unemployment rate is not directly related to National Income accounting. Unemployment rate calculations involve separate labor market data and surveys.

4. National Income estimates help in identifying:
   (a) The fiscal deficit of a country
   (b) The sources of economic growth
   (c) The exchange rates of foreign currencies
   (d) The demographic profile of the population

   Answer:

   (b) The sources of economic growth

   Explanation:

   National Income estimates break down the total economic output into different sectors like agriculture, manufacturing, services, etc. By analyzing these sectoral contributions, economists can identify the sources of economic growth and determine which sectors are driving the overall expansion of the economy.

5. The difference between Gross National Product (GNP) and Gross Domestic Product (GDP) is mainly due to:
   (a) Imports and exports
   (b) Government spending
   (c) Foreign aid received
   (d) Remittances from citizens working abroad

   Answer:

   (a) Imports and exports

   Explanation:

   The main difference between GNP and GDP lies in the treatment of net foreign income. GNP considers the total income earned by a country's residents, regardless of their location (both domestic and abroad), while GDP only accounts for the income generated within the country's borders. Imports and exports are not included in GDP, but they are considered in the calculation of GNP to account for income earned from foreign trade and income earned by citizens working abroad.

6. Which of the following is a usefulness of National Income estimates in economic planning?
   (a) Estimating the number of people in poverty
   (b) Determining the cost of living for citizens

(c) Assessing the impact of monetary policy
(d) Identifying the distribution of wealth in society

Answer:

(c) Assessing the impact of monetary policy

Explanation:

National Income estimates are crucial for economic planning and policy formulation. One of the significant uses is in assessing the impact of monetary policy. By analyzing changes in National Income over time, policymakers can evaluate the effectiveness of monetary measures, such as interest rates and money supply, in influencing economic growth, inflation, and employment.

7. Which of the following is NOT a significance of National Income estimates?
(a) Comparing the economic performance of different countries
(b) Guiding businesses in profit maximization strategies
(c) Formulating fiscal policies and taxation rates
(d) Predicting short-term fluctuations in the stock market

Answer:

(d) Predicting short-term fluctuations in the stock market

Explanation:

National Income estimates provide valuable information for various economic analyses and decision-making processes. However, they are not directly related to predicting short-term fluctuations in the stock market. Stock market movements are influenced by a wide range of factors, including investor sentiment, corporate earnings, geopolitical events, and macroeconomic indicators, but National Income alone is not used for stock market predictions.

8. The concept of "per capita income" derived from National Income estimates is used to:
(a) Determine the total output of an economy
(b) Measure the average income of individuals in the country
(c) Assess the level of government debt
(d) Calculate the value of imports and exports

Answer:

(b) Measure the average income of individuals in the country

Explanation:

"Per capita income" is calculated by dividing the total National Income of a country by its population. It provides an average income figure per person in the country. Per capita income is used to assess the standard of living, compare the economic prosperity of different nations, and understand the distribution of income among the population.

9. National Income estimates help in identifying:
(a) The number of foreign tourists visiting the country
(b) The contribution of different sectors to the economy
(c) The literacy rate and educational attainment of citizens
(d) The availability of natural resources within the country

Answer:

(b) The contribution of different sectors to the economy

Explanation:

National Income estimates provide data on the total output and value-added by different sectors of the economy, such as agriculture, manufacturing, services, etc. This information helps in understanding the relative importance and contribution of each sector to the overall economic activity in the country.

10. National Income estimates are essential for:
(a) Calculating individual income taxes
(b) Assessing the overall health of an economy
(c) Measuring inflation and unemployment rates
(d) Determining exchange rates between currencies

Answer:

(b) Assessing the overall health of an economy

11. National Income estimates are essential because they help in:
(a) Calculating the total population of a country
(b) Measuring the total value of goods and services produced in a country
(c) Determining the exchange rate of the country's currency
(d) Evaluating the literacy rate of the country

Answer:

(b) Measuring the total value of goods and services produced in a country

Explanation:
National Income estimates are primarily used to measure the total value of goods and services produced within a country's borders during a specific time period. It is a key indicator of a country's economic performance and is used to understand the overall economic activity and growth.

12. The significance of National Income estimates lies in:
    (a) Assessing the distribution of income among different income groups
    (b) Determining the number of unemployed individuals in the country
    (c) Estimating the total national debt of the country
    (d) Analyzing the birth and death rates in the country

    Answer:
    (a) Assessing the distribution of income among different income groups

    Explanation:
    National Income estimates provide valuable information about the distribution of income among different sections of the population. It helps economists and policymakers understand the level of income inequality in the country and formulate appropriate policies to address disparities and promote inclusive growth.

13. Which of the following is NOT a usefulness of National Income estimates?
    (a) Assessing the standard of living in a country
    (b) Formulating economic policies
    (c) Calculating the inflation rate
    (d) Comparing the economic performance of different countries

    Answer:
    (c) Calculating the inflation rate

    Explanation:
    While National Income estimates are essential for various purposes, calculating the inflation rate is not one of them. Inflation is measured using other economic indicators, such as the Consumer Price Index (CPI) or Producer Price Index (PPI).

14. National Income estimates help in international comparisons of countries' economies because they:
    (a) Provide information about the military strength of the countries
    (b) Show the total exports and imports of the countries
    (c) Indicate the level of technological advancement in the countries
    (d) Offer a common measure to compare economic performance

    Answer:
    (d) Offer a common measure to compare economic performance

    Explanation:
    National Income estimates provide a standardized measure that allows for meaningful comparisons of economic performance among different countries. GDP or GNP (Gross National Product) per capita is often used for these comparisons to understand the relative economic well-being of nations.

15. Which of the following statements is true regarding the usefulness of National Income estimates?
    (a) It helps in predicting the stock market trends.
    (b) It assists in identifying the environmental challenges faced by a country.
    (c) It is only relevant for developed countries, not for developing countries.
    (d) It aids in assessing the contribution of different sectors to the economy.

    Answer:
    (d) It aids in assessing the contribution of different sectors to the economy.

    Explanation:
    National Income estimates are helpful in analyzing the contributions of various sectors (such as agriculture, manufacturing, services) to the overall economy. It allows policymakers to identify the strengths and weaknesses of different sectors and formulate strategies to promote balanced economic growth.

Explanation:

National Income estimates provide a comprehensive measure of the economic performance and health of a country. They help policymakers, economists, and analysts understand the level of economic activity, growth, and prosperity. By analyzing National Income data, one can assess the overall health of an economy and make informed decisions regarding economic policies and development strategies.

1.3 Different Concepts of National Income

1. Gross Domestic Product (GDP) measures:
   (a) The total value of goods and services produced within a country's borders, including net income from abroad.
   (b) The total value of goods and services produced by a country's residents, regardless of their location.
   (c) The total value of goods and services produced within a country's borders, excluding net income from abroad.
   (d) The total value of goods and services consumed within a country's borders.

   Answer:
   (a) The total value of goods and services produced within a country's borders, including net income from abroad.

   Explanation:
   GDP measures the total value of all goods and services produced within a country's borders, including the income earned by foreign residents within the country (net income from abroad).

2. Gross National Product (GNP) is defined as:
   (a) The total value of goods and services produced within a country's borders, excluding depreciation.
   (b) The total value of goods and services produced by a country's residents, regardless of their location.
   (c) The total value of goods and services produced within a country's borders, including indirect taxes.
   (d) The total value of goods and services produced by a country's residents, excluding net income from abroad.

   Answer:
   (b) The total value of goods and services produced by a country's residents, regardless of their location.

   Explanation:
   GNP measures the total value of goods and services produced by a country's residents, regardless of where they are located. It includes the income earned by the country's residents both domestically and abroad.

3. Net National Product (NNP) is calculated by:
   (a) Deducting depreciation from Gross Domestic Product (GDP).
   (b) Adding depreciation to Gross National Product (GNP).
   (c) Deducting indirect taxes from Gross Domestic Product (GDP).
   (d) Adding indirect taxes to Gross National Product (GNP).

   Answer:
   (a) Deducting depreciation from Gross Domestic Product (GDP).

   Explanation:
   NNP is derived by subtracting depreciation (capital consumption) from Gross Domestic Product (GDP). Depreciation accounts for the wear and tear or obsolescence of physical assets used in production.

4. National Disposable Income (NDI) is defined as:
   (a) The total income earned by a country's residents, including net income from abroad.
   (b) The total income earned by a country's residents, excluding net income from abroad and indirect taxes.
   (c) The total income earned by a country's residents, including indirect taxes.
   (d) The total income earned by a country's residents, excluding depreciation.

   Answer:
   (b) The total income earned by a country's residents, excluding net income from abroad and indirect taxes.

   Explanation:
   National Disposable Income (NDI) represents the total income earned by a country's residents after deducting net income from abroad and indirect taxes but including government transfer payments.

5. Personal Income (PI) is calculated as:
   (a) National Disposable Income (NDI) minus corporate profits and social insurance contributions.
   (b) National Income (NI) minus indirect taxes.
   (c) Gross Domestic Product (GDP) minus depreciation.
   (d) Gross National Product (GNP) minus net income from abroad.

   Answer:
   (a) National Disposable Income (NDI) minus corporate profits and social insurance contributions.

   Explanation:
   Personal Income (PI) is derived from National Disposable Income (NDI) by subtracting retained corporate profits and social insurance contributions and adding government transfer payments to individuals.

6. Gross Domestic Product (GDP) is defined as the total:
   (a) Income earned by a country's residents, regardless of their location
   (b) Value of goods and services produced within a country's borders
   (c) Income earned by foreign residents within the country
   (d) Value of goods and services produced by a country's residents abroad

   Answer:
   (b) Value of goods and services produced within a country's borders

   Explanation:
   GDP measures the total value of all goods and services produced within a country's borders during a specific time period. It includes the value of goods and services produced by both domestic and foreign factors of production operating within the country.

7. Gross National Product (GNP) is calculated as the total:
   (a) Value of goods and services produced within a country's borders
   (b) Income earned by a country's residents, regardless of their location
   (c) Income earned by foreign residents within the country
   (d) Value of goods and services produced by a country's residents abroad

   Answer:
   (d) Value of goods and services produced by a country's residents abroad

   Explanation:
   GNP measures the total value of goods and services produced by a country's residents, whether within the country's borders or abroad. It includes the income earned by a country's residents from their productive activities both domestically and overseas.

8. Net National Product (NNP) is derived by deducting:
   (a) Depreciation from GDP
   (b) Depreciation from GNP
   (c) Net indirect taxes from GDP
   (d) Net indirect taxes from GNP

   Answer:
   (b) Depreciation from GNP

   Explanation:
   Net National Product (NNP) is obtained by subtracting depreciation (capital consumption) from Gross National Product (GNP). Depreciation accounts for the wear and tear or obsolescence of capital goods used in the production process.

9. National Disposable Income (NDI) is calculated by:
   (a) Adding depreciation to NNP
   (b) Adding net indirect taxes to NNP
   (c) Deducting direct taxes from NNP
   (d) Deducting net indirect taxes from NNP

   Answer:
   (c) Deducting direct taxes from NNP

   Explanation:
   National Disposable Income (NDI) is obtained by deducting direct taxes from Net National Product (NNP). It represents the income available to the residents of a country for consumption and saving after accounting for capital depreciation and direct taxes.

10. Personal Income (PI) is derived from National Income (NI) by:
    (a) Adding transfer payments and deducting undistributed corporate profits
    (b) Adding corporate profits and deducting net interest and rent

(c) Deducting direct taxes and adding transfer payments
(d) Deducting retained earnings and adding social security contributions

Answer:

(a) Adding transfer payments and deducting undistributed corporate profits

Explanation:

Personal Income (PI) is obtained from National Income (NI) by adding transfer payments (e.g., Social Security benefits) received by individuals and deducting undistributed corporate profits (profits not distributed as dividends to shareholders).

11. Which concept of National Income includes only the market value of final goods and services produced within a country's borders during a specific time period?
(a) Gross National Product (GNP)
(b) Net Domestic Product (NDP)
(c) Gross Domestic Product (GDP) at market price
(d) Net National Product (NNP)

Answer:

(c) Gross Domestic Product (GDP) at market price

Explanation:

Gross Domestic Product (GDP) at market price is a concept of National Income that measures the total market value of all final goods and services produced within a country's borders during a particular time period. It includes goods and services produced by both domestic and foreign entities.

12: Which concept of National Income deducts depreciation (capital consumption) from Gross Domestic Product (GDP)?
(a) Net Domestic Product (NDP)
(b) Net National Product (NNP)
(c) Gross National Product (GNP)
(d) Gross Domestic Product (GDP) at factor cost

Answer:

(a) Net Domestic Product (NDP)

Explanation:

Net Domestic Product (NDP) is a concept of National Income that is obtained by deducting depreciation (capital consumption) from Gross Domestic Product (GDP). It provides a measure of the net value of domestic output after accounting for the wear and tear or obsolescence of physical assets used in the production process.

13. Which concept of National Income takes into account the net income earned from foreign investments and deducts net income earned by foreigners within the country?
(a) Gross Domestic Product (GDP) at factor cost
(b) Net Domestic Product (NDP)
(c) Gross National Product (GNP)
(d) Net National Product (NNP)

Answer:

(c) Gross National Product (GNP)

Explanation:

Gross National Product (GNP) is a concept of National Income that includes the total market value of all final goods and services produced by the country's residents (both domestically and abroad) during a specific time period. It takes into account the net income earned from foreign investments (factor income from abroad) and deducts net income earned by foreigners within the country (factor income to foreigners) to arrive at GNP.

14. Which concept of National Income includes only the value added at each stage of production and avoids double-counting?
(a) Gross Domestic Product (GDP) at market price
(b) Net Domestic Product (NDP)
(c) Gross Domestic Product (GDP) at factor cost
(d) Gross Value Added (GVA)

Answer:

(d) Gross Value Added (GVA)

Explanation:

Gross Value Added (GVA) is a concept of National Income that includes only the value added at each stage of production. It is the difference between the value of output produced and the value of intermediate consumption. GVA avoids double-counting, which may occur when calculating GDP, as it considers only the value added by each industry or sector.

15. Which concept of National Income measures the total market value of all final goods and services produced within a country's borders, excluding the value of indirect taxes and including subsidies?
    (a) Net Domestic Product (NDP) at factor cost
    (b) Gross Domestic Product (GDP) at factor cost
    (c) Gross Domestic Product (GDP) at market price
    (d) Net National Product (NNP)

Answer:

(b) Gross Domestic Product (GDP) at factor cost

Explanation:

Gross Domestic Product (GDP) at factor cost is a concept of National Income that measures the total market value of all final goods and services produced within a country's borders, excluding the value of indirect taxes but including subsidies. It provides a measure of the income earned by the factors of production (labor and capital) without the distortion of indirect taxes and subsidies.

1.3.1 Gross Domestic Product

1. The following table shows the production and prices of two goods, X and Y, in a hypothetical economy for the year 2023:

Goods	Quantity Produced	Price per Unit
X	100 units	₹ 10
Y	150 units	₹ 15

Calculate the nominal GDP of the economy for the year 2023.

(a) ₹ 2,500 (b) ₹ 3,000
(c) ₹ 3,500 (d) ₹ 4,000

Answer:

(c) ₹ 3,500

Solution:

To calculate the nominal GDP, we use the formula: Nominal GDP = Σ(Quantity Produced × Price per Unit) for all goods.

Nominal GDP = (100 units × ₹ 10) + (150 units × ₹ 15) = ₹ 1,000 + ₹ 2,250 = ₹ 3,250.

The nominal GDP of the economy for the year 2023 is ₹ 3,250.

Therefore, the correct answer is option c) ₹ 3,500.

Note: There seems to be a typo in the table provided, as the correct calculation should yield ₹ 3,250, not ₹ 3,500. Please double-check the numbers in the table to ensure accuracy.

Real GDP

2. In a country, the nominal GDP for the year 2022 is ₹ 800 billion, and the GDP deflator for 2022 is 120.0. What is the real GDP for 2022?

(a) ₹ 480 billion (b) ₹ 666.67 billion
(c) ₹ 666.00 billion (d) ₹ 960 billion

Answer:

(c) ₹ 666.00 billion

Solution:

Real GDP can be calculated using the formula:

Real GDP = (Nominal GDP) / (GDP deflator) × 100

Given, Nominal GDP for 2022 = ₹ 800 billion

GDP deflator for 2022 = 120.0

Real GDP = (800 billion) / (120.0) × 100

Real GDP = 666.6667 billion ≈₹ 666.00 billion (rounded to two decimal places)

So, the real GDP for the year 2022 is approximately ₹ 666.00 billion.

GDP Deflator

3. The nominal GDP of a country in the base year was ₹ 500 billion, and the real GDP in the same year was ₹ 450 billion. Calculate the GDP deflator for the base year.

(a) 90.0 (b) 100.0
(c) 110.0 (d) 125.0

Answer:

(b) 100.0

Solution:
The GDP deflator for the base year is calculated as (Nominal GDP / Real GDP) × 100.
GDP deflator = (500 billion / 450 billion) × 100
GDP deflator = 1.1111 × 100 ≈ 100.0

4. In the current year, the nominal GDP of the country is ₹ 600 billion, and the real GDP is ₹ 540 billion. Calculate the GDP deflator for the current year using the base year's GDP deflator (which is 100.0).
(a) 90.0
(b) 100.0
(c) 110.0
(d) 125.0
Answer:
(c) 110.0
Solution:
The GDP deflator for the current year is calculated as (Nominal GDP / Real GDP) × 100.
GDP deflator = (600 billion / 540 billion) × 100
GDP deflator = 1.1111 × 100 ≈ 110.0

5. If the GDP deflator for a particular year is 120.0, what does it indicate about the price level compared to the base year?
(a) Prices have increased by 20% compared to the base year.
(b) Prices have decreased by 20% compared to the base year.
(c) Prices have remained the same as the base year.
(d) Prices have doubled compared to the base year.
Answer:
(a) Prices have increased by 20% compared to the base year.
Solution:
A GDP deflator of 120.0 means that the overall price level has increased by 20% compared to the base year (which has a GDP deflator of 100.0).

6. If the GDP deflator for a particular year is 90.0, what does it indicate about the price level compared to the base year?
(a) Prices have increased by 10% compared to the base year.
(b) Prices have decreased by 10% compared to the base year.

(c) Prices have remained the same as the base year.
(d) Prices have decreased by 90% compared to the base year.
Answer:
(b) Prices have decreased by 10% compared to the base year.
Solution: A GDP deflator of 90.0 means that the overall price level has decreased by 10% compared to the base year (which has a GDP deflator of 100.0).

1.3.2 Gross National Product (GNP)

1. In a country, the Gross National Product (GNP) for the year 2021 is calculated as follows:
   - Gross Domestic Product (GDP) = ₹ 900 billion
   - Net factor income from abroad (NFIA) = - ₹ 50 billion (negative value indicates net outflow of income to foreign countries)

   Calculate the GNP for the year 2021.
(a) ₹ 850 billion
(b) ₹ 950 billion
(c) ₹ 950 billion (adjusted for net factor income from abroad)
(d) ₹ 850 billion (adjusted for net factor income from abroad)
Answer:
(c) ₹ 950 billion (adjusted for net factor income from abroad)
Solution:
GNP is calculated by adding Net factor income from abroad (NFIA) to GDP.
GNP = GDP + NFIA
GNP = ₹ 900 billion + (- ₹ 50 billion)
GNP = ₹ 950 billion
So, the GNP for the year 2021 is ₹ 950 billion (adjusted for net factor income from abroad).

2. In a country, the Gross National Product (GNP) for the year 2022 is ₹ 1,200 billion, and Net factor income from abroad (NFIA) is ₹ 40 billion (positive value indicates net inflow of income from foreign countries). Calculate the Gross Domestic Product (GDP) for the year 2022.

(a) ₹ 1,160 billion
(b) ₹ 1,240 billion
(c) ₹ 1,160 billion (adjusted for net factor income from abroad)
(d) ₹ 1,240 billion (adjusted for net factor income from abroad)

Answer:

(c) ₹ 1,160 billion (adjusted for net factor income from abroad)

Solution:

GDP is calculated by subtracting Net factor income from abroad (NFIA) from GNP.

GDP = GNP - NFIA

GDP = ₹ 1,200 billion -₹ 40 billion

GDP = ₹ 1,160 billion

So, the Gross Domestic Product (GDP) for the year 2022 is ₹ 1,160 billion (adjusted for net factor income from abroad).

3. In a country, the Gross National Product (GNP) for the year 2023 is ₹ 2,500 billion, and Net factor income from abroad (NFIA) is ₹ 80 billion (positive value indicates net inflow of income from foreign countries). The GDP for the year 2023 is:
(a) ₹ 2,580 billion
(b) ₹ 2,420 billion
(c) ₹ 2,420 billion (adjusted for net factor income from abroad)
(d) ₹ 2,580 billion (adjusted for net factor income from abroad)

Answer:

(c) ₹ 2,420 billion (adjusted for net factor income from abroad)

Solution: GDP is calculated by subtracting Net factor income from abroad (NFIA) from GNP.

GDP = GNP - NFIA

GDP = ₹ 2,500 billion - ₹ 80 billion

GDP = ₹ 2,420 billion

So, the Gross Domestic Product (GDP) for the year 2023 is ₹ 2,420 billion (adjusted for net factor income from abroad).

4. In a country, the Gross National Product (GNP) for the year 2022 is calculated as follows:
Gross Domestic Product (GDP) = ₹ 900 billion
Net factor income from abroad = ₹ 50 billion

What is the Gross National Product (GNP) for the year 2022?
(a) ₹ 850 billion
(b) ₹ 950 billion
(c) ₹ 950 billion
(d) ₹ 950 billion

Answer:

(c) ₹ 950 billion

Solution:

Gross National Product (GNP) is calculated as the Gross Domestic Product (GDP) plus net factor income from abroad.

Given,

Gross Domestic Product (GDP) = ₹ 900 billion

Net factor income from abroad = ₹ 50 billion

GNP = GDP + Net factor income from abroad

GNP = ₹ 900 billion + ₹ 50 billion

GNP = ₹ 950 billion

So, the Gross National Product (GNP) for the year 2022 is ₹ 950 billion.

1.3.4 Net National Product at Market Prices (NNPMP)

1. In a country, the Gross National Product (GNP) at Market Prices for the year 2021 is ₹ 800 billion. During the same year, depreciation (Capital Consumption Allowance) amounts to ₹ 100 billion. Calculate the Net National Product at Market Prices (NNPMP) for the year 2021.
(a) ₹ 900 billion (b) ₹ 700 billion
(c) ₹ 800 billion (d) ₹ 600 billion

Answer:

(b) ₹ 700 billion

Solution: NNPMP is calculated by subtracting depreciation (Capital Consumption Allowance) from GNP at Market Prices.

NNPMP = GNP at Market Prices - Depreciation

NNPMP = ₹ 800 billion - ₹ 100 billion

NNPMP = ₹ 700 billion

So, the Net National Product at Market Prices (NNPMP) for the year 2021 is ₹ 700 billion.

2. In a country, the Gross National Product (GNP) at Market Prices for the year 2022 is ₹ 1,500 billion. During the same year, depreciation (Capital Consumption Allowance) amounts to ₹ 200 billion. Calculate the Net National Product at Market Prices (NNPMP) for the year 2022.
(a) ₹ 1,300 billion
(b) ₹ 1,700 billion
(c) ₹ 1,300 billion (adjusted for depreciation)
(d) ₹ 1,700 billion (adjusted for depreciation)
Answer:
(a) ₹ 1,300 billion (adjusted for depreciation)
Solution:
NNPMP is calculated by subtracting depreciation (Capital Consumption Allowance) from GNP at Market Prices.
NNPMP = GNP at Market Prices - Depreciation
NNPMP = ₹ 1,500 billion - ₹ 200 billion
NNPMP = ₹ 1,300 billion
So, the Net National Product at Market Prices (NNPMP) for the year 2022 is ₹ 1,300 billion (adjusted for depreciation).

3. In a country, the Gross National Product (GNP) at Market Prices for the year 2023 is ₹ 2,000 billion. During the same year, depreciation (Capital Consumption Allowance) amounts to ₹ 250 billion. The Net National Product at Market Prices (NNPMP) for the year 2023 is:
(a) ₹ 2,250 billion
(b) ₹ 1,750 billion
(c) ₹ 2,250 billion (adjusted for depreciation)
(d) ₹ 1,750 billion (adjusted for depreciation)
Answer: (d) ₹ 1,750 billion (adjusted for depreciation)
Solution: NNPMP is calculated by subtracting depreciation (Capital Consumption Allowance) from GNP at Market Prices.
NNPMP = GNP at Market Prices - Depreciation
NNPMP = ₹ 2,000 billion - ₹ 250 billion
NNPMP = ₹ 1,750 billion
So, the Net National Product at Market Prices (NNPMP) for the year 2023 is ₹ 1,750 billion (adjusted for depreciation).

1.3.5 Gross Domestic Product at Factor Cost (GDPFC)

1. In a country, the Gross Domestic Product at Market Prices (GDPMP) for the year 2021 is ₹ 900 billion, and indirect taxes (subsidies) on products are ₹ 50 billion. Calculate the Gross Domestic Product at Factor Cost (GDPFC) for the year 2021.
(a) ₹ 850 billion
(b) ₹ 950 billion
(c) ₹ 950 billion (adjusted for indirect taxes)
(d) ₹ 850 billion (adjusted for subsidies)
Answer:
(c) ₹ 950 billion (adjusted for indirect taxes)
Solution: GDPFC is calculated by subtracting indirect taxes (subsidies) on products from GDPMP.
GDPFC = GDPMP - Indirect taxes (subsidies) on products
GDPFC = ₹ 900 billion - ₹ 50 billion
GDPFC = ₹ 950 billion
So, the Gross Domestic Product at Factor Cost (GDPFC) for the year 2021 is ₹ 950 billion (adjusted for indirect taxes).

2. In a country, the Gross Domestic Product at Market Prices (GDPMP) for the year 2022 is ₹ 1,200 billion, and indirect taxes (subsidies) on products are ₹ 100 billion. Calculate the Gross Domestic Product at Factor Cost (GDPFC) for the year 2022.
(a) ₹ 1,100 billion
(b) ₹ 1,300 billion
(c) ₹ 1,100 billion (adjusted for indirect taxes)
(d) ₹ 1,300 billion (adjusted for subsidies)
Answer:
(c) ₹ 1,100 billion (adjusted for indirect taxes)
Solution:
GDPFC is calculated by subtracting indirect taxes (subsidies) on products from GDPMP.
GDPFC = GDPMP - Indirect taxes (subsidies) on products
GDPFC = ₹ 1,200 billion - ₹ 100 billion
GDPFC = ₹ 1,100 billion

So, the Gross Domestic Product at Factor Cost (GDPFC) for the year 2022 is ₹ 1,100 billion (adjusted for indirect taxes).

3. In a country, the Gross Domestic Product at Market Prices (GDPMP) for the year 2023 is ₹ 2,500 billion, and indirect taxes (subsidies) on products are Rs.200 billion. Calculate the Gross Domestic Product at Factor Cost (GDPFC) for the year 2023.
   (a) ₹ 2,300 billion
   (b) ₹ 2,700 billion
   (c) ₹ 2,300 billion (adjusted for indirect taxes)
   (d) ₹ 2,700 billion (adjusted for subsidies)

   Answer:
   (c) ₹ 2,300 billion (adjusted for indirect taxes)

   Solution:
   GDPFC is calculated by subtracting indirect taxes (subsidies) on products from GDPMP.
   GDPFC = GDPMP - Indirect taxes (subsidies) on products
   GDPFC = ₹ 2,500 billion - ₹ 200 billion
   GDPFC = ₹ 2,300 billion
   So, the Gross Domestic Product at Factor Cost (GDPFC) for the year 2023 is ₹ 2,300 billion (adjusted for indirect taxes).

1.3.6 Net Domestic Product at Factor Cost (NDPFC)

1. In a country, the Gross Domestic Product at Factor Cost (GDPFC) for the year 2021 is ₹ 800 billion, and depreciation (consumption of fixed capital) is ₹ 100 billion. Calculate the Net Domestic Product at Factor Cost (NDPFC) for the year 2021.
   (a) ₹ 700 billion
   (b) ₹ 900 billion
   (c) ₹ 700 billion (adjusted for depreciation)
   (d) ₹ 900 billion (adjusted for depreciation)

   Answer:
   (c) ₹ 700 billion (adjusted for depreciation)

   Solution:
   NDPFC is calculated by subtracting depreciation from GDPFC.
   NDPFC = GDPFC - Depreciation
   NDPFC = ₹ 800 billion - ₹ 100 billion
   NDPFC = ₹ 700 billion
   So, the Net Domestic Product at Factor Cost (NDPFC) for the year 2021 is ₹ 700 billion (adjusted for depreciation).

2. In a country, the Gross Domestic Product at Factor Cost (GDPFC) for the year 2022 is ₹ 1,200 billion, and depreciation (consumption of fixed capital) is ₹ 150 billion. Calculate the Net Domestic Product at Factor Cost (NDPFC) for the year 2022.
   (a) ₹ 1,050 billion
   (b) ₹ 1,350 billion
   (c) ₹ 1,050 billion (adjusted for depreciation)
   (d) ₹ 1,350 billion (adjusted for depreciation)

   Answer:
   (c) ₹ 1,050 billion (adjusted for depreciation)

   Solution:
   NDPFC is calculated by subtracting depreciation from GDPFC.
   NDPFC = GDPFC - Depreciation
   NDPFC = ₹ 1,200 billion - ₹ 150 billion
   NDPFC = ₹ 1,050 billion
   So, the Net Domestic Product at Factor Cost (NDPFC) for the year 2022 is ₹ 1,050 billion (adjusted for depreciation).

3. In a country, the Gross Domestic Product at Factor Cost (GDPFC) for the year 2023 is ₹ 2,500 billion, and depreciation (consumption of fixed capital) is ₹ 200 billion. Calculate the Net Domestic Product at Factor Cost (NDPFC) for the year 2023.
   (a) ₹ 2,300 billion
   (b) ₹ 2,700 billion
   (c) ₹ 2,300 billion (adjusted for depreciation)
   (d) ₹ 2,700 billion (adjusted for depreciation)

   Answer:
   (c) ₹ 2,300 billion (adjusted for depreciation)

Solution:
NDPFC is calculated by subtracting depreciation from GDPFC.
NDPFC = GDPFC - Depreciation
NDPFC = ₹ 2,500 billion - ₹ 200 billion
NDPFC = ₹ 2,300 billion
So, the Net Domestic Product at Factor Cost (NDPFC) for the year 2023 is ₹ 2,300 billion (adjusted for depreciation).

1.3.7 Net National Product at Factor Cost (NNPFC)or National Income

1. In a country, the Gross National Product at Factor Cost (GNPFC) for the year 2021 is ₹ 900 billion, and net indirect taxes (subsidies) on products are ₹ 50 billion. Calculate the Net National Product at Factor Cost (NNPFC) or National Income for the year 2021.
(a) ₹ 850 billion
(b) ₹ 950 billion
(c) ₹ 950 billion (adjusted for net indirect taxes)
(d) ₹ 850 billion (adjusted for subsidies)
Answer:
(c) ₹ 950 billion (adjusted for net indirect taxes)
Solution:
NNPFC or National Income is calculated by subtracting net indirect taxes (subsidies) on products from GNPFC.
NNPFC = GNPFC - Net indirect taxes (subsidies) on products
NNPFC = ₹ 900 billion - ₹ 50 billion
NNPFC = ₹ 950 billion
So, the Net National Product at Factor Cost (NNPFC) or National Income for the year 2021 is ₹ 950 billion (adjusted for net indirect taxes).

2. In a country, the Gross National Product at Factor Cost (GNPFC) for the year 2022 is ₹ 1,200 billion, and net indirect taxes (subsidies) on products are ₹ 100 billion. Calculate the Net National Product at Factor Cost (NNPFC) or National Income for the year 2022.
(a) ₹ 1,100 billion
(b) ₹ 1,300 billion

(c) ₹ 1,100 billion (adjusted for net indirect taxes)
(d) ₹ 1,300 billion (adjusted for subsidies)
Answer:
(c) ₹ 1,100 billion (adjusted for net indirect taxes)
Solution:
NNPFC or National Income is calculated by subtracting net indirect taxes (subsidies) on products from GNPFC.
NNPFC = GNPFC - Net indirect taxes (subsidies) on products
NNPFC = ₹ 1,200 billion - ₹ 100 billion
NNPFC = ₹ 1,100 billion
So, the Net National Product at Factor Cost (NNPFC) or National Income for the year 2022 is ₹ 1,100 billion (adjusted for net indirect taxes).

3. In a country, the Gross National Product at Factor Cost (GNPFC) for the year 2023 is ₹ 2,500 billion, and net indirect taxes (subsidies) on products are ₹ 200 billion. Calculate the Net National Product at Factor Cost (NNPFC) or National Income for the year 2023.
(a) ₹ 2,300 billion
(b) ₹ 2,700 billion
(c) ₹ 2,300 billion (adjusted for net indirect taxes)
(d) ₹ 2,700 billion (adjusted for subsidies)
Answer:
(c) ₹ 2,300 billion (adjusted for net indirect taxes)
Solution:
NNPFC or National Income is calculated by subtracting net indirect taxes (subsidies) on products from GNPFC.
NNPFC = GNPFC - Net indirect taxes (subsidies) on products
NNPFC = ₹ 2,500 billion - ₹ 200 billion
NNPFC = ₹ 2,300 billion
So, the Net National Product at Factor Cost (NNPFC) or National Income for the year 2023 is ₹ 2,300 billion (adjusted for net indirect taxes).

1.3.8 Per Capita Income

1. In a country, the Gross National Product at Factor Cost (GNPFC) for the year 2021 is ₹ 800 billion, and the total population is 200 million. Calculate the Per Capita Income for the year 2021.

   (a) ₹ 4,000 (b) ₹ 4,500
   (c) ₹ 3,500 (d) ₹ 4,200

   Answer:
   (a) ₹ 4,000

   Solution:
   Per Capita Income is calculated by dividing the GNPFC by the total population.
   Per Capita Income = GNPFC / Total population
   Per Capita Income = ₹ 800 billion / 200 million
   Per Capita Income = ₹ 4,000
   So, the Per Capita Income for the year 2021 is ₹ 4,000.

2. In a country, the Gross National Product at Factor Cost (GNPFC) for the year 2022 is ₹ 1,200 billion, and the total population is 250 million. Calculate the Per Capita Income for the year 2022.

   (a) ₹ 4,800
   (b) ₹ 4,000
   (c) ₹ 4,500
   (d) ₹ 5,000

   Answer:
   (c) ₹ 4,500

   Solution:
   Per Capita Income is calculated by dividing the GNPFC by the total population.
   Per Capita Income = GNPFC / Total population
   Per Capita Income = ₹ 1,200 billion / 250 million
   Per Capita Income = ₹ 4,500
   So, the Per Capita Income for the year 2022 is ₹ 4,500.

3. In a country, the Gross National Product at Factor Cost (GNPFC) for the year 2023 is ₹ 2,500 billion, and the total population is 300 million. Calculate the Per Capita Income for the year 2023.

   (a) ₹ 8,000
   (b) ₹ 6,000
   (c) ₹ 7,500
   (d) ₹ 5,000

   Answer:
   (b) ₹ 6,000

   Solution:
   Per Capita Income is calculated by dividing the GNPFC by the total population.
   Per Capita Income = GNPFC / Total population
   Per Capita Income = ₹ 2,500 billion / 300 million
   Per Capita Income = ₹ 6,000
   So, the Per Capita Income for the year 2023 is ₹ 6,000.

1.3.9 Personal Income

1. In a country, the Gross National Product at Factor Cost (GNPFC) for the year 2021 is ₹ 900 billion, depreciation (consumption of fixed capital) is ₹ 100 billion, net indirect taxes (subsidies) on products are ₹ 50 billion, and net current transfers from abroad are ₹ 20 billion. Calculate the Personal Income for the year 2021.

   (a) ₹ 730 billion
   (b) ₹ 830 billion
   (c) ₹ 850 billion
   (d) ₹ 900 billion

   Answer:
   (b) ₹ 830 billion

   Solution:
   Personal Income is calculated as follows:
   Personal Income = GNPFC - Depreciation + Net current transfers from abroad - Net indirect taxes (subsidies) on products

Personal Income = ₹ 900 billion - ₹ 100 billion + ₹ 20 billion - ₹ 50 billion
Personal Income = ₹ 770 billion + ₹ 20 billion - ₹ 50 billion
Personal Income = ₹ 790 billion - ₹ 50 billion
Personal Income = ₹ 830 billion
So, the Personal Income for the year 2021 is ₹ 830 billion.

2. In a country, the Gross National Product at Factor Cost (GNPFC) for the year 2022 is ₹ 1,200 billion, depreciation (consumption of fixed capital) is ₹ 150 billion, net indirect taxes (subsidies) on products are ₹ 80 billion, and net current transfers from abroad are ₹ 30 billion. Calculate the Personal Income for the year 2022.
   (a) ₹ 1,000 billion
   (b) ₹ 1,100 billion
   (c) ₹ 1,020 billion
   (d) ₹ 1,130 billion

   Answer:
   (c) ₹ 1,020 billion

   Solution:
   Personal Income is calculated as follows:
   Personal Income = GNPFC - Depreciation + Net current transfers from abroad - Net indirect taxes (subsidies) on products
   Personal Income = ₹ 1,200 billion - ₹ 150 billion + ₹ 30 billion - ₹ 80 billion
   Personal Income = ₹ 1,050 billion + ₹ 30 billion - ₹ 80 billion
   Personal Income = ₹ 1,080 billion - ₹ 80 billion
   Personal Income = ₹ 1,020 billion
   So, the Personal Income for the year 2022 is ₹ 1,020 billion.

3. In a country, the Gross National Product at Factor Cost (GNPFC) for the year 2023 is ₹ 2,500 billion, depreciation (consumption of fixed capital) is ₹ 200 billion, net indirect taxes (subsidies) on products are ₹ 100 billion, and net current transfers from abroad are ₹ 40 billion. Calculate the Personal Income for the year 2023.
   (a) ₹ 2,240 billion
   (b) ₹ 2,440 billion
   (c) ₹ 2,380 billion
   (d) ₹ 2,540 billion

   Answer:
   (a) ₹ 2,240 billion

   Solution:
   Personal Income is calculated as follows:
   Personal Income = GNPFC - Depreciation + Net current transfers from abroad - Net indirect taxes (subsidies) on products
   Personal Income = ₹ 2,500 billion - ₹ 200 billion + ₹ 40 billion - ₹ 100 billion
   Personal Income = ₹ 2,300 billion + ₹ 40 billion - ₹ 100 billion
   Personal Income = ₹ 2,340 billion - ₹ 100 billion
   Personal Income = ₹ 2,240 billion
   So, the Personal Income for the year 2023 is ₹ 2,240 billion.

4. In a country, the Gross National Product at Factor Cost (GNPFC) for the year 2021 is ₹ 900 billion. The indirect taxes (net of subsidies) on products are ₹ 50 billion, and the consumption of fixed capital (depreciation) is ₹ 100 billion. Calculate the Personal Income for the year 2021, given that there are no other income transfer ₹
   (a) ₹ 750 billion
   (b) ₹ 800 billion
   (c) ₹ 850 billion
   (d) ₹ 900 billion

   Answer:
   (a) ₹ 750 billion

   Solution:
   Personal Income is calculated by subtracting indirect taxes (net of subsidies) on products and depreciation from GNPFC.
   Personal Income = GNPFC - Indirect taxes (net of subsidies) - Depreciation
   Personal Income = ₹ 900 billion - ₹ 50 billion - ₹ 100 billion
   Personal Income = ₹ 750 billion
   So, the Personal Income for the year 2021 is ₹ 750 billion.

5. In a country, the Gross National Product at Factor Cost (GNPFC) for the year 2022 is ₹ 1,200 billion. The indirect taxes (net of subsidies) on products are ₹ 80 billion, and the consumption of fixed capital (depreciation) is ₹ 150 billion. Calculate the Personal Income for the year 2022, given that there are no other income transfer

(a) ₹ 960 billion
(b) ₹ 970 billion
(c) ₹ 980 billion
(d) ₹ 990 billion

Answer:

(b) ₹ 970 billion

Solution:

Personal Income is calculated by subtracting indirect taxes (net of subsidies) on products and depreciation from GNPFC.

Personal Income = GNPFC - Indirect taxes (net of subsidies) - Depreciation

Personal Income = ₹ 1,200 billion - ₹ 80 billion - ₹ 150 billion

Personal Income = ₹ 970 billion

So, the Personal Income for the year 2022 is ₹ 970 billion.

6. In a country, the Gross National Product at Factor Cost (GNPFC) for the year 2023 is ₹ 2,500 billion. The indirect taxes (net of subsidies) on products are ₹ 150 billion, and the consumption of fixed capital (depreciation) is ₹ 200 billion. Calculate the Personal Income for the year 2023, given that there are no other income transfe₹

(a) ₹ 2,150 billion
(b) ₹ 2,150 billion
(c) ₹ 2,150 billion
(d) ₹ 2,150 billion

Answer:

(c) ₹ 2,150 billion

Solution:

Personal Income is calculated by subtracting indirect taxes (net of subsidies) on products and depreciation from GNPFC.

Personal Income = GNPFC - Indirect taxes (net of subsidies) - Depreciation

Personal Income = ₹ 2,500 billion - ₹ 150 billion - ₹ 200 billion

Personal Income = ₹ 2,150 billion

So, the Personal Income for the year 2023 is ₹ 2,150 billion.

1.3.10 Disposable Personal Income (DI)

1. In a country, the Personal Income (PI) for the year 2021 is ₹ 800 billion. The direct taxes are ₹ 100 billion, and the social security contributions are ₹ 50 billion. Calculate the Disposable Personal Income (DI) for the year 2021, given that there are no other income transfe₹

(a) ₹ 650 billion (b) ₹ 750 billion
(c) ₹ 700 billion (d) ₹ 600 billion

Answer:

(a) ₹ 650 billion

Solution:

Disposable Personal Income (DI) is calculated by subtracting direct taxes and social security contributions from Personal Income (PI).

Disposable Personal Income (DI) = Personal Income (PI) - Direct Taxes - Social Security Contributions

Disposable Personal Income (DI) = ₹ 800 billion - ₹ 100 billion - ₹ 50 billion

Disposable Personal Income (DI) = ₹ 650 billion

So, the Disposable Personal Income (DI) for the year 2021 is ₹ 650 billion.

2. In a country, the Personal Income (PI) for the year 2022 is ₹ 1,200 billion. The direct taxes are ₹ 150 billion, and the social security contributions are ₹ 100 billion. Calculate the Disposable Personal Income (DI) for the year 2022, given that there are no other income transfer ₹

(a) ₹ 950 billion (b) ₹ 1,050 billion
(c) ₹ 1,000 billion (d) ₹ 900 billion

Answer:

(d) ₹ 900 billion

Solution:

Disposable Personal Income (DI) is calculated by subtracting direct taxes and social security contributions from Personal Income (PI).

Disposable Personal Income (DI) = Personal Income (PI) - Direct Taxes - Social Security Contributions

Disposable Personal Income (DI) = ₹ 1,200 billion - ₹ 150 billion - ₹ 100 billion

Disposable Personal Income (DI) = ₹ 900 billion

So, the Disposable Personal Income (DI) for the year 2022 is ₹ 900 billion.

3. In a country, the Personal Income (PI) for the year 2023 is ₹ 2,500 billion. The direct taxes are ₹ 200 billion, and the social security contributions are ₹ 150 billion. Calculate the Disposable Personal Income (DI) for the year 2023, given that there are no other income transfer ₹

(a) ₹ 2,200 billion
(b) ₹ 2,300 billion
(c) ₹ 2,350 billion
(d) ₹ 2,400 billion

Answer:

(a) ₹ 2,200 billion

Solution:

Disposable Personal Income (DI) is calculated by subtracting direct taxes and social security contributions from Personal Income (PI).

Disposable Personal Income (DI) = Personal Income (PI) - Direct Taxes - Social Security Contributions

Disposable Personal Income (DI) = ₹ 2,500 billion - ₹ 200 billion - ₹ 150 billion

Disposable Personal Income (DI) = ₹ 2,200 billion

So, the Disposable Personal Income (DI) for the year 2023 is ₹ 2,200 billion.

4. In a country, the Personal Income (PI) for the year 2021 is ₹ 900 billion. Personal taxes for the year 2021 are ₹ 150 billion. Calculate the Disposable Personal Income (DI) for the year 2021.

(a) ₹ 750 billion
(b) ₹ 900 billion
(c) ₹ 750 billion (adjusted for personal taxes)
(d) ₹ 1,050 billion

Answer:

(c) ₹ 750 billion (adjusted for personal taxes)

Solution:

Disposable Personal Income (DI) is calculated by subtracting personal taxes from Personal Income (PI).

DI = PI - Personal taxes

DI = ₹ 900 billion - ₹ 150 billion

DI = ₹ 750 billion

So, the Disposable Personal Income (DI) for the year 2021 is ₹ 750 billion (adjusted for personal taxes).

5. In a country, the Personal Income (PI) for the year 2022 is ₹ 1,200 billion. Personal taxes for the year 2022 are ₹ 180 billion. Calculate the Disposable Personal Income (DI) for the year 2022.

(a) ₹ 1,020 billion
(b) ₹ 1,200 billion
(c) ₹ 1,020 billion (adjusted for personal taxes)
(d) ₹ 1,380 billion

Answer:

(c) ₹ 1,020 billion (adjusted for personal taxes)

Solution:

Disposable Personal Income (DI) is calculated by subtracting personal taxes from Personal Income (PI).

DI = PI - Personal taxes

DI = ₹ 1,200 billion - ₹ 180 billion

DI = ₹ 1,020 billion

So, the Disposable Personal Income (DI) for the year 2022 is ₹ 1,020 billion (adjusted for personal taxes).

6. In a country, the Personal Income (PI) for the year 2023 is ₹ 2,500 billion. Personal taxes for the year 2023 are ₹ 300 billion. Calculate the Disposable Personal Income (DI) for the year 2023.

(a) ₹ 2,200 billion
(b) ₹ 2,800 billion
(c) ₹ 2,200 billion (adjusted for personal taxes)
(d) ₹ 2,800 billion (adjusted for personal taxes)

Answer:

(c) ₹ 2,200 billion (adjusted for personal taxes)

Solution:

Disposable Personal Income (DI) is calculated by subtracting personal taxes from Personal Income (PI).

DI = PI - Personal taxes

DI = ₹ 2,500 billion - ₹ 300 billion

DI = ₹ 2,200 billion

So, the Disposable Personal Income (DI) for the year 2023 is ₹ 2,200 billion (adjusted for personal taxes).

1.3.11 Private Income

1. In a country, the Personal Income (PI) for the year 2021 is ₹ 900 billion. Current transfers from the government and rest of the world to individuals for the year 2021 are ₹ 50 billion. Social contributions by individuals for the year 2021 are ₹ 100 billion. Calculate the Private Income for the year 2021.
   (a) ₹ 750 billion
   (b) ₹ 800 billion
   (c) ₹ 850 billion
   (d) ₹ 950 billion

   Answer:

   (b) ₹ 800 billion

   Solution:

   Private Income is calculated by subtracting current transfers from the government and rest of the world to individuals and social contributions by individuals from Personal Income (PI).

   Private Income = PI - Current transfers - Social contributions

   Private Income = ₹ 900 billion - ₹ 50 billion - ₹ 100 billion

   Private Income = ₹ 800 billion

   So, the Private Income for the year 2021 is ₹ 800 billion.

2. In a country, the Personal Income (PI) for the year 2022 is ₹ 1,200 billion. Current transfers from the government and rest of the world to individuals for the year 2022 are ₹ 80 billion. Social contributions by individuals for the year 2022 are ₹ 150 billion. Calculate the Private Income for the year 2022.

   (a) ₹ 970 billion
   (b) ₹ 970 billion
   (c) ₹ 970 billion
   (d) ₹ 970 billion

   Answer:

   (a) ₹ 970 billion

   Solution: Private Income is calculated by subtracting current transfers from the government and rest of the world to individuals and social contributions by individuals from Personal Income (PI).

   Private Income = PI - Current transfers - Social contributions

   Private Income = ₹ 1,200 billion - ₹ 80 billion - ₹ 150 billion

   Private Income = ₹ 970 billion

   So, the Private Income for the year 2022 is ₹ 970 billion.

3. In a country, the Personal Income (PI) for the year 2023 is ₹ 2,500 billion. Current transfers from the government and rest of the world to individuals for the year 2023 are ₹ 200 billion. Social contributions by individuals for the year 2023 are ₹ 200 billion. Calculate the Private Income for the year 2023.
   (a) ₹ 2,300 billion
   (b) ₹ 2,700 billion
   (c) ₹ 2,500 billion
   (d) ₹ 2,900 billion

   Answer:

   (a) ₹ 2,300 billion

   Solution:

   Private Income is calculated by subtracting current transfers from the government and rest of the world to individuals and social contributions by individuals from Personal Income (PI).

   Private Income = PI - Current transfers - Social contributions

   Private Income = ₹ 2,500 billion - ₹ 200 billion - ₹ 200 billion

   Private Income = ₹ 2,300 billion

   So, the Private Income for the year 2023 is ₹ 2,300 billion.

4. In a country, the Personal Income (PI) for the year 2021 is ₹ 900 billion. Transfer payments for the year 2021 are ₹ 100 billion, and corporate taxes are ₹ 50 billion. Calculate the Private Income for the year 2021.

(a) ₹ 750 billion
(b) ₹ 750 billion (adjusted for transfer payments)
(c) ₹ 850 billion
(d) ₹ 950 billion

Answer:

(b) ₹ 750 billion (adjusted for transfer payments)

Solution:

Private Income is calculated by subtracting transfer payments and corporate taxes from Personal Income (PI).

Private Income = PI - Transfer payments - Corporate taxes

Private Income = ₹ 900 billion - ₹ 100 billion - ₹ 50 billion

Private Income = ₹ 750 billion

So, the Private Income for the year 2021 is ₹ 750 billion (adjusted for transfer payments).

5. In a country, the Personal Income (PI) for the year 2022 is ₹ 1,200 billion. Transfer payments for the year 2022 are ₹ 150 billion, and corporate taxes are ₹ 80 billion. Calculate the Private Income for the year 2022.

(a) ₹ 970 billion
(b) ₹ 1,020 billion
(c) ₹ 970 billion (adjusted for transfer payments)
(d) ₹ 1,080 billion

Answer:

(a) ₹ 970 billion

Solution:

Private Income is calculated by subtracting transfer payments and corporate taxes from Personal Income (PI).

Private Income = PI - Transfer payments - Corporate taxes

Private Income = ₹ 1,200 billion - ₹ 150 billion - ₹ 80 billion

Private Income = ₹ 970 billion

So, the Private Income for the year 2022 is ₹ 970 billion.

6. In a country, the Personal Income (PI) for the year 2023 is ₹ 2,500 billion. Transfer payments for the year 2023 are ₹ 200 billion, and corporate taxes are ₹ 150 billion. Calculate the Private Income for the year 2023.

(a) ₹ 2,200 billion
(b) ₹ 2,150 billion
(c) ₹ 2,200 billion (adjusted for transfer payments)
(d) ₹ 2,350 billion

Answer:

(a) ₹ 2,200 billion

Solution:

Private Income is calculated by subtracting transfer payments and corporate taxes from Personal Income (PI).

Private Income = PI - Transfer payments - Corporate taxes

Private Income = ₹ 2,500 billion - ₹ 200 billion - ₹ 150 billion

Private Income = ₹ 2,200 billion

So, the Private Income for the year 2023 is ₹ 2,200 billion.

1.4 Measurement of National Income in India

1. Which of the following organizations is responsible for estimating the National Income of India?

(a) Reserve Bank of India (RBI) (b) Central Statistical Office (CSO)
(c) Ministry of Finance (d) World Bank

Answer:

(b) Central Statistical Office (CSO)

Explanation:

The Central Statistical Office (CSO) is the organization responsible for estimating the National Income and related macroeconomic indicators in India. It operates under the Ministry of Statistics and Programme Implementation (MOSPI).

2. Which of the following methods is used to estimate the National Income of India?

(a) Expenditure approach
(b) Consumer Price Index method
(c) Profit and Loss method
(d) Balance of Payments approach

Answer:

(a) Expenditure approach

Explanation:
The Expenditure approach is one of the methods used to estimate the National Income of India. It calculates the total expenditure on all final goods and services produced in the country during a specific time period. It includes components like consumption expenditure, investment expenditure, government expenditure, and net exports.

3. Which of the following is NOT considered a part of the National Income of India?
(a) Wages of factory workers
(b) Dividends received by shareholders from a domestic company
(c) Profits earned by a foreign company from its operations in India
(d) Government grants given to a state for infrastructure development

Answer:
(c) Profits earned by a foreign company from its operations in India

Explanation:
The National Income of India includes wages, salaries, profits, rents, and dividends earned within the country's borde₹ Profits earned by a foreign company from its operations in India would be accounted for in Gross National Income (GNI) rather than National Income, as GNI includes both domestic and foreign factors of production.

4. Which base year is currently used for calculating the real Gross Domestic Product (GDP) in India?
(a) 2010-2011
(b) 2004-2005
(c) 2015-2016
(d) 2008-2009

Answer:
(a) 2010-2011

Explanation: As of my last update in September 2021, the base year used for calculating the real Gross Domestic Product (GDP) in India was 2010-2011. The base year is periodically revised to account for changes in the structure of the economy and to provide more accurate estimates of economic growth.

5. Which component of National Income in India is known as the "single largest component" contributing to the economy's output?
(a) Agriculture
(b) Manufacturing
(c) Services
(d) Construction

Answer:
(c) Services

Explanation:
In the Indian economy, the Services sector is known as the "single largest component" contributing to the country's output. It includes various activities like trade, transport, communication, banking, education, healthcare, and other services, which have significant contributions to the overall National Income of India.

6. Which organization is responsible for estimating and publishing National Income data in India?
(a) Reserve Bank of India (RBI)
(b) Ministry of Finance
(c) Central Statistical Office (CSO)
(d) Indian Statistical Institute (ISI)

Answer:
(c) Central Statistical Office (CSO)

Explanation:
In India, the Central Statistical Office (CSO), which functions under the Ministry of Statistics and Programme Implementation (MoSPI), is responsible for estimating and publishing National Income data. The CSO prepares estimates of GDP and other macroeconomic indicators on a regular basis.

7. Which method is used to estimate National Income in India?
(a) Expenditure approach (b) Production approach
(c) Income approach (d) All of the above

Answer:
(d) All of the above

Explanation:
In India, National Income is estimated using all three approaches: expenditure approach, production approach, and income approach. These approaches provide different perspectives on measuring the total economic output of the country and help ensure accuracy and reliability in the estimation process.

8. The base year for computing the Gross Domestic Product (GDP) in India is generally revised after every:
(a) 5 years
(b) 8 years
(c) 10 years
(d) 15 years

Answer:
(c) 10 years

Explanation:
In India, the base year for computing GDP and other economic indicators is typically revised approximately every 10 yea₹ The revision of the base year helps in incorporating changes in the structure of the economy and updating the weights of various sectors based on their contributions to GDP.

9. Which factor cost adjustment is necessary to arrive at Gross Domestic Product (GDP) at factor cost from GDP at market prices in India?
(a) Deducting indirect taxes and adding subsidies
(b) Adding indirect taxes and deducting subsidies
(c) Adding net exports
(d) Deducting net exports

Answer:
(a) Deducting indirect taxes and adding subsidies

Explanation:
To arrive at Gross Domestic Product (GDP) at factor cost from GDP at market prices in India, the adjustment involves deducting indirect taxes (e.g., excise duty, sales tax) and adding subsidies provided by the government. This adjustment eliminates the impact of indirect taxes and subsidies to calculate the income earned by the factors of production.

10. Which of the following sectors is NOT included in the sectoral classification used for estimating National Income in India?
(a) Agriculture and allied activities (b) Manufacturing
(c) Services (d) Foreign Trade

Answer:
(d) Foreign Trade

Explanation:
In the sectoral classification used for estimating National Income in India, the foreign trade sector is not considered as a separate sector. Foreign trade, including exports and imports, is taken into account when estimating the GDP through the expenditure approach (Net Exports) but is not treated as a separate sector in the production-based estimation. Instead, it is incorporated into the overall calculations using the appropriate approach.

11. In India, which organization is responsible for the estimation of National Income?
(a) Ministry of Finance
(b) Reserve Bank of India (RBI)
(c) Central Statistical Office (CSO)
(d) Planning Commission of India

Answer:
(c) Central Statistical Office (CSO)

Explanation:
In India, the Central Statistical Office (CSO) is responsible for the estimation of National Income and other macroeconomic indicato₹ It operates under the Ministry of Statistics and Programme Implementation.

12. Which factor-based method is used for calculating Gross Domestic Product (GDP) in India?
(a) Production Approach (b) Expenditure Approach
(c) Income Approach (d) Value Added Approach

Answer:
(c) Income Approach

Explanation:
In India, the Income Approach is used for calculating Gross Domestic Product (GDP). It estimates GDP by summing up all the factor incomes earned by individuals and businesses during a specific time period, such as wages, interest, rent, and profits.

13. Which fiscal year is considered for the computation of India's National Income statistics?
(a) January 1^{st} to December 31^{st}
(b) April 1^{st} to March 31^{st}
(c) July 1^{st} to June 30^{th}
(d) October 1^{st} to September 30^{th}
Answer:
(b) April 1^{st} to March 31^{st}
Explanation:
In India, the fiscal year for the computation of National Income statistics is from April 1st to March 31st. It aligns with the country's financial year.

14. In India, which sector contributes the most to the Gross Domestic Product (GDP)?
(a) Agriculture and Allied Activities (b) Manufacturing
(c) Services (d) Mining and Quarrying
Answer:
(c) Services
Explanation:
In India, the services sector is the largest contributor to the Gross Domestic Product (GDP). It includes various industries such as banking, IT, telecommunications, healthcare, education, and more.

15. In the context of National Income accounting, what does GVA stand for?
(a) Gross Value Adjustment
(b) Gross Value Added
(c) Gross Variable Assessment
(d) General Value Adjustment
Answer:
(b) Gross Value Added

Explanation:
GVA stands for Gross Value Added. It is a concept used in National Income accounting that measures the value added by each industry or sector to the economy during the production process. GVA is used as a key input in calculating Gross Domestic Product (GDP) in India.

1.4.1 The Circular Flow of Income

1. In a simple economy, the total value of goods and services produced (Gross Domestic Product - GDP) is ₹ 500 billion. The total income earned by households (wages, rent, and profits) is ₹ 400 billion. Calculate the total value of savings and taxes in this economy.
(a) ₹ 100 billion (b) ₹ 200 billion
(c) ₹ 300 billion (d) ₹ 400 billion
Answer:
(a) ₹ 100 billion
Solution:
In a simple economy, the total value of goods and services produced (GDP) is equal to the total income earned by households (wages, rent, and profits). Therefore, the total value of savings and taxes is equal to the difference between GDP and total income earned by households.
Total Value of Savings and Taxes = GDP - Total Income earned by households
Total Value of Savings and Taxes = ₹ 500 billion - ₹ 400 billion
Total Value of Savings and Taxes = ₹ 100 billion
So, the total value of savings and taxes in this economy is ₹ 100 billion.

2. In a closed economy, the total value of goods and services produced (Gross Domestic Product - GDP) is ₹ 800 billion. The total value of consumption expenditure is ₹ 600 billion. Calculate the total value of savings in this closed economy.
(a) ₹ 100 billion (b) ₹ 200 billion
(c) ₹ 300 billion (d) ₹ 400 billion
Answer:
(c) ₹ 300 billion

Solution:

In a closed economy, the total value of goods and services produced (GDP) is equal to the total value of consumption expenditure plus total value of savings (since there are no exports or imports).

Total Value of Savings = GDP - Total Value of Consumption Expenditure

Total Value of Savings = ₹ 800 billion - ₹ 600 billion

Total Value of Savings = ₹ 200 billion

So, the total value of savings in this closed economy is ₹ 200 billion.

3. In an open economy, the total value of goods and services produced (Gross Domestic Product - GDP) is ₹ 1,500 billion. The total value of consumption expenditure is ₹ 1,000 billion, and exports are ₹ 300 billion. Calculate the total value of savings in this open economy.

(a) ₹ 300 billion (b) ₹ 500 billion
(c) ₹ 800 billion (d) ₹ 1,200 billion

Answer:

(a) ₹ 300 billion

Solution:

In an open economy, the total value of goods and services produced (GDP) is equal to the total value of consumption expenditure plus total value of savings plus net exports (exports - imports).

Total Value of Savings + Net Exports = GDP - Total Value of Consumption Expenditure

Total Value of Savings + ₹ 300 billion = ₹ 1,500 billion - ₹ 1,000 billion

Total Value of Savings = ₹ 500 billion - ₹ 300 billion

Total Value of Savings = ₹ 200 billion

So, the total value of savings in this open economy is ₹ 200 billion.

4. In a two-sector economy, the total value of output (Gross Domestic Product) is ₹ 800 billion. Calculate the total value of income generated in the economy.

(a) ₹ 800 billion (b) ₹ 600 billion
(c) ₹ 400 billion (d) ₹ 1,200 billion

Answer:

(a) ₹ 800 billion

Solution:

In a two-sector economy, the total value of output (Gross Domestic Product) is equal to the total value of income generated. Therefore, the total value of income generated in the economy is ₹ 800 billion.

5. In a three-sector economy, the total value of output (Gross Domestic Product) is ₹ 1,200 billion. The value of exports is ₹ 100 billion, and the value of government spending on goods and services is ₹ 150 billion. Calculate the total value of income generated in the economy.

(a) ₹ 1,200 billion
(b) ₹ 1,050 billion
(c) ₹ 950 billion
(d) ₹ 1,000 billion

Answer:

(b) ₹ 1,050 billion

Solution:

In a three-sector economy, the total value of output (Gross Domestic Product) is equal to the total value of income generated plus taxes minus subsidies. Since there are no taxes or subsidies mentioned in the question, the total value of income generated in the economy is ₹ 1,200 billion.

Total value of income generated = Total value of output

Total value of income generated = ₹ 1,200 billion

6. In a four-sector economy, the total value of output (Gross Domestic Product) is ₹ 2,000 billion. The value of imports is ₹ 300 billion, and the value of government spending on goods and services is ₹ 400 billion. Calculate the total value of income generated in the economy.

(a) ₹ 1,300 billion (b) ₹ 1,600 billion
(c) ₹ 2,000 billion (d) ₹ 2,700 billion

Answer:

(b) ₹ 1,600 billion

Solution:

In a four-sector economy, the total value of output (Gross Domestic Product) is equal to the total value of income generated plus taxes minus subsidies and imports.

Total value of income generated = Total value of output - Imports
Total value of income generated = ₹ 2,000 billion - ₹ 300 billion
Total value of income generated = ₹ 1,700 billion
Since there are no taxes or subsidies mentioned in the question, the total value of income generated in the economy is ₹ 1,700 billion.
Total value of income generated = ₹ 1,700 billion

1.4.2 Value Added Method or Product Method

1. Consider a three-stage production process. The value of raw materials purchased by a firm is ₹ 500, the cost of intermediate goods is ₹ 300, and the firm adds a value of ₹ 200 to produce the final goods. Calculate the value added by the firm.

   (a) ₹ 200 (b) ₹ 300
   (c) ₹ 500 (d) ₹ 1,000

   Answer:
   (a) ₹ 200

   Solution:
   The value added by a firm in the production process is the difference between the value of its output and the value of its inputs.
   Value Added = Value of Output - Value of Inputs
   Value Added = ₹ 200 (final goods value) - (₹ 500 + ₹ 300) (raw materials + intermediate goods)
   Value Added = ₹ 200 - ₹ 800
   Value Added = ₹ 200
   So, the value added by the firm is ₹ 200.

2. Consider a four-stage production process. The value of raw materials purchased by a firm is ₹ 800, the cost of intermediate goods at each stage is ₹ 100, ₹ 150, and ₹ 200, respectively. The firm adds a value of ₹ 300 at the final stage to produce the final goods. Calculate the value added by the firm.

   (a) ₹ 100 (b) ₹ 150
   (c) ₹ 300 (d) ₹ 450

   Answer:
   (d) ₹ 450

   Solution:
   The value added by a firm in the production process is the difference between the value of its output and the value of its inputs.
   Value Added = Value of Output - Value of Inputs
   Value Added = ₹ 300 (final goods value) - (₹ 800 + ₹ 100 + ₹ 150 + ₹ 200) (raw materials + intermediate goods at each stage)
   Value Added = ₹ 300 - ₹ 1250
   Value Added = ₹ 450
   So, the value added by the firm is ₹ 450.

3. Consider a two-stage production process. The value of raw materials purchased by a firm is ₹ 400, and the firm adds a value of ₹ 600 to produce the final goods. Calculate the value added by the firm.

   (a) ₹ 400
   (b) ₹ 600
   (c) ₹ 1,000
   (d) ₹ 200

   Answer:
   (d) ₹ 200

   Solution:
   The value added by a firm in the production process is the difference between the value of its output and the value of its inputs.
   Value Added = Value of Output - Value of Inputs
   Value Added = ₹ 600 (final goods value) - ₹ 400 (raw materials)
   Value Added = ₹ 600 - ₹ 400
   Value Added = ₹ 200
   So, the value added by the firm is ₹ 200.

4. In a three-stage production process, the value of raw materials purchased by a company is ₹ 500 million. The company adds value worth ₹ 300 million during the production process. Calculate the total value of the final product.

   (a) ₹ 100 million (b) ₹ 200 million
   (c) ₹ 300 million (d) ₹ 800 million

   Answer:
   (d) ₹ 800 million

Solution:
The Value Added Method calculates the value of the final product by summing up the value added at each stage of production.
Total value of final product = Value of raw materials + Value added
Total value of final product = ₹ 500 million + ₹ 300 million
Total value of final product = ₹ 800 million
So, the total value of the final product is ₹ 800 million.

5. In a four-stage production process, the value of intermediate goods purchased by a company is ₹ 800 billion. The company adds value worth ₹ 400 billion during the production process. Calculate the total value of the final product.
(a) ₹ 200 billion
(b) ₹ 400 billion
(c) ₹ 800 billion
(d) ₹ 1,200 billion
Answer:
(d) ₹ 1,200 billion
Solution:
The Value Added Method calculates the value of the final product by summing up the value added at each stage of production.
Total value of final product = Value of intermediate goods + Value added
Total value of final product = ₹ 800 billion + ₹ 400 billion
Total value of final product = ₹ 1,200 billion
So, the total value of the final product is ₹ 1,200 billion.

6. In a five-stage production process, the value of raw materials purchased by a company is ₹ 1,000 million. The company adds value worth ₹ 500 million during the production process. Calculate the total value of the final product.
(a) ₹ 500 million
(b) ₹ 1,000 million
(c) ₹ 1,500 million
(d) ₹ 2,000 million
Answer:
(c) ₹ 1,500 million

Solution:
The Value Added Method calculates the value of the final product by summing up the value added at each stage of production.
Total value of final product = Value of raw materials + Value added
Total value of final product = ₹ 1,000 million + ₹ 500 million
Total value of final product = ₹ 1,500 million
So, the total value of the final product is ₹ 1,500 million.

1.4.3 Income Method

1. In an economy, the following income components are given: employee compensation (₹ 300 billion), rents (₹ 50 billion), interest (₹ 100 billion), proprietor's income (₹ 150 billion), corporate profits (₹ 200 billion), and taxes on production and imports (₹ 50 billion). Calculate the Gross Domestic Product (GDP) using the Income Method.
(a) ₹ 500 billion (b) ₹ 700 billion
(c) ₹ 800 billion (d) ₹ 850 billion
Answer:
(c) ₹ 800 billion
Solution:
The Income Method calculates the Gross Domestic Product (GDP) by summing up all the income components earned in the economy.
GDP = Employee compensation + Rents + Interest + Proprietor's income + Corporate profits + Taxes on production and imports
GDP = ₹ 300 billion + ₹ 50 billion + ₹ 100 billion + ₹ 150 billion + ₹ 200 billion + ₹ 50 billion
GDP = ₹ 800 billion
So, the Gross Domestic Product (GDP) using the Income Method is ₹ 800 billion.

2. In an economy, the following income components are given: employee compensation (₹ 400 billion), rents (₹ 70 billion), interest (₹ 120 billion), proprietor's income (₹ 180 billion), corporate profits (₹ 250 billion), and taxes on production and imports (₹ 60 billion). Calculate the Gross Domestic Product (GDP) using the Income Method.

(a) ₹ 800 billion
(b) ₹ 900 billion
(c) ₹ 1,000 billion
(d) ₹ 1,080 billion

Answer:

(b) ₹ 900 billion

Solution:

The Income Method calculates the Gross Domestic Product (GDP) by summing up all the income components earned in the economy.

GDP = Employee compensation + Rents + Interest + Proprietor's income + Corporate profits + Taxes on production and imports

GDP = ₹ 400 billion + ₹ 70 billion + ₹ 120 billion + ₹ 180 billion + ₹ 250 billion + ₹ 60 billion

GDP = ₹ 900 billion

So, the Gross Domestic Product (GDP) using the Income Method is ₹ 900 billion.

3. In an economy, the following income components are given: employee compensation (₹ 500 billion), rents (₹ 90 billion), interest (₹ 150 billion), proprietor's income (₹ 200 billion), corporate profits (₹ 300 billion), and taxes on production and imports (₹ 80 billion). Calculate the Gross Domestic Product (GDP) using the Income Method.

(a) ₹ 950 billion
(b) ₹ 1,000 billion
(c) ₹ 1,200 billion
(d) ₹ 1,220 billion

Answer:

(d) ₹ 1,220 billion

Solution:

The Income Method calculates the Gross Domestic Product (GDP) by summing up all the income components earned in the economy.

GDP = Employee compensation + Rents + Interest + Proprietor's income + Corporate profits + Taxes on production and imports

GDP = ₹ 500 billion + ₹ 90 billion + ₹ 150 billion + ₹ 200 billion + ₹ 300 billion + ₹ 80 billion

GDP = ₹ 1,220 billion

So, the Gross Domestic Product (GDP) using the Income Method is ₹ 1,220 billion.

4. In a country, the total compensation of employees (wages, salaries, and benefits) for the year 2021 is ₹ 500 billion. The gross operating surplus (profit) earned by businesses for the year 2021 is ₹ 300 billion. Calculate the Gross National Income (GNI) for the year 2021.

(a) ₹ 200 billion
(b) ₹ 500 billion
(c) ₹ 800 billion
(d) ₹ 300 billion

Answer:

(c) ₹ 800 billion

Solution:

The Income Method calculates Gross National Income (GNI) by summing up the total compensation of employees and gross operating surplus.

GNI = Total compensation of employees + Gross operating surplus

GNI = ₹ 500 billion + ₹ 300 billion

GNI = ₹ 800 billion

So, the Gross National Income (GNI) for the year 2021 is ₹ 800 billion.

5. In a country, the total compensation of employees (wages, salaries, and benefits) for the year 2022 is ₹ 600 billion. The gross operating surplus (profit) earned by businesses for the year 2022 is ₹ 400 billion. Calculate the Gross National Income (GNI) for the year 2022.

(a) ₹ 1,000 billion
(b) ₹ 400 billion
(c) ₹ 600 billion
(d) ₹ 1,200 billion

Answer:

(a) ₹ 1,000 billion

Solution:

The Income Method calculates Gross National Income (GNI) by summing up the total compensation of employees and gross operating surplus.

GNI = Total compensation of employees + Gross operating surplus

GNI = ₹ 600 billion + ₹ 400 billion

GNI = ₹ 1,000 billion

So, the Gross National Income (GNI) for the year 2022 is ₹ 1,000 billion.

6. In a country, the total compensation of employees (wages, salaries, and benefits) for the year 2023 is ₹ 800 billion. The gross operating surplus (profit) earned by businesses for the year 2023 is ₹ 500 billion. Calculate the Gross National Income (GNI) for the year 2023.
   (a) ₹ 1,300 billion
   (b) ₹ 1,500 billion
   (c) ₹ 800 billion
   (d) ₹ 300 billion

   Answer:

   (b) ₹ 1,500 billion

   Solution:

   The Income Method calculates Gross National Income (GNI) by summing up the total compensation of employees and gross operating surplus.

   GNI = Total compensation of employees + Gross operating surplus

   GNI = ₹ 800 billion + ₹ 500 billion

   GNI = ₹ 1,500 billion

   So, the Gross National Income (GNI) for the year 2023 is ₹ 1,500 billion.

1.4.4 Expenditure Method

1. In a country, the total private consumption expenditure for the year 2021 is ₹ 800 billion. The total investment expenditure for the year 2021 is ₹ 200 billion. The government's total expenditure on goods and services for the year 2021 is ₹ 300 billion. Calculate the Gross Domestic Product (GDP) for the year 2021.
   (a) ₹ 500 billion (b) ₹ 1,000 billion
   (c) ₹ 1,300 billion (d) ₹ 900 billion,

   Answer:

   (b) ₹ 1,000 billion

   Solution:

   The Expenditure Method calculates Gross Domestic Product (GDP) by summing up the total private consumption expenditure, total investment expenditure, and government expenditure on goods and services.

   GDP = Total private consumption expenditure + Total investment expenditure + Government expenditure on goods and services

   GDP = ₹ 800 billion + ₹ 200 billion + ₹ 300 billion

   GDP = ₹ 1,000 billion

   So, the Gross Domestic Product (GDP) for the year 2021 is ₹ 1,000 billion.

2. In a country, the total private consumption expenditure for the year 2022 is ₹ 900 billion. The total investment expenditure for the year 2022 is ₹ 250 billion. The government's total expenditure on goods and services for the year 2022 is ₹ 350 billion. Calculate the Gross Domestic Product (GDP) for the year 2022.
   (a) ₹ 1,500 billion
   (b) ₹ 1,100 billion
   (c) ₹ 1,200 billion
   (d) ₹ 1,500 billion

   Answer:

   (c) ₹ 1,200 billion

   Solution:

   The Expenditure Method calculates Gross Domestic Product (GDP) by summing up the total private consumption expenditure, total investment expenditure, and government expenditure on goods and services.

   GDP = Total private consumption expenditure + Total investment expenditure + Government expenditure on goods and services

   GDP = ₹ 900 billion + ₹ 250 billion + ₹ 350 billion

   GDP = ₹ 1,200 billion

   So, the Gross Domestic Product (GDP) for the year 2022 is ₹ 1,200 billion.

3. In a country, the total private consumption expenditure for the year 2023 is ₹ 1,200 billion. The total investment expenditure for the year 2023 is ₹ 300 billion. The government's total expenditure on goods and services for the year 2023 is ₹ 400 billion. Calculate the Gross Domestic Product (GDP) for the year 2023.
   (a) ₹ 1,500 billion
   (b) ₹ 1,900 billion

(c) ₹ 1,900 billion (adjusted for imports)
(d) ₹ 1,500 billion (adjusted for exports)

Answer:

(b) ₹ 1,900 billion

Solution:

The Expenditure Method calculates Gross Domestic Product (GDP) by summing up the total private consumption expenditure, total investment expenditure, and government expenditure on goods and services.

GDP = Total private consumption expenditure + Total investment expenditure + Government expenditure on goods and services

GDP = ₹ 1,200 billion + ₹ 300 billion + ₹ 400 billion

GDP = ₹ 1,900 billion

So, the Gross Domestic Product (GDP) for the year 2023 is ₹ 1,900 billion.

4. In a country, the total private consumption expenditure for the year 2021 is ₹ 800 billion. The gross private domestic investment for the year 2021 is ₹ 200 billion. The government expenditure on goods and services for the year 2021 is ₹ 300 billion, and the net exports (exports minus imports) for the year 2021 are -₹ 100 billion. Calculate the Gross Domestic Product (GDP) for the year 2021.

(a) ₹ 1,000 billion
(b) ₹ 1,000 billion
(c) ₹ 1,200 billion
(d) ₹ 900 billion

Answer:

(a) ₹ 1,000 billion

Solution:

The Expenditure Method calculates Gross Domestic Product (GDP) by summing up private consumption expenditure, gross private domestic investment, government expenditure on goods and services, and net exports.

GDP = Private consumption expenditure + Gross private domestic investment + Government expenditure on goods and services + Net exports

GDP = ₹ 800 billion + ₹ 200 billion + ₹ 300 billion + (-₹ 100 billion)

GDP = ₹ 1,000 billion

So, the Gross Domestic Product (GDP) for the year 2021 is ₹ 1,000 billion.

5. In a country, the total private consumption expenditure for the year 2022 is ₹ 1,200 billion. The gross private domestic investment for the year 2022 is ₹ 300 billion. The government expenditure on goods and services for the year 2022 is ₹ 400 billion, and the net exports (exports minus imports) for the year 2022 are -₹ 150 billion. Calculate the Gross Domestic Product (GDP) for the year 2022.

(a) ₹ 1,350 billion
(b) ₹ 1,350 billion
(c) ₹ 1,550 billion
(d) ₹ 1,100 billion

Answer:

(a) ₹ 1,350 billion

Solution:

The Expenditure Method calculates Gross Domestic Product (GDP) by summing up private consumption expenditure, gross private domestic investment, government expenditure on goods and services, and net exports.

GDP = Private consumption expenditure + Gross private domestic investment + Government expenditure on goods and services + Net exports

GDP = ₹ 1,200 billion + ₹ 300 billion + ₹ 400 billion + (-₹ 150 billion)

GDP = ₹ 1,350 billion

So, the Gross Domestic Product (GDP) for the year 2022 is ₹ 1,350 billion.

6. In a country, the total private consumption expenditure for the year 2023 is ₹ 1,500 billion. The gross private domestic investment for the year 2023 is ₹ 400 billion. The government expenditure on goods and services for the year 2023 is ₹ 500 billion, and the net exports (exports minus imports) for the year 2023 are -₹ 200 billion. Calculate the Gross Domestic Product (GDP) for the year 2023.

(a) ₹ 1,300 billion
(b) ₹ 1,300 billion
(c) ₹ 1,600 billion
(d) ₹ 1,200 billion

Answer:

(c) ₹ 1,600 billion

Solution:

The Expenditure Method calculates Gross Domestic Product (GDP) by summing up private consumption expenditure, gross private domestic investment, government expenditure on goods and services, and net exports.

GDP = Private consumption expenditure + Gross private domestic investment + Government expenditure on goods and services + Net exports

GDP = ₹ 1,500 billion + ₹ 400 billion + ₹ 500 billion + (-₹ 200 billion)

GDP = ₹ 1,600 billion

So, the Gross Domestic Product (GDP) for the year 2023 is ₹ 1,600 billion.

1.5 The System of Regional Accounts in India

1. The System of Regional Accounts in India provides economic data at which level of geographical aggregation?
   (a) District level
   (b) State level
   (c) National level
   (d) International level

Answer:

(b) State level

Explanation:

The System of Regional Accounts in India provides economic data at the state level. It focuses on measuring and analyzing the economic performance and indicators of individual states and union territories within the country.

2. Which government agency is responsible for preparing the System of Regional Accounts in India?
   (a) Ministry of Finance
   (b) Reserve Bank of India (RBI)
   (c) Central Statistical Office (CSO)
   (d) National Institution for Transforming India (NITI Aayog)

Answer:

(c) Central Statistical Office (CSO)

Explanation:

The Central Statistical Office (CSO), operating under the Ministry of Statistics and Programme Implementation, is responsible for preparing and publishing the System of Regional Accounts in India.

3. The System of Regional Accounts in India provides data on which of the following aspects at the state level?
   (a) Population and demographic trends
   (b) Agricultural production and land use
   (c) Industrial output and manufacturing activities
   (d) All of the above

Answer:

(d) All of the above

Explanation:

The System of Regional Accounts in India provides data on various aspects at the state level, including population and demographic trends, agricultural production and land use, industrial output and manufacturing activities, services sector performance, and other economic indicato₹

4. Which of the following is NOT a primary purpose of the System of Regional Accounts in India?
   (a) Facilitating inter-state economic comparisons
   (b) Informing state-level economic planning and policy formulation
   (c) Identifying regional disparities and inequalities
   (d) Regulating regional fiscal policies

Answer:

(d) Regulating regional fiscal policies

Explanation:
The System of Regional Accounts in India is primarily focused on facilitating inter-state economic comparisons, informing state-level economic planning and policy formulation, and identifying regional disparities and inequalities. It does not involve regulating regional fiscal policies, which is the domain of state governments and central fiscal authorities.

5. Which statistical yearbook published by the CSO includes the data and analysis on the System of Regional Accounts in India?
   (a) Economic Survey of India
   (b) Indian Financial Yearbook
   (c) India in Figures
   (d) National Accounts Statistics

   Answer:
   (d) National Accounts Statistics

   Explanation:
   The National Accounts Statistics, published by the Central Statistical Office (CSO), provides comprehensive data and analysis on the System of Regional Accounts in India, along with other macroeconomic indicators and national income accounting data.

6. What is the primary purpose of the System of Regional Accounts in India?
   (a) To estimate the national income of the country
   (b) To measure the economic growth of different states
   (c) To calculate the GDP of individual cities
   (d) To track the inflation rate at the regional level

   Answer:
   (b) To measure the economic growth of different states

   Explanation:
   The System of Regional Accounts in India is primarily used to measure and analyze the economic growth and performance of different states and regions within the country. It provides valuable data on the regional distribution of economic activities and helps in identifying disparities and development imbalances.

7. Which organization is responsible for preparing the System of Regional Accounts in India?
   (a) Reserve Bank of India (RBI)
   (b) Ministry of Finance
   (c) Central Statistical Office (CSO)
   (d) National Sample Survey Office (NSSO)

   Answer:
   (c) Central Statistical Office (CSO)

   Explanation:
   The Central Statistical Office (CSO), operating under the Ministry of Statistics and Programme Implementation, is responsible for preparing the System of Regional Accounts in India.

8. Which of the following indicators is NOT covered in the System of Regional Accounts in India?
   (a) Gross State Domestic Product (GSDP)
   (b) Per Capita Income of states
   (c) Industrial Production Index of states
   (d) National Unemployment Rate

   Answer:
   (d) National Unemployment Rate

   Explanation:
   The System of Regional Accounts in India primarily focuses on regional economic indicators such as Gross State Domestic Product (GSDP), per capita income of states, and industrial production index of states. The national unemployment rate is a macroeconomic indicator that is not specific to individual states and is not covered under regional accounts.

9. Which method is used for estimating the Gross State Domestic Product (GSDP) in India?
   (a) Production Approach
   (b) Income Approach
   (c) Expenditure Approach
   (d) Value Added Approach

   Answer:
   (c) Expenditure Approach

Explanation:
The Expenditure Approach is used for estimating the Gross State Domestic Product (GSDP) in India. It calculates the GSDP by summing up all the final expenditures made on goods and services produced within the state during a specific time period.

10. The System of Regional Accounts in India provides data at which level of geographical aggregation?
(a) District level
(b) City level
(c) State level
(d) Village level
Answer:
(c) State level
Explanation:
The System of Regional Accounts in India provides economic data and estimates at the state level. It assesses the economic performance and growth of different states in the country.

1.6 GDP and Welfare

1. Gross Domestic Product (GDP) measures:
(a) The total value of goods and services produced within a country's border ₹
(b) The total value of goods and services consumed by households.
(c) The total value of goods and services exported by a country.
(d) The total value of goods and services imported by a country.
Answer:
(a) The total value of goods and services produced within a country's border ₹
Explanation:
GDP is a measure of the total economic output produced within a country's borders during a specific time period. It includes the value of all goods and services produced by domestic industries, regardless of whether they are consumed domestically or exported.

2. Which of the following statements is true regarding the relationship between GDP and welfare?
(a) Higher GDP always leads to higher welfare for all citizens.
(b) Higher GDP guarantees improved living standards for all citizens.
(c) GDP is a comprehensive measure of societal well-being.
(d) GDP per capita is a useful but incomplete indicator of welfare.
Answer:
(d) GDP per capita is a useful but incomplete indicator of welfare.
Explanation:
While GDP per capita is a commonly used indicator to assess the economic well-being of a country's citizens, it is not a comprehensive measure of welfare. GDP measures the economic output and production but does not directly capture aspects like income distribution, health, education, and environmental quality, which are important determinants of overall welfare.

3. Which of the following factors is NOT considered in the calculation of GDP?
(a) Government spending on infrastructure projects
(b) Investment in new factories and equipment
(c) Income earned by citizens working abroad
(d) Transfer payments, such as social welfare benefits
Answer:
(d) Transfer payments, such as social welfare benefits
Explanation:
Transfer payments, such as social welfare benefits, are not included in the calculation of GDP because they do not represent goods and services produced. GDP measures only the value of final goods and services produced, so transfer payments, which involve the redistribution of income without any production of goods or services, are excluded.

4. Which of the following situations can lead to a discrepancy between GDP growth and citizens' well-being?
(a) When inflation is high, and GDP growth is low
(b) When income inequality increases during a period of economic expansion

(c) When a country's exports decrease, and GDP growth slows down
(d) When government spending increases to fund public services and welfare programs

Answer:

(b) When income inequality increases during a period of economic expansion

Explanation:

Income inequality can lead to a discrepancy between GDP growth and citizens' well-being. Economic expansion and GDP growth may benefit certain segments of the population more than others, leading to unequal distribution of income and welfare. In such cases, GDP growth may not reflect the overall improvement in the living standards of all citizens.

5. Which of the following is a limitation of using GDP as a measure of welfare?
(a) GDP does not account for the value of goods and services produced in the informal sector.
(b) GDP does not consider government spending on defense and security.
(c) GDP does not take into account changes in the trade balance.
(d) GDP does not capture the impact of technological advancements on productivity.

Answer:

(a) GDP does not account for the value of goods and services produced in the informal sector.

Explanation:

One of the limitations of using GDP as a measure of welfare is that it does not fully account for the value of goods and services produced in the informal sector of the economy, which can be significant in some countries. The informal sector includes activities that are not formally recorded or regulated, such as street vending or unregistered small businesses. These activities contribute to economic output but may not be adequately captured in official GDP calculations.

6. Gross Domestic Product (GDP) is a measure of:
(a) The total population of a country
(b) The total value of goods and services produced in a country
(c) The total government spending in a country
(d) The total imports and exports of a country

Answer:

(b) The total value of goods and services produced in a country

Explanation:

GDP is a measure of the total value of all final goods and services produced within a country's borders during a specific time period. It is an important indicator of a country's economic activity and output.

7. Which of the following statements is true regarding GDP and welfare?
(a) A higher GDP always indicates higher welfare for the population.
(b) GDP is unrelated to the well-being and welfare of the population.
(c) GDP is a good indicator of economic growth but does not fully capture the overall welfare of the population.
(d) GDP is a measure of income distribution among the population.

Answer:

(c) GDP is a good indicator of economic growth but does not fully capture the overall welfare of the population.

Explanation:

While GDP is an important indicator of economic growth and activity, it does not provide a comprehensive assessment of the overall well-being or welfare of the population. GDP measures the total economic output and does not take into account factors such as income distribution, inequality, environmental sustainability, and social well-being, which are crucial components of welfare.

8. Which of the following is an example of a limitation of using GDP as a measure of welfare?
(a) GDP includes the value of illegal activities, such as drug trafficking.
(b) GDP accounts for environmental degradation and pollution.
(c) GDP reflects the level of education and healthcare in a country.
(d) GDP considers the distribution of income among different income groups.

Answer:
(a) GDP includes the value of illegal activities, such as drug trafficking.
Explanation:
One of the limitations of using GDP as a measure of welfare is that it includes the value of all goods and services produced within a country's borders, regardless of their legality. This means that illegal activities, such as drug trafficking and other black-market transactions, are also included in GDP, which can distort the actual welfare level of a country.

9. Which term refers to the total GDP adjusted for inflation or changes in price levels?
(a) Real GDP
(b) Nominal GDP
(c) Per capita GDP
(d) Gross National Product (GNP)
Answer:
(a) Real GDP
Explanation:
Real GDP refers to the total GDP of a country that has been adjusted for inflation or changes in price levels. It provides a more accurate measure of economic growth by removing the influence of price changes over time.

10. Which of the following factors is NOT considered in GDP calculations?
(a) Government spending on infrastructure projects
(b) Private investment in businesses and factories
(c) Household savings and personal investments
(d) Value of intermediate goods used in the production process
Answer:
(c) Household savings and personal investments
Explanation:
GDP calculations do not directly consider household savings and personal investments. GDP measures the value of goods and services produced in an economy, including government spending, private investment, and the value of intermediate goods used in the production process. Household savings and personal investments are important for the economy but are not directly included in GDP calculations.

1.7 Limitations and Challenges of National Income Computation

1. Which of the following is a limitation of using Gross Domestic Product (GDP) as a measure of economic welfare?
(a) GDP does not account for changes in the population size.
(b) GDP includes the value of all final goods and services.
(c) GDP considers income distribution among different income groups.
(d) GDP measures the total value of goods and services produced.
Answer:
(a) GDP does not account for changes in the population size.
Explanation:
One limitation of using GDP as a measure of economic welfare is that it does not account for changes in the population size. As a result, even if GDP increases, it does not necessarily mean that the standard of living or welfare of the population has improved, especially if the population has grown at a faster rate than GDP.

2. Which factor can lead to an overestimation of a country's GDP?
(a) Inclusion of government transfer payments
(b) Exclusion of household consumption
(c) Exclusion of exports of goods and services
(d) Inclusion of imports of goods and services
Answer:
(a) Inclusion of government transfer payments
Explanation:
The inclusion of government transfer payments (e.g., social security benefits, unemployment benefits) in GDP calculations can lead to an overestimation of a country's GDP. Transfer payments are payments made without the production of goods or services, so including them in GDP would count the same income twice.

3. Which aspect is not adequately captured by GDP, making it an incomplete measure of economic performance?
(a) Economic growth rate (b) Inflation rate
(c) Income distribution (d) Unemployment rate
Answer:
(c) Income distribution

Explanation:
GDP does not directly capture income distribution among different income groups in the economy. It measures the total economic output, but it does not provide information about how that output is distributed among the population. As a result, it is an incomplete measure of economic performance in terms of assessing income inequality.

4. Which challenge arises due to the difficulty of accurately measuring the informal or underground economy?
   (a) Seasonal adjustments
   (b) Double-counting of intermediate goods
   (c) Price fluctuations
   (d) Shadow economy estimation

   Answer:
   (d) Shadow economy estimation

   Explanation:
   The challenge of accurately measuring the informal or underground economy is often referred to as "shadow economy estimation." The informal economy includes economic activities that are not recorded in official statistics, making it challenging to include them in GDP calculations.

5. Which of the following is NOT a limitation of using GDP as a measure of well-being?
   (a) GDP ignores the value of leisure time and non-market activities.
   (b) GDP does not account for environmental degradation and resource depletion.
   (c) GDP considers the level of investment in human capital and education.
   (d) GDP focuses solely on economic activities and production.

   Answer:
   (c) GDP considers the level of investment in human capital and education.

   Explanation:
   One of the limitations of GDP as a measure of well-being is that it does not directly account for the level of investment in human capital and

education. GDP primarily focuses on economic activities and the production of goods and services, but it does not fully capture the social and human development aspects of a country.

6. Which of the following is a limitation of using National Income as a measure of economic welfare?
   (a) It does not account for income inequality.
   (b) It includes the value of illegal activities in the economy.
   (c) It is difficult to calculate accurately.
   (d) It is not relevant for developed countries.

   Answer:
   (a) It does not account for income inequality.

   Explanation:
   One of the limitations of using National Income as a measure of economic welfare is that it does not account for income inequality. It provides an aggregate measure of the total income generated in an economy but does not reflect how this income is distributed among different income groups. A country with high GDP or National Income may still experience significant income inequality, impacting the overall well-being of its population.

7. Which challenge arises due to the existence of the informal or underground economy?
   (a) Difficulty in measuring the overall economic output accurately
   (b) The inclusion of illegal activities in the GDP calculation
   (c) Inflationary pressure on the economy
   (d) Increased government expenditure

   Answer:
   (a) Difficulty in measuring the overall economic output accurately

   Explanation:
   The existence of the informal or underground economy, where certain economic activities are not reported or officially recorded, poses a challenge in accurately measuring the overall economic output. Since such activities are not captured in official records, they can lead to underestimation or inaccurate estimation of National Income or GDP.

8. Which of the following is a limitation of using GDP as an indicator of well-being in terms of environmental sustainability?
   (a) GDP includes the value of illegal activities.
   (b) GDP does not consider income distribution.
   (c) GDP growth may be accompanied by environmental degradation.
   (d) GDP does not account for changes in price levels.

   Answer:
   (c) GDP growth may be accompanied by environmental degradation.

   Explanation:
   One of the limitations of using GDP as an indicator of well-being is that GDP growth may be accompanied by environmental degradation. Economic growth and increased production often lead to increased resource consumption and environmental pollution, which may negatively impact the overall well-being and sustainability in the long term.

9. Which limitation of National Income computation arises due to the exclusion of non-market activities and household production?
   (a) Overestimation of economic output
   (b) Difficulty in calculating GDP at factor cost
   (c) Underestimation of economic output and welfare
   (d) Overestimation of economic growth rate

   Answer:
   (c) Underestimation of economic output and welfare

   Explanation:
   The exclusion of non-market activities (e.g., household work and voluntary services) and household production (e.g., self-consumption of food and goods) from National Income computation leads to an underestimation of the actual economic output and welfare. These activities contribute to the well-being of the population but are not accounted for in GDP calculations.

10. Which challenge arises due to the constant changes in the structure of the economy and the introduction of new goods and services?
   (a) Difficulty in calculating inflation rate
   (b) Changes in government policies
   (c) Difficulty in measuring real GDP
   (d) Difficulty in estimating the savings rate

   Answer:
   (c) Difficulty in measuring real GDP

   Explanation:
   The constant changes in the structure of the economy, along with the introduction of new goods and services, pose a challenge in accurately measuring real GDP. Real GDP is adjusted for changes in price levels, but it becomes challenging to determine appropriate price deflators for new products and rapidly evolving sectors, making real GDP calculations complex.

Additional Question Bank

1.1 National Income Accounting

1. National income accounting is a method used to:
   (a) Calculate the total profits of private companies
   (b) Measure the economic performance of a country
   (c) Determine the total savings of the government
   (d) Assess the inflation rate in the economy
2. Gross Domestic Product (GDP) is defined as:
   (a) The total value of all goods and services produced within a country's borders in a specific time period
   (b) The total value of all imports and exports of a country
   (c) The total value of all goods and services produced by a country's citizens, regardless of their location
   (d) The total value of all goods and services produced by a country's companies, regardless of their ownership

3. Which of the following is NOT included in GDP calculations?
   (a) Investment spending by businesses
   (b) Government spending on infrastructure
   (c) Social security payments to retirees
   (d) Consumer spending on durable goods
4. The income approach to calculating GDP:
   (a) Adds up all the wages, salaries, and profits earned in an economy
   (b) Only considers the total spending on final goods and services
   (c) Focuses on the net exports of a country
   (d) Includes only the value of intermediate goods and services
5. Real GDP differs from Nominal GDP in that:
   (a) Real GDP accounts for inflation, while Nominal GDP does not
   (b) Real GDP includes government spending, while Nominal GDP does not
   (c) Real GDP is measured in current market prices, while Nominal GDP is adjusted for inflation
   (d) Real GDP considers only the value of goods, while Nominal GDP includes services as well
6. National Income is calculated as:
   (a) GDP minus depreciation
   (b) GDP plus net exports
   (c) GDP minus indirect taxes and subsidies
   (d) GDP minus government spending
7. The expenditure approach to calculating GDP:
   (a) Adds up all the wages, salaries, and profits earned in an economy
   (b) Focuses on the total spending on final goods and services
   (c) Includes only the value of intermediate goods and services
   (d) Considers the net exports of a country
8. Which of the following is a component of Gross Domestic Product (GDP)?
   (a) Money supply in the economy
   (b) Unemployment rate
   (c) Government budget deficit
   (d) Investment spending by businesses

1.2 Usefulness and Significance of National Income Estimates

Certainly! Here are some multiple-choice questions (MCQs) related to the usefulness and significance of national income estimates:

1. National income estimates are essential for:
   (a) Calculating the profits of individual companies
   (b) Assessing the distribution of wealth in a country
   (c) Determining the exchange rates between currencies
   (d) Monitoring the stock market performance
2. The primary use of national income estimates is to:
   (a) Measure the overall happiness and well-being of citizens
   (b) Determine the economic growth rate of the country
   (c) Calculate the total value of imports and exports
   (d) Evaluate the effectiveness of foreign aid programs
3. Why is it important to calculate Gross Domestic Product (GDP)?
   (a) To understand the unemployment rate in the country
   (b) To analyze the overall debt of the government
   (c) To determine the total value of all goods and services produced in the economy
   (d) To evaluate the efficiency of the banking sector
4. National income estimates help in comparing the economic performance of different countries by:
   (a) Converting all currencies to a common unit of measurement
   (b) Focusing solely on the GDP growth rate
   (c) Ignoring the impact of inflation on the economy
   (d) Excluding the service sector from the calculations
5. The per capita income, derived from national income estimates, is useful for:
   (a) Understanding the total population of a country
   (b) Analyzing the average income of individuals in the country
   (c) Measuring the total number of employed people
   (d) Evaluating the performance of the agricultural sector
6. One of the limitations of using national income estimates is that they:
   (a) Cannot account for the underground economy
   (b) Overstate the value of intermediate goods

(c) Ignore the impact of international trade on the economy
(d) Focus excessively on government spending

7. National income estimates help policymakers in making informed decisions about:
(a) The promotion of consumer spending
(b) The allocation of resources and budget planning
(c) The reduction of inflation rates
(d) The regulation of the stock market

8. In times of economic downturn, national income estimates can be used to:
(a) Encourage more foreign investments
(b) Identify the sectors that require government bailouts
(c) Increase taxes on businesses and individuals
(d) Decrease government spending on infrastructure

1.3 Different concepts of National Income

Sure, here are some multiple-choice questions (MCQs) related to different concepts of national income:

1. Gross Domestic Product (GDP) is the total value of:
(a) All goods and services produced within a country's borders in a specific time period
(b) All goods and services produced by a country's citizens, regardless of their location
(c) All goods and services produced by a country's companies, regardless of their ownership
(d) All final goods and services produced within a country's borders in a specific time period

2. Gross National Product (GNP) differs from GDP in that GNP:
(a) Includes only the value of final goods and services
(b) Excludes the value of exports
(c) Accounts for depreciation of capital goods
(d) Includes the value of goods and services produced by a country's citizens abroad

3. Net National Product (NNP) is calculated by:
(a) Adding depreciation to GDP
(b) Subtracting depreciation from GDP
(c) Adding depreciation to GNP
(d) Subtracting depreciation from GNP

4. National Income (NI) is calculated by:
(a) Adding indirect taxes to NNP
(b) Subtracting indirect taxes from NNP
(c) Adding net foreign factor income to NNP
(d) Subtracting net foreign factor income from NNP

5. Personal Income (PI) is the total income received by:
(a) Individuals before paying personal taxes
(b) Individuals after paying personal taxes
(c) Households before paying personal taxes
(d) Households after paying personal taxes

6. Disposable Income (DI) is calculated by:
(a) Adding personal taxes to personal income
(b) Subtracting personal taxes from personal income
(c) Adding corporate taxes to personal income
(d) Subtracting corporate taxes from personal income

7. Which of the following represents the broadest measure of a country's national income?
(a) GDP (b) GNP
(c) NNP (d) PI

8. Gross National Income (GNI) is defined as:
(a) The total value of all goods and services produced by a country's companies, regardless of their ownership
(b) The total value of all goods and services produced by a country's citizens, regardless of their location
(c) The total value of all final goods and services produced within a country's borders in a specific time period
(d) The total value of all goods and services produced within a country's borders, excluding foreign factors of production

1.4 Measurement of National Income in India

Certainly! Here are some multiple-choice questions (MCQs) related to the measurement of national income in India:

1. In India, the organization responsible for estimating national income is:
   (a) Reserve Bank of India (RBI)
   (b) Ministry of Finance
   (c) Central Statistical Office (CSO)
   (d) Planning Commission
2. Which of the following methods is primarily used to estimate national income in India?
   (a) Production approach
   (b) Expenditure approach
   (c) Income approach
   (d) All of the above
3. The base year for estimating Gross Domestic Product (GDP) using constant prices in India is typically updated every:
   (a) 5 years
   (b) 7 years
   (c) 10 years
   (d) 12 years
4. In India, Gross Domestic Product (GDP) at market prices is calculated by adding:
   (a) Indirect taxes and depreciation to GDP at factor cost
   (b) Indirect taxes and net factor income from abroad to GDP at factor cost
   (c) Indirect taxes and subsidies to GDP at factor cost
   (d) Indirect taxes and net factor income from abroad to GDP at market prices
5. National Income in India is also known as:
   (a) Gross National Product (GNP)
   (b) Net Domestic Product (NDP)
   (c) Net National Product (NNP)
   (d) Gross Domestic Product (GDP)

6. The Central Statistical Office (CSO) in India operates under the purview of the:
   (a) Ministry of Finance
   (b) Ministry of Statistics and Programme Implementation
   (c) Reserve Bank of India (RBI)
   (d) Planning Commission
7. In the context of India's national income estimation, GVA stands for:
   (a) Gross Value Added
   (b) Gross Variable Analysis
   (c) Government Value Assessment
   (d) Government Variable Account
8. Which of the following sectors is NOT covered in the estimation of national income in India?
   (a) Agriculture and Allied Activities
   (b) Manufacturing
   (c) Financial Services
   (d) Household Consumption

1.5 The System of Regional Accounts in India

1. The System of Regional Accounts (SRA) in India aims to:
   (a) Calculate the national income of India
   (b) Measure the economic performance of different states and regions within India
   (c) Assess the exchange rates between different Indian states
   (d) Determine the total imports and exports of each Indian state
2. The Ministry responsible for the compilation of the System of Regional Accounts in India is:
   (a) Ministry of Finance
   (b) Ministry of Commerce and Industry
   (c) Ministry of Home Affairs
   (d) Ministry of Statistics and Programme Implementation
3. The base year used for estimating the System of Regional Accounts in India is generally revised every:
   (a) 3 years
   (b) 5 years

(c) 7 years
(d) 10 years

4. The regional accounts data in India provides insights into:
(a) The inflation rate in each state
(b) The fiscal deficit of the central government
(c) The economic activities and their contribution to each state's GDP
(d) The foreign direct investments received by different Indian states

5. Which of the following is NOT a component of the System of Regional Accounts in India?
(a) Gross State Domestic Product (GSDP)
(b) Per Capita Income of states
(c) Sectoral distribution of states' population
(d) International trade data of each state

6. The primary source of data used for compiling the System of Regional Accounts in India is:
(a) Annual reports of different state governments
(b) Survey data collected by private agencies
(c) Data from the Reserve Bank of India (RBI)
(d) Data from various government departments and surveys conducted by the Central Statistical Office (CSO)

7. The System of Regional Accounts helps in identifying the:
(a) Number of state-owned enterprises in each region
(b) Level of unemployment in the country
(c) Disparities in economic growth and development among states
(d) Composition of the national budget

1.6 Limitations and Challenges of National Income Computation

Certainly! Here are some multiple-choice questions (MCQs) related to the limitations and challenges of national income computation:

1. One of the limitations of national income computation is that it:
(a) Ignores the contribution of the services sector to the economy
(b) Overestimates the value of intermediate goods and services
(c) Excludes the impact of inflation on the economy
(d) Does not consider non-market activities and the informal economy

2. The challenge of accurately measuring national income arises due to:
(a) Difficulties in collecting data on government spending
(b) Limited availability of data on international trade
(c) The constantly changing structure of the economy
(d) The exclusion of the financial sector from the calculations

3. Which of the following is NOT a challenge in computing national income?
(a) Difficulty in accounting for depreciation of assets
(b) Estimating the value of household production and unpaid work
(c) Dealing with fluctuations in exchange rates
(d) Accounting for income generated from illegal activities

4. National income computation may not accurately reflect the economic well-being of:
(a) The government sector
(b) The manufacturing sector
(c) The agricultural sector
(d) Different income groups within the population

5. One of the limitations of using Gross Domestic Product (GDP) as a measure of welfare is that it:
(a) Does not account for income distribution within the country
(b) Ignores the value of net exports in the economy
(c) Overestimates the contribution of government spending to the economy
(d) Excludes the value of investment spending by businesses

6. The concept of national income fails to consider the economic value of:
(a) Social security payments to retirees
(b) Imports of goods and services
(c) Gross fixed capital formation
(d) National debt and government borrowing

7. Which of the following does NOT pose a challenge in calculating Gross National Product (GNP)?
(a) Accounting for the income earned by foreign residents in the country
(b) Estimating the value of exports of goods and services
(c) Dealing with changes in the national currency's exchange rate
(d) Measuring the value of capital goods used in the production process

Answer

1.1 National Income Accounting

1. (b) Measure the economic performance of a country
2. (a) The total value of all goods and services produced within a country's borders in a specific time period 3. c) Social security payments to retirees
4. (a) Adds up all the wages, salaries, and profits earned in an economy
5. (a) Real GDP accounts for inflation, while Nominal GDP does not
6. (c) GDP minus indirect taxes and subsidies
7. (b) Focuses on the total spending on final goods and services
8. (d) Investment spending by businesses

1.2 Usefulness and Significance of National Income Estimates

1. (b) Assessing the distribution of wealth in a country
2. (b) Determine the economic growth rate of the country
3. (c) To determine the total value of all goods and services produced in the economy
4. (a) Converting all currencies to a common unit of measurement
5. (b) Analyzing the average income of individuals in the country
6. (a) Cannot account for the underground economy
7. (b) The allocation of resources and budget planning
8. (b) Identify the sectors that require government bailouts

1.3 Different concepts of National Income

1. (a) All goods and services produced within a country's borders in a specific time period
2. (d) Includes the value of goods and services produced by a country's citizens abroad
3. (b) Subtracting depreciation from GDP
4. (b) Subtracting indirect taxes from NNP
5. (b) Individuals after paying personal taxes
6. (b) Subtracting personal taxes from personal income

7. (b) GNP
8. (b) The total value of all goods and services produced by a country's citizens, regardless of their location

1.4 Measurement of National Income in India

1. (c) Central Statistical Office (CSO)
2. (d) All of the above (Production approach, Expenditure approach, Income approach)
3. (a) 5 years
4. (d) Indirect taxes and net factor income from abroad to GDP at market prices
5. (c) Net National Product (NNP)
6. (b) Ministry of Statistics and Programme Implementation
7. (a) Gross Value Added
8. (d) Household Consumption

1.5 The System of Regional Accounts in India

1. (b) Measure the economic performance of different states and regions within India
2. (d) Ministry of Statistics and Programme Implementation
3. (b) 5 years
4. (c) The economic activities and their contribution to each state's GDP
5. (d) International trade data of each state
6. (d) Data from various government departments and surveys conducted by the Central Statistical Office (CSO)
7. (c) Disparities in economic growth and development among states

1.6 Limitations and Challenges of National Income Computation

1. (d) Does not consider non-market activities and the informal economy
2. (c) The constantly changing structure of the economy
3. (c) Dealing with fluctuations in exchange rates
4. (d) Different income groups within the population
5. (a) Does not account for income distribution within the country
6. (a) Social security payments to retirees
7. (d) Measuring the value of capital goods used in the production process

6 DETERMINATION OF NATIONAL INCOME

Unit:2 The Keynesian Theory of Determination of National Income

Multiple Choice Questions

1.1 Introduction

1. What is the central proposition of Keynesian theory regarding the determination of national income?
   (a) National income is determined by aggregate supply.
   (b) National income is determined by aggregate demand.
   (c) National income is determined by both aggregate supply and aggregate demand.
   (d) National income is determined by the government's fiscal policy.

   Answer:
   (b) National income is determined by aggregate demand.

   Explanation:
   According to Keynesian theory, the level of national income is determined primarily by the level of aggregate demand in the economy. Keynes argued that fluctuations in aggregate demand could lead to fluctuations in economic output and employment.

2. During a recession, Keynesian economists recommend which of the following policies to stimulate economic growth and increase national income?
   (a) Decreasing government spending and raising taxes.
   (b) Decreasing the money supply to control inflation.
   (c) Increasing government spending and lowering taxes.
   (d) Reducing exports to protect domestic industries.

   Answer:
   (c) Increasing government spending and lowering taxes.

   Explanation:
   During a recession, Keynesian economists recommend expansionary fiscal policies to stimulate economic growth and increase national income. This involves increasing government spending on public projects and services and lowering taxes to boost consumer spending and overall aggregate demand.

3. In the Keynesian model, what is the role of private investment in determining national income?
   (a) Private investment has no impact on national income.
   (b) Private investment solely determines national income.
   (c) Private investment is a component of aggregate demand affecting national income.
   (d) Private investment only affects the inflation rate, not national income.

   Answer:
   (c) Private investment is a component of aggregate demand affecting national income.

   Explanation:
   In the Keynesian model, private investment is one of the components of aggregate demand, which also includes consumption, government spending, and net exports. Changes in private investment can have significant effects on overall aggregate demand and, consequently, on the level of national income.

4. According to the Keynesian theory, what can lead to a situation of "underemployment equilibrium" in an economy?
   (a) When aggregate demand exceeds aggregate supply.
   (b) When aggregate supply exceeds aggregate demand.
   (c) When there is full employment in the economy.
   (d) When aggregate demand is insufficient to create full employment.

   Answer:
   (d) When aggregate demand is insufficient to create full employment.

   Explanation:
   "Underemployment equilibrium" occurs in the Keynesian model when aggregate demand in the economy is not strong enough to generate full

employment. In this situation, there is involuntary unemployment and unused capacity, leading to an output level below the economy's potential.

5. Which of the following represents the primary tool for the government to influence aggregate demand and stabilize the economy, according to Keynesian economics?
   (a) Monetary policy.
   (b) Fiscal policy.
   (c) Supply-side policies.
   (d) Exchange rate policy.

   Answer:
   (b) Fiscal policy.

   Explanation:
   According to Keynesian economics, fiscal policy, which involves government spending and taxation, is the primary tool for influencing aggregate demand and stabilizing the economy. By adjusting government spending and taxes, the government can directly impact aggregate demand and support economic growth and stability.

6. Who is the main proponent of the Keynesian theory of determination of National Income?
   (a) Adam Smith
   (b) John Maynard Keynes
   (c) Milton Friedman
   (d) Friedrich Hayek

   Answer:
   (b) John Maynard Keynes

   Explanation:
   John Maynard Keynes, a British economist, is the main proponent of the Keynesian theory of determination of National Income. He developed his ideas during the Great Depression in the 1930s and proposed policies to address unemployment and economic downturns.

7. According to Keynesian theory, what determines the level of employment and output in an economy?
   (a) Consumer preferences and saving habits
   (b) Government spending and taxation policies

   (c) The interaction of aggregate demand and aggregate supply
   (d) The natural rate of unemployment

   Answer:
   (c) The interaction of aggregate demand and aggregate supply.

   Explanation:
   According to Keynesian theory, the level of employment and output in an economy is determined by the interaction of aggregate demand (total spending in the economy) and aggregate supply (the total production of goods and services). Changes in aggregate demand, such as government spending or consumer expenditure, can lead to fluctuations in output and employment.

8. The central idea of the Keynesian theory is that:
   (a) Government intervention is necessary to stabilize the economy
   (b) The market forces alone can ensure full employment and economic stability
   (c) Tax cuts are the most effective tool for economic growth
   (d) Private investment is the primary driver of economic prosperity

   Answer:
   (a) Government intervention is necessary to stabilize the economy

   Explanation:
   The central idea of the Keynesian theory is that government intervention is necessary to stabilize the economy, particularly during times of recession or high unemployment. Keynes advocated for active government policies, such as increasing public spending or reducing taxes, to boost aggregate demand and promote economic growth.

9. According to Keynes, what can lead to a situation of "effective demand deficiency" in the economy?
   (a) Excessive government spending
   (b) High levels of consumer saving
   (c) Low interest rates set by the central bank
   (d) High levels of inflation

   Answer:
   (b) High levels of consumer saving

Explanation:
According to Keynes, a situation of "effective demand deficiency" can arise in the economy when there is a high level of consumer saving relative to consumer spending. In such a scenario, overall demand for goods and services may fall short of the economy's productive capacity, leading to unemployment and economic stagnation.

10. Keynesian theory suggests that during an economic downturn, the government should implement:
(a) Austerity measures to reduce public debt
(b) Supply-side policies to boost production
(c) Contractionary monetary policies to control inflation
(d) Expansionary fiscal policies to increase spending

Answer:
(d) Expansionary fiscal policies to increase spending

Explanation:
During an economic downturn, the Keynesian theory suggests that the government should implement expansionary fiscal policies. These policies involve increasing government spending and reducing taxes to boost aggregate demand, stimulate economic activity, and counter the negative effects of recession or unemployment.

11. Keynes argued that during periods of economic recession or depression, the government should:
(a) Increase taxes to reduce budget deficits
(b) Reduce government spending to control inflation
(c) Decrease interest rates to encourage private investment
(d) Increase government spending to stimulate aggregate demand

Answer:
(d) Increase government spending to stimulate aggregate demand

Explanation:
Keynes advocated for an increase in government spending during periods of economic recession or depression. This increase in government expenditure would lead to higher aggregate demand, resulting in increased economic activity and employment.

12. The concept of "Multiplier Effect" in the Keynesian theory suggests that:
(a) Changes in government spending have a larger impact on National Income than changes in taxes.
(b) A change in investment leads to a proportionate change in National Income.
(c) Increases in exports result in higher economic growth and employment.
(d) Changes in consumption have a direct and immediate impact on investment.

Answer:
(a) Changes in government spending have a larger impact on National Income than changes in taxes.

Explanation:
The concept of "Multiplier Effect" in the Keynesian theory suggests that changes in government spending have a larger impact on National Income than changes in taxes. An increase in government spending leads to a chain reaction of increased consumption and investment, which further raises National Income by multiple times.

13. According to Keynes, in situations of insufficient aggregate demand, the economy may experience:
(a) Demand-pull inflation
(b) Cost-push inflation
(c) Deflation and unemployment
(d) Stagflation

Answer:
(c) Deflation and unemployment

Explanation:
According to Keynes, in situations of insufficient aggregate demand, the economy may experience deflation (a decrease in the general price level) and unemployment. He argued that inadequate demand could lead to a downward spiral of reduced production, lower employment, and falling prices.

1.2 Circular Flow in a Simple Two-sector Model

1. In a simple two-sector model of the circular flow, the two sectors are:
   (a) Government and households
   (b) Business firms and households
   (c) Government and business firms
   (d) Foreign sector and households

   Answer:
   (b) Business firms and households

   Explanation:
   In a simple two-sector model of the circular flow, the two sectors are business firms and households. Business firms produce goods and services, while households provide factors of production (such as labor and capital) and consume the produced goods and services.
2. In the circular flow model, which sector is the ultimate consumer of goods and services?
   (a) Business firms
   (b) Households
   (c) Government
   (d) Foreign sector

   Answer:
   (b) Households

   Explanation:
   In the circular flow model, households are the ultimate consumer of goods and services. They purchase goods and services from business firms in the product market.
3. In the circular flow model, which sector supplies factors of production to business firms?
   (a) Government
   (b) Households
   (c) Business firms
   (d) Foreign sector

   Answer:
   (b) Households

   Explanation:
   In the circular flow model, households supply factors of production (such as labor and capital) to business firms in exchange for wages, rent, and profits in the factor market.
4. Which of the following flows represents the payment made by business firms to households for providing factors of production?
   (a) Factor payments
   (b) Transfer payments
   (c) Investment spending
   (d) Consumption expenditure

   Answer:
   (a) Factor payments

   Explanation:
   Factor payments represent the payment made by business firms to households for providing factors of production (such as wages for labor, rent for land, and profits for entrepreneurship). It occurs in the factor market.
5. In the circular flow model, which sector provides funds to business firms for investment purposes?
   (a) Government
   (b) Households
   (c) Business firms
   (d) Foreign sector

   Answer:
   (b) Households

   Explanation:
   In the circular flow model, households are the primary savers, and they provide funds to business firms for investment purposes. These funds come from savings and are used by businesses to finance capital investments and expand their productive capacity.
6. In the circular flow model, households are the:
   (a) Sellers of goods and services and buyers of factors of production
   (b) Buyers of goods and services and sellers of factors of production

(c) Buyers of goods and services and buyers of factors of production
(d) Sellers of goods and services and sellers of factors of production

Answer:

(a) Sellers of goods and services and buyers of factors of production

Explanation:

In the circular flow model, households act as sellers of factors of production (such as labor) to businesses and as buyers of goods and services produced by businesses.

7. Which of the following best represents the flow of goods and services in the circular flow model?
(a) Money flows from households to businesses for goods and services.
(b) Goods and services flow from households to businesses in exchange for money.
(c) Money flows from businesses to households for factors of production.
(d) Factors of production flow from businesses to households in exchange for money.

Answer:

(b) Goods and services flow from households to businesses in exchange for money.

Explanation:

In the circular flow model, goods and services flow from households to businesses in exchange for money (income).

8. Savings in the circular flow model refer to:
(a) The money that businesses save from their profits
(b) The money that households save from their income
(c) The money that businesses invest in new projects
(d) The money that households spend on goods and services

Answer:

(b) The money that households save from their income

Explanation:

Savings in the circular flow model refer to the portion of household income that is not spent on consumption and is instead saved for future use or investment.

9. In the circular flow model, the total value of goods and services produced in the economy is measured by:
(a) Gross Domestic Product (GDP)
(b) Gross National Product (GNP)
(c) Net Domestic Product (NDP)
(d) Net National Product (NNP)

Answer:

(a) Gross Domestic Product (GDP)

Explanation:

In the circular flow model, the total value of goods and services produced in the economy is measured by Gross Domestic Product (GDP). GDP represents the sum of all final goods and services produced within a country's borders during a specific time period.

10. In the circular flow model, households receive income in the form of:
(a) Profits
(b) Taxes
(c) Wages, rent, and interest
(d) Government transfers

Answer:

(c) Wages, rent, and interest

Explanation:

In the circular flow model, households receive income in the form of wages (for labor services), rent (for land), and interest (for capital). These are the payments households receive for providing their factors of production to firms.

11. Which component of the circular flow represents the total spending by households on goods and services?
(a) Savings
(b) Investment
(c) Government spending
(d) Consumption expenditure

Answer:

(d) Consumption expenditure

Explanation:
Consumption expenditure represents the total spending by households on goods and services produced by firms. It is a crucial component of the circular flow as it indicates the demand side of the economy.

12. In the two-sector circular flow model, savings by households are equal to:
(a) Consumption expenditure (b) Taxes paid to the government
(c) Investment by firms (d) Government spending

Answer:
(c) Investment by firms

Explanation:
In the two-sector circular flow model, savings by households are equal to investment by firms. In a simplified closed economy, savings equal investment since households' savings are the source of funds for firms' investment in new capital goods.

13. The circular flow model assumes that all income earned by households is either spent on consumption or saved, and there is no:
(a) Government intervention (b) Investment by firms
(c) Financial sector (d) Foreign trade

Answer:
(d) Foreign trade

Explanation:
The circular flow model assumes a closed economy, meaning there is no foreign trade involved. It assumes that all income earned by households is either spent on consumption or saved, and there is no import or export of goods and services in this simplified model.

1.3 Basic Concepts and Functions

1. In economics, the study of how individuals and societies allocate limited resources to satisfy their unlimited wants is known as:
(a) Microeconomics (b) Macroeconomics
(c) Economic planning (d) Economics

Answer:
(d) Economics

Explanation:
Economics is the study of how individuals, households, firms, and societies allocate limited resources to satisfy their unlimited wants. It encompasses both microeconomics (study of individual units) and macroeconomics (study of the overall economy).

2. The total value of all final goods and services produced within a country's borders during a specific time period is known as:
(a) Gross Domestic Product (GDP)
(b) Gross National Product (GNP)
(c) Net National Product (NNP)
(d) National Income

Answer:
(a) Gross Domestic Product (GDP)

Explanation:
Gross Domestic Product (GDP) is the total value of all final goods and services produced within a country's borders during a specific time period, usually a year. It is a key indicator of a country's economic performance.

3. Which of the following is NOT a factor of production in economics?
(a) Land (b) Labor
(c) Capital (d) Money

Answer:
(d) Money

Explanation:
Money is not considered a factor of production in economics. The factors of production are land (natural resources), labor (human effort and skills), and capital (physical and human-made resources used in production).

4. The price at which the quantity demanded of a good or service equals the quantity supplied is known as:
(a) Equilibrium price (b) Market price
(c) Maximum price (d) Minimum price

Answer:
(a) Equilibrium price

Explanation:
Equilibrium price is the price at which the quantity demanded of a good or service equals the quantity supplied in the market. At this price, there is no shortage or surplus of the product.

5. The study of how individuals and firms make decisions and interact in markets is known as:
   (a) Macroeconomics (b) Microeconomics
   (c) Economic planning (d) Econometrics

   Answer:
   (b) Microeconomics

   Explanation:
   Microeconomics is the study of individual economic units such as households and firms and how they make decisions and interact in various markets. It focuses on the behavior of specific economic agents and the allocation of resources at a smaller level.

6. Which of the following is a basic concept in economics that refers to the limited nature of resources?
   (a) Opportunity cost
   (b) Scarcity
   (c) Inflation
   (d) Gross Domestic Product (GDP)

   Answer:
   (b) Scarcity

   Explanation:
   Scarcity is a fundamental concept in economics that refers to the limited availability of resources (such as land, labor, and capital) in relation to unlimited wants and needs. It necessitates choices and trade-offs in allocating resources to various uses.

7. Opportunity cost is defined as:
   (a) The cost of producing one additional unit of a good or service
   (b) The total cost of all inputs used in the production process
   (c) The highest-valued alternative given up when a choice is made
   (d) The difference between total revenue and total cost

   Answer:
   (c) The highest-valued alternative given up when a choice is made

   Explanation:
   Opportunity cost is the value of the next best alternative forgone when a choice is made. It represents the trade-off between different options and helps in understanding the real cost of decisions.

8. Which function of money refers to money serving as a medium of exchange in transactions?
   (a) Store of value
   (b) Unit of account
   (c) Medium of exchange
   (d) Standard of deferred payment

   Answer:
   (c) Medium of exchange

   Explanation:
   The function of money as a medium of exchange refers to its use as a generally accepted medium to facilitate the exchange of goods and services in an economy. It eliminates the need for barter and enhances the efficiency of transactions.

9. The Consumer Price Index (CPI) is a measure of:
   (a) The overall level of prices in an economy
   (b) The total output produced in an economy
   (c) The unemployment rate in an economy
   (d) The government's budget deficit

   Answer:
   (a) The overall level of prices in an economy

   Explanation:
   The Consumer Price Index (CPI) is a measure of the overall level of prices of a basket of goods and services purchased by consumers. It is used to monitor inflation and changes in the cost of living over time.

10. The total market value of all final goods and services produced within a country's borders during a specific time period is known as:
    (a) Gross Domestic Product (GDP) (b) Gross National Product (GNP)
    (c) Net Domestic Product (NDP) (d) Net National Product (NNP)

    Answer:
    (a) Gross Domestic Product (GDP)

Explanation:

Gross Domestic Product (GDP) is the total market value of all final goods and services produced within a country's borders during a specific time period, usually a year. It is a key indicator of a country's economic performance.

11. The total value of all goods and services produced within a country's borders during a specific time period is known as:
(a) Gross National Product (GNP)
(b) Gross Domestic Product (GDP)
(c) Net Domestic Product (NDP)
(d) Net National Product (NNP)

Answer:

(b) Gross Domestic Product (GDP)

Explanation:

Gross Domestic Product (GDP) is the total value of all goods and services produced within a country's borders during a specific time period. It is a key indicator of a country's economic performance.

12. The measure of the responsiveness of quantity demanded of a good to a change in its price is known as:
(a) Elasticity of demand (b) Elasticity of supply
(c) Marginal utility (d) Consumer surplus

Answer:

(a) Elasticity of demand

Explanation:

Elasticity of demand measures the responsiveness of quantity demanded of a good to a change in its price. It helps economists understand how sensitive consumers are to price changes.

13. Which type of unemployment occurs when there is a temporary mismatch between job seekers and available job vacancies?
(a) Cyclical unemployment (b) Frictional unemployment
(c) Structural unemployment (d) Seasonal unemployment

Answer:

(b) Frictional unemployment

Explanation:

Frictional unemployment occurs when individuals are temporarily between jobs or are seeking new employment opportunities. It is a natural and unavoidable part of the job search process.

14. The interest rate at which a central bank lends money to commercial banks is known as:
(a) Prime rate
(b) Discount rate
(c) Federal funds rate
(d) LIBOR rate

Answer:

(b) Discount rate

Explanation:

The interest rate at which a central bank lends money to commercial banks is known as the discount rate. It is one of the tools used by central banks to control monetary policy.

1.3.1 Aggregate Demand Function

1. In an economy, the Aggregate Demand (AD) function is represented as AD = 1,000 - 100P, where P is the price level. Calculate the Aggregate Demand when the price level is ₹ 5.
(a) 1,500 (b) 500
(c) 1,000 (d) 2,000

Answer:

(b) 500

Solution:

To calculate Aggregate Demand, we need to substitute the given price level (P) into the AD function.

AD = 1,000 - 100P
AD = 1,000 - 100 * ₹ 5
AD = 1,000 - 500
AD = 500

So, the Aggregate Demand when the price level is ₹ 5 is 500.

2. In an economy, the Aggregate Demand (AD) function is represented as AD = 2,500 - 150P, where P is the price level. Calculate the Aggregate Demand when the price level is ₹ 10.
   (a) 1,500
   (b) 2,500
   (c) 2,000
   (d) 3,000

   Answer:
   (c) 2,000

   Solution:
   To calculate Aggregate Demand, we need to substitute the given price level (P) into the AD function.
   AD = 2,500 - 150P
   AD = 2,500 - 150 * ₹ 10
   AD = 2,500 - 1,500
   AD = 2,000
   So, the Aggregate Demand when the price level is ₹ 10 is 2,000.

3. In an economy, the Aggregate Demand (AD) function is represented as AD = 3,000 - 200P, where P is the price level. Calculate the Aggregate Demand when the price level is ₹ 15.
   (a) 2,500
   (b) 3,000
   (c) 1,500
   (d) 2,000

   Answer:
   (c) 1,500

   Solution:
   To calculate Aggregate Demand, we need to substitute the given price level (P) into the AD function.
   AD = 3,000 - 200P
   AD = 3,000 - 200 * ₹ 15
   AD = 3,000 - 3,000
   AD = 1,500
   So, the Aggregate Demand when the price level is ₹ 15 is 1,500.

4. In an economy, the aggregate demand (AD) function is represented as AD = 2,000 - 100P, where P is the price level. Calculate the equilibrium level of aggregate demand when the price level (P) is ₹ 15.
   (a) ₹ 1,000
   (b) ₹ 2,500
   (c) ₹ 1,500
   (d) ₹ 500

   Answer:
   (c) ₹ 1,500

   Solution:
   To calculate the equilibrium level of aggregate demand, we need to substitute the given price level (P) into the AD function and solve for AD.
   AD = 2,000 - 100P
   AD = 2,000 - 100 * ₹ 15
   AD = 2,000 - ₹ 1,500
   AD = ₹ 500
   So, the equilibrium level of aggregate demand when the price level (P) is ₹ 15 is ₹ 1,500.

1.3.2 The Consumption Function

1. In an economy, the consumption function is represented as C = 500 + 0.8Y, where Y is the disposable income. Calculate the level of consumption when the disposable income (Y) is ₹ 2,000.
   (a) ₹ 1,800
   (b) ₹ 1,900
   (c) ₹ 2,500
   (d) ₹ 2,200

   Answer:
   (b) ₹ 1,900

   Solution:
   To calculate the level of consumption, we need to substitute the given disposable income (Y) into the consumption function and solve for C.
   C = 500 + 0.8Y
   C = 500 + 0.8 * ₹ 2,000

C = 500 + ₹ 1,600
C = ₹ 2,100
So, the level of consumption when the disposable income (Y) is ₹ 2,000 is ₹ 1,900.

2. In an economy, the consumption function is represented as C = 500 + 0.8Y, where C is consumption and Y is disposable income. Calculate the level of consumption when disposable income (Y) is ₹ 1,000.
(a) ₹ 1,200
(b) ₹ 1,300
(c) ₹ 1,400
(d) ₹ 1,500
Answer:
(b) ₹ 1,300
Solution:
To calculate the level of consumption, we need to substitute the given disposable income (Y) into the consumption function and solve for C.
C = 500 + 0.8Y
C = 500 + 0.8 * ₹ 1,000
C = 500 + ₹ 800
C = ₹ 1,300
So, the level of consumption when disposable income (Y) is ₹ 1,000 is ₹ 1,300.

3. In an economy, the consumption function is represented as C = 1,000 + 0.8Y, where Y is the disposable income. Calculate the level of consumption when the disposable income (Y) is ₹ 2,000.
(a) ₹ 800
(b) ₹ 1,200
(c) ₹ 2,400
(d) ₹ 2,800
Answer:
(b) ₹ 1,200
Solution:
To calculate the level of consumption, we need to substitute the given disposable income (Y) into the consumption function and solve for C.

C = 1,000 + 0.8Y
C = 1,000 + 0.8 * ₹ 2,000
C = 1,000 + ₹ 1,600
C = ₹ 2,600
So, the level of consumption when the disposable income (Y) is ₹ 2,000 is ₹ 1,200.

1.3.3 Relationship Between Income and Consumption

1. In an economy, the consumption function is represented as C = 800 + 0.6Y, where Y is the disposable income. Calculate the level of consumption when the disposable income (Y) is ₹ 3,000.
(a) ₹ 1,000
(b) ₹ 1,800
(c) ₹ 2,200
(d) ₹ 1,400
Answer:
(b) ₹ 1,800
Solution:
To calculate the level of consumption, we need to substitute the given disposable income (Y) into the consumption function and solve for C.
C = 800 + 0.6Y
C = 800 + 0.6 * ₹ 3,000
C = 800 + ₹ 1,800
C = ₹ 2,600
So, the level of consumption when the disposable income (Y) is ₹ 3,000 is ₹ 1,800.

2. In an economy, the consumption function is represented as C = 800 + 0.6Y, where Y is the disposable income. Calculate the level of consumption when the disposable income (Y) is ₹ 2,500.
(a) ₹ 1,500 (b) ₹ 2,000
(c) ₹ 2,200 (d) ₹ 2,800
Answer:
(c) ₹ 2,200

Solution:

To calculate the level of consumption, we need to substitute the given disposable income (Y) into the consumption function and solve for C.

C = 800 + 0.6Y

C = 800 + 0.6 * ₹ 2,500

C = 800 + ₹ 1,500

C = ₹ 2,300

So, the level of consumption when the disposable income (Y) is ₹ 2,500 is ₹ 2,200.

3. In an economy, the consumption function is represented as C = 1,000 + 0.8Y, where C is the consumption and Y is the disposable income. Calculate the level of consumption when the disposable income (Y) is ₹ 5,000.

(a) ₹ 1,800 (b) ₹ 3,800
(c) ₹ 4,000 (d) ₹ 5,000

Answer:

(b) ₹ 3,800

Solution:

To calculate the level of consumption, we need to substitute the given disposable income (Y) into the consumption function and solve for C.

C = 1,000 + 0.8Y

C = 1,000 + 0.8 * ₹ 5,000

C = 1,000 + ₹ 4,000

C = ₹ 5,000

So, the level of consumption when the disposable income (Y) is ₹ 5,000 is ₹ 3,800.

1.3.4 The Relationship Between Income, Consumption and Saving

1. In an economy, the consumption function is represented as C = 1,000 + 0.6Y, where C is the consumption and Y is the disposable income. Calculate the level of saving when the disposable income (Y) is ₹ 4,000.

(a) ₹ 2,400 (b) ₹ 1,600
(c) ₹ 2,000 (d) ₹ 1,000

Answer:

(a) ₹ 2,400

Solution:

To calculate the level of saving, we need to subtract the consumption from the disposable income (Y).

Saving (S) = Y - C

Saving (S) = ₹ 4,000 - (1,000 + 0.6 * ₹ 4,000)

Saving (S) = ₹ 4,000 - (1,000 + ₹ 2,400)

Saving (S) = ₹ 4,000 - ₹ 3,400

Saving (S) = ₹ 600

So, the level of saving when the disposable income (Y) is ₹ 4,000 is ₹ 2,400.

2. In an economy, the consumption function is represented as C = 800 + 0.6Y, where C is the consumption, Y is the disposable income, and S is the saving. Calculate the level of saving when the disposable income (Y) is ₹ 2,000.

(a) ₹ 1,200
(b) ₹ 800
(c) ₹ 400
(d) ₹ 1,600

Answer:

(c) ₹ 400

Solution:

The saving (S) is the difference between disposable income (Y) and consumption (C). We can calculate it using the given consumption function.

C = 800 + 0.6Y

C = 800 + 0.6 * ₹ 2,000

C = 800 + ₹ 1,200

C = ₹ 2,000

Now, calculate saving (S):

S = Y - C

S = ₹ 2,000 - ₹ 2,000

S = ₹ 0

So, the level of saving when the disposable income (Y) is ₹ 2,000 is ₹ 400.

3. In an economy, the consumption function is represented as C = 1,000 + 0.6Y, where C is the consumption, and Y is the disposable income. Calculate the level of saving when the disposable income (Y) is ₹ 4,000.
   (a) ₹ 600
   (b) ₹ 1,600
   (c) ₹ 2,400
   (d) ₹ 2,600
   Answer:
   (b) ₹ 1,600
   Solution:
   To calculate the level of saving, we need to subtract the consumption (C) from disposable income (Y).
   S = Y - C
   S = ₹ 4,000 - (1,000 + 0.6 * ₹ 4,000)
   S = ₹ 4,000 - (1,000 + ₹ 2,400)
   S = ₹ 4,000 - ₹ 3,400
   S = ₹ 600
   So, the level of saving when the disposable income (Y) is ₹ 4,000 is ₹ 1,600.

1.3.5 Aggregate Supply

1. In an economy, the short-run aggregate supply (SRAS) curve is represented as SRAS = 1,500 + 0.5P, where P is the price level. Calculate the level of aggregate supply when the price level (P) is ₹ 10.
   (a) 1,550
   (b) 2,000
   (c) 2,500
   (d) 1,000
   Answer:
   (a) 1,550
   Solution:
   To calculate the level of aggregate supply, we need to substitute the given price level (P) into the short-run aggregate supply (SRAS) curve and solve for SRAS.

   SRAS = 1,500 + 0.5P
   SRAS = 1,500 + 0.5 * ₹ 10
   SRAS = 1,500 + ₹ 5
   SRAS = 1,550
   So, the level of aggregate supply when the price level (P) is ₹ 10 is 1,550.

2. In an economy, the short-run aggregate supply (SRAS) curve is represented as SRAS = 2,000 + 100P, where P is the price level. Calculate the level of aggregate supply when the price level (P) is ₹ 10.
   (a) 2,100
   (b) 3,000
   (c) 2,500
   (d) 2,200
   Answer:
   (a) 2,100
   Solution:
   To calculate the level of aggregate supply, we need to substitute the given price level (P) into the SRAS curve and solve for SRAS.
   SRAS = 2,000 + 100P
   SRAS = 2,000 + 100 * ₹ 10
   SRAS = 2,000 + ₹ 1,000
   SRAS = ₹ 3,000
   So, the level of aggregate supply when the price level (P) is ₹ 10 is 2,100.

3. In an economy, the aggregate supply (AS) function is represented as AS = 2,000 + 100P, where P is the price level. Calculate the level of aggregate supply when the price level (P) is ₹ 10.
   (a) ₹ 2,000
   (b) ₹ 3,000
   (c) ₹ 2,100
   (d) ₹ 2,500
   Answer:
   (b) ₹ 3,000

Solution:

To calculate the level of aggregate supply, we need to substitute the given price level (P) into the AS function and solve for AS.

AS = 2,000 + 100P

AS = 2,000 + 100 * ₹ 10

AS = 2,000 + ₹ 1,000

AS = ₹ 3,000

So, the level of aggregate supply when the price level (P) is ₹ 10 is ₹ 3,000.

1.4 The Two-sector Model of National Income Determination

1. In the two-sector model of National Income determination, the two main sectors are:
   (a) Government and households
   (b) Government and foreign trade
   (c) Households and firms (businesses)
   (d) Firms (businesses) and foreign trade

   Answer:
   (c) Households and firms (businesses)

   Explanation:
   In the two-sector model, the economy consists of two main sectors - households and firms (businesses). Households are the consumers who own factors of production (labor, land, capital), and firms are the producers that use these factors to produce goods and services.

2. In the two-sector model, the total output produced by firms is either consumed by households or:
   (a) Saved by households
   (b) Invested by firms
   (c) Exported to foreign countries
   (d) Imported from foreign countries

   Answer:
   (a) Saved by households

   Explanation:
   In the two-sector model, the total output produced by firms is either consumed by households or saved by households. Saving is the portion of income not spent on consumption.

3. In the two-sector model, the total income earned by households is either spent on consumption or:
   (a) Invested by firms
   (b) Taxed by the government
   (c) Exported to foreign countries
   (d) Imported from foreign countries

   Answer:
   (a) Invested by firms

   Explanation:
   In the two-sector model, the total income earned by households is either spent on consumption or invested by firms. Investment represents the portion of income used by firms to acquire new capital goods and expand production.

4. In the two-sector model, the equilibrium level of National Income occurs when:
   (a) Total consumption equals total investment
   (b) Total savings equals total investment
   (c) Total consumption equals total savings
   (d) Total income equals total expenditure

   Answer:
   (c) Total consumption equals total savings

   Explanation:
   In the two-sector model, the equilibrium level of National Income occurs when total consumption equals total savings. At equilibrium, all produced output is either consumed or saved by households.

5. If total consumption in the two-sector model is greater than total income, the economy will experience:
   (a) An increase in inventories
   (b) An increase in investment

(c) An increase in National Income
(d) A decrease in National Income

Answer:

(d) A decrease in National Income

Explanation:

If total consumption in the two-sector model is greater than total income, it means households are spending more than their current income, resulting in dissaving. This leads to a decrease in National Income until consumption and income are equalized at equilibrium.

6. In the two-sector model, the income earned by households is allocated between:
(a) Taxes and Savings
(b) Consumption and Savings
(c) Consumption and Investment
(d) Taxes and Investment

Answer:

(b) Consumption and Savings

Explanation:

In the two-sector model, the income earned by households is allocated between consumption (C) and savings (S). Consumption expenditure represents the total spending by households on goods and services, while savings represent the portion of income not spent on consumption.

7. In the two-sector model, the equilibrium condition is achieved when:
(a) Consumption equals savings
(b) Consumption exceeds savings
(c) Savings exceed consumption
(d) Consumption and savings are both zero

Answer: (a) Consumption equals savings

Explanation:

In the two-sector model, equilibrium is achieved when consumption (C) equals savings (S). This means that all income earned by households is either spent on consumption or saved, and there is no leakage from the circular flow of income.

8. If in the two-sector model, consumption exceeds income, it would result in:
(a) Equilibrium
(b) A budget surplus
(c) A budget deficit
(d) An increase in investment

Answer:

(c) A budget deficit

Explanation:

In the two-sector model, if consumption exceeds income, it would result in a budget deficit. This situation occurs when households are spending more than their income, leading to a shortfall in savings.

9. In the two-sector model, investment is assumed to be:
(a) Autonomous
(b) Derived
(c) Dependent on consumption
(d) Dependent on government spending

Answer:

(a) Autonomous

Explanation:

In the two-sector model, investment is assumed to be autonomous, meaning it is not directly dependent on the level of income or consumption. It is considered an exogenous variable, determined by factors such as business expectations and government policies.

10. In the two-sector model, the total income earned by households is divided into two components: consumption expenditure (C) and:
(a) Gross Domestic Product (GDP)
(b) Investment (I)
(c) Net exports (NX)
(d) Savings (S)

Answer:

(d) Savings (S)

Explanation:

In the two-sector model, the total income earned by households is divided into two components: consumption expenditure (C) and savings (S). The income that is not spent on consumption is saved.

11. The equilibrium condition in the two-sector model occurs when:
 (a) Savings are greater than investment
 (b) Consumption equals investment
 (c) Savings equal investment
 (d) Consumption equals GDP

 Answer:

 (c) Savings equal investment

 Explanation:

 The equilibrium condition in the two-sector model occurs when total savings (S) equal total investment (I). At equilibrium, the amount households save is equal to the amount firms invest, ensuring that all income generated in the economy is either consumed or invested.

12. If, in the two-sector model, aggregate savings are greater than aggregate investment, the economy is in:
 (a) Recession
 (b) Equilibrium
 (c) Inflation
 (d) Unemployment

 Answer:

 (a) Recession

 Explanation:

 If aggregate savings (S) are greater than aggregate investment (I) in the two-sector model, it means that households are saving more than what firms are investing. This situation may lead to a decrease in demand and economic slowdown, which is often associated with a recession.

13. The formula for calculating national income (Y) in the two-sector model is:
 (a) Y = C - S
 (b) Y = C + S
 (c) Y = C + I
 (d) Y = C - I

 Answer:

 (b) Y = C + S

 Explanation:

 In the two-sector model, national income (Y) is equal to consumption expenditure (C) plus savings (S). This is because all income earned by households is either consumed or saved, so Y = C + S.

1.4.1 Equilibrium with Unemployment or Inflation

1. In an economy, the aggregate demand (A(d) function is represented as AD = 2,000 - 100P, and the short-run aggregate supply (SRAS) function is represented as SRAS = 1,000 + 150P. Calculate the equilibrium price level (P) and output level when the economy is at equilibrium.
 (a) P = ₹ 6, Y = 1,400 (b) P = ₹ 8, Y = 1,200
 (c) P = ₹ 10, Y = 1,000 (d) P = ₹ 12, Y = 800

 Answer:

 (a) P = ₹ 6, Y = 1,400

 Solution:

 To find the equilibrium price level (P) and output level (Y), we need to set the aggregate demand (AD) equal to the short-run aggregate supply (SRAS) and solve for P and Y.

 Equilibrium occurs when AD = SRAS:

 2,000 - 100P = 1,000 + 150P

 Combine the terms with P on one side:

 2,000 - 100P - 150P = 1,000

 Simplify the equation:

 2,000 - 250P = 1,000

 Subtract 2,000 from both sides:

 -250P = -1,000

 Divide both sides by -250:

 P = 4

 Now that we have the equilibrium price level (P), we can find the output level (Y) by substituting P back into the SRAS function:

 SRAS = 1,000 + 150P

 SRAS = 1,000 + 150 * 4

 SRAS = 1,000 + 600

 SRAS = 1,600

 So, the equilibrium price level (P) is ₹ 6, and the output level (Y) is 1,400.

2. In an economy, the aggregate demand (AD) and short-run aggregate supply (SRAS) functions are given by AD = 2,000 - 100P and SRAS = 1,000 + 150P, where P is the price level. Calculate the equilibrium price level and output level.
   (a) Equilibrium price level: ₹ 8; Output level: 1,400 units
   (b) Equilibrium price level: ₹ 10; Output level: 1,500 units
   (c) Equilibrium price level: ₹ 12; Output level: 1,600 units
   (d) Equilibrium price level: ₹ 6; Output level: 1,200 units

   Answer:
   (a) Equilibrium price level: ₹ 8; Output level: 1,400 units

   Solution:
   To find the equilibrium price level and output level, we need to set the aggregate demand (AD) equal to the short-run aggregate supply (SRAS) and solve for P.
   AD = SRAS
   2,000 - 100P = 1,000 + 150P
   2,000 - 1,000 = 150P + 100P
   1,000 = 250P
   P = 1,000 / 250
   P = 4
   Now, we can find the output level (Y) using either the AD or SRAS function.
   Y = AD = 2,000 - 100P = 2,000 - 100 * 4 = 2,000 - 400 = 1,600 units
   So, the equilibrium price level is ₹ 4, and the output level is 1,600 units.

3. In an economy, the aggregate demand (A(d) function is represented as AD = 2,000 - 100P, and the short-run aggregate supply (SRAS) function is represented as SRAS = 500 + 100P. Calculate the equilibrium price level and output level in the economy.
   (a) Equilibrium price level = ₹ 8; Equilibrium output level = 1,200 units
   (b) Equilibrium price level = ₹ 10; Equilibrium output level = 1,000 units
   (c) Equilibrium price level = ₹ 12; Equilibrium output level = 800 units
   (d) Equilibrium price level = ₹ 14; Equilibrium output level = 600 units

   Answer:
   (b) Equilibrium price level = ₹ 10; Equilibrium output level = 1,000 units

   Solution:
   To find the equilibrium price level and output level, we need to equate the aggregate demand (AD) function and the short-run aggregate supply (SRAS) function.
   Equating AD and SRAS:
   2,000 - 100P = 500 + 100P
   Now, solve for P:
   2,000 - 500 = 100P + 100P
   1,500 = 200P
   P = 1,500 / 200
   P = 7.5
   Now, substitute the value of P into either the AD or SRAS function to find the equilibrium output level:
   AD = 2,000 - 100P
   AD = 2,000 - 100 * 7.5
   AD = 2,000 - 750
   AD = 1,250
   So, the equilibrium price level is ₹ 7.5, and the equilibrium output level is 1,250 units.

1.5 The Investment Multiplier

1. The investment multiplier measures the relationship between:
   (a) Consumer spending and investment
   (b) Government spending and investment
   (c) Investment and changes in national income
   (d) Changes in national income and consumer spending

   Answer:
   (c) Investment and changes in national income

   Explanation:
   The investment multiplier measures the relationship between changes in investment and the resulting changes in national income. It shows how an initial change in investment can lead to a more significant overall increase in national income through the multiplier effect.

2. The formula to calculate the investment multiplier is:
   (a) Investment Multiplier = 1 / Marginal Propensity to Consume (MPC)
   (b) Investment Multiplier = 1 / Marginal Propensity to Save (MPS)
   (c) Investment Multiplier = 1 + Marginal Propensity to Consume (MPC)
   (d) Investment Multiplier = 1 + Marginal Propensity to Save (MPS)
   Answer:
   (d) Investment Multiplier = 1 + Marginal Propensity to Save (MPS)
   Explanation:
   The formula to calculate the investment multiplier is 1 / (1 - MPS) or equivalently, 1 / MPS. Since MPS (Marginal Propensity to Save) is the proportion of additional income that households save, the investment multiplier is 1 divided by (1 - MPS) or 1 divided by MPS.
3. If the Marginal Propensity to Save (MPS) is 0.2, what is the value of the investment multiplier?
   (a) 1.2 (b) 5
   (c) 0.2 (d) 0.8
   Answer:
   (b) 5
   Explanation:
   The investment multiplier is calculated as 1 / (1 - MPS). If MPS is 0.2, then the investment multiplier is 1 / (1 - 0.2) = 1 / 0.8 = 5.
4. The investment multiplier indicates that an increase in investment of a certain amount will lead to a/an:
   (a) Smaller increase in national income
   (b) Equal decrease in national income
   (c) Larger increase in national income
   (d) No change in national income
   Answer:
   (c) Larger increase in national income
   Explanation:
   The investment multiplier shows that an increase in investment will result in a larger overall increase in national income. For example, if the investment multiplier is 5, an initial increase in investment of ₹ 100 will lead to a total increase in national income of ₹ 500 (5 times the initial investment).

5. The investment multiplier assumes that:
   (a) The economy is at full employment
   (b) Consumer spending is constant
   (c) Government spending is constant
   (d) There are no leakages in the economy
   Answer:
   (d) There are no leakages in the economy
   Explanation:
   The investment multiplier assumes that there are no leakages in the economy, meaning that all additional income generated through the multiplier effect is spent and not saved or taxed away. In other words, the multiplier effect assumes that the entire increase in income is spent on consumption and not saved or taxed.
6. The investment multiplier measures the:
   (a) Increase in government spending due to an increase in investment
   (b) Increase in investment due to an increase in government spending
   (c) Total change in national income resulting from a change in investment
   (d) Total change in investment resulting from a change in national income
   Answer:
   (c) Total change in national income resulting from a change in investment
   Explanation:
   The investment multiplier measures the total change in national income that results from a change in investment. It shows the magnified impact of changes in investment on the overall economy.
7. The value of the investment multiplier is calculated as:
   (a) 1 / Marginal Propensity to Consume (MPC)
   (b) Marginal Propensity to Consume (MPC) / 1
   (c) 1 / Marginal Propensity to Save (MPS)
   (d) Marginal Propensity to Save (MPS) / 1
   Answer:
   (a) 1 / Marginal Propensity to Save (MPS)

Explanation:
The value of the investment multiplier (K) is calculated as 1 / Marginal Propensity to Save (MPS). It shows how changes in investment lead to a magnified change in national income.

8. If the Marginal Propensity to Consume (MPC) is 0.8, the value of the investment multiplier will be:
   (a) 2
   (b) 3
   (c) 4
   (d) 5

   Answer:
   (c) 4

   Explanation:
   If the Marginal Propensity to Consume (MPC) is 0.8, the value of the investment multiplier (K) is calculated as 1 / (1 - MPC) = 1 / (1 - 0.8) = 1 / 0.2 = 5.

9. The investment multiplier can be used to calculate the total change in income when there is an autonomous increase in investment. Autonomous investment refers to investment that:
   (a) Depends on changes in income
   (b) Does not depend on changes in income
   (c) Is made by the government sector
   (d) Is made by the foreign sector

   Answer:
   (b) Does not depend on changes in income

   Explanation:
   Autonomous investment refers to investment that does not depend on changes in income. It is independent of the level of income in the economy. The investment multiplier helps calculate the total change in income resulting from this autonomous increase in investment.

10. If the investment multiplier is 3, an initial increase in investment of ₹ 100 million will lead to a total increase in national income of:
   (a) ₹ 200 million
   (b) ₹ 300 million

   (c) ₹ 400 million
   (d) ₹ 500 million

   Answer:
   (b) ₹ 300 million

   Explanation:
   If the investment multiplier is 3 and there is an initial increase in investment of ₹ 100 million, the total increase in national income will be ₹ 100 million * 3 = ₹ 300 million.

11. The investment multiplier measures the:
   (a) Change in investment due to changes in interest rates.
   (b) Change in investment due to changes in government spending.
   (c) Change in national income due to changes in investment.
   (d) Change in consumption due to changes in income.

   Answer:
   (c) Change in national income due to changes in investment.

   Explanation: The investment multiplier measures the change in national income that results from a change in investment spending. It shows how an initial change in investment can lead to a larger overall impact on the economy through a multiplier effect.

12. The formula for calculating the investment multiplier is:
   (a) Investment Multiplier = 1 / Marginal Propensity to Consume (MPC)
   (b) Investment Multiplier = 1 / Marginal Propensity to Save (MPS)
   (c) Investment Multiplier = 1 / Marginal Propensity to Import (MPI)
   (d) Investment Multiplier = 1 / Marginal Propensity to Invest (MPI)

   Answer:
   (a) Investment Multiplier = 1 / Marginal Propensity to Consume (MPC)

   Explanation:
   The formula for calculating the investment multiplier is: Investment Multiplier = 1 / Marginal Propensity to Consume (MPC). The marginal propensity to consume (MPC) represents the fraction of additional income that households spend on consumption.

13. If the marginal propensity to consume (MPC) is 0.8, the value of the investment multiplier would be:
    (a) 0.8 (b) 5
    (c) 0.2 (d) 2

    Answer:
    (d) 2

    Explanation:
    If the marginal propensity to consume (MPC) is 0.8, the value of the investment multiplier would be 1 / 0.8 = 2. This means that a change in investment will lead to a two-times larger change in national income due to the multiplier effect.

14. The investment multiplier is based on the idea that an initial change in investment:
    (a) Directly affects consumption spending by households.
    (b) Indirectly affects consumption and investment spending through changes in interest rates.
    (c) Indirectly affects consumption spending by households.
    (d) Directly affects government spending.

    Answer:
    (c) Indirectly affects consumption spending by households.

    Explanation:
    The investment multiplier is based on the idea that an initial change in investment indirectly affects consumption spending by households. An increase in investment leads to an increase in income, which, in turn, increases consumption spending by households.

15. If the investment multiplier is 4, a ₹ 100 million increase in investment will lead to a total increase in national income of:
    (a) ₹ 200 million
    (b) ₹ 400 million
    (c) ₹ 600 million
    (d) ₹ 800 million

    Answer:
    (c) ₹ 600 million

    Explanation:
    If the investment multiplier is 4, a ₹ 100 million increase in investment will lead to a total increase in national income of ₹ 100 million × 4 = ₹ 400 million. The investment multiplier shows the cumulative impact of changes in investment on national income.

1.6 Determination of Equilibrium Income: Three Sector Model

1. In the three-sector model, the three main sectors of the economy are:
    (a) Government, households, and foreign trade
    (b) Government, households, and financial institutions
    (c) Households, firms (businesses), and foreign trade
    (d) Households, firms (businesses), and financial institutions

    Answer:
    (a) Government, households, and foreign trade

    Explanation:
    In the three-sector model, the economy consists of three main sectors-government, households, and foreign trade. Households are the consumers who own factors of production, firms are the producers that use these factors to produce goods and services, and the foreign trade sector represents international trade and transactions.

2. In the three-sector model, the equilibrium condition occurs when:
    (a) Total consumption equals total savings
    (b) Total income equals total consumption
    (c) Total income equals total expenditure
    (d) Total savings equals total investment

    Answer: (c) Total income equals total expenditure

    Explanation:
    In the three-sector model, the equilibrium condition occurs when total income (Y) equals total expenditure (C + I + G + NX), where C is consumption expenditure, I is investment expenditure, G is government expenditure, and NX is net exports (exports minus imports).

3. The formula for calculating the equilibrium level of income (Y) in the three-sector model is:
    (a) Y = C + I + G
    (b) Y = C + S + T

(c) Y = C + I + NX
(d) Y = C + I - NX
Answer:
(c) Y = C + I + NX
Explanation:
In the three-sector model, the formula for calculating the equilibrium level of income (Y) is Y = C + I + NX, where C is consumption expenditure, I is investment expenditure, and NX is net exports (exports minus imports).

4. If in the three-sector model, total consumption is ₹ 800 million, total investment is ₹ 200 million, government expenditure is ₹ 300 million, and net exports are ₹ 50 million, the equilibrium level of income (Y) would be:
(a) ₹ 1,050 million
(b) ₹ 1,250 million
(c) ₹ 750 million
(d) ₹ 1,350 million
Answer:
(b) ₹ 1,250 million
Explanation:
To calculate the equilibrium level of income (Y), we use the formula Y = C + I + NX. Substituting the given values: Y = ₹ 800 million (consumption) + ₹ 200 million (investment) + ₹ 50 million (net exports) = ₹ 1,050 million.

5. If in the three-sector model, total consumption is ₹ 500 million, total investment is ₹ 300 million, government expenditure is ₹ 200 million, and net exports are -₹ 50 million (trade deficit), the equilibrium level of income (Y) would be:
(a) ₹ 1,050 million
(b) ₹ 950 million
(c) ₹ 750 million
(d) ₹ 1,150 million
Answer:
(b) ₹ 950 million

Explanation:
To calculate the equilibrium level of income (Y), we use the formula Y = C + I + NX. Substituting the given values: Y = ₹ 500 million (consumption) + ₹ 300 million (investment) - ₹ 50 million (net exports) = ₹ 950 million.

6. In a three-sector model, the three main sectors of the economy are:
(a) Households, firms, and government
(b) Households, firms, and foreign trade
(c) Households, firms, and banks
(d) Households, firms, and financial institutions
Answer:
(b) Households, firms, and foreign trade
Explanation:
In a three-sector model, the economy consists of three main sectors - households, firms (businesses), and foreign trade. Households are the consumers, firms produce goods and services, and foreign trade represents international transactions.

7. In a three-sector model, the equilibrium condition occurs when:
(a) Aggregate savings equal aggregate investment
(b) Aggregate consumption equals aggregate income
(c) Total exports equal total imports
(d) Total government spending equals total tax revenue
Answer:
(b) Aggregate consumption equals aggregate income
Explanation:
In a three-sector model, the equilibrium condition occurs when aggregate consumption (C) equals aggregate income (Y). At equilibrium, total income earned in the economy is either consumed, saved, or spent on imports.

8. If, in the three-sector model, aggregate consumption is greater than aggregate income, the economy is in:
(a) Recession
(b) Equilibrium

(c) Inflation
(d) A trade surplus

Answer:

(a) Recession

Explanation:

If aggregate consumption (C) is greater than aggregate income (Y) in the three-sector model, it means that households are spending more than their income, which can lead to decreased savings and economic slowdown, often associated with a recession.

9. The formula for calculating the equilibrium level of income (Y) in a three-sector model is:
(a) Y = C - I + X - M
(b) Y = C + I + G
(c) Y = C + S + T
(d) Y = C + I + X

Answer:

(b) Y = C + I + G

Explanation:

In a three-sector model with government (G) included, the formula for calculating the equilibrium level of income (Y) is Y = C + I + G. This equation represents total consumption, investment, and government spending.

10. The concept of the marginal propensity to import (MPM) in a three-sector model refers to:
(a) The change in government spending due to changes in income.
(b) The change in consumption due to changes in income.
(c) The change in imports due to changes in income.
(d) The change in investment due to changes in interest rates.

Answer:

(c) The change in imports due to changes in income.

Explanation:

The concept of the marginal propensity to import (MPM) in a three-sector model refers to the change in imports due to changes in income. It represents the fraction of additional income that is spent on imports.

11. The formula for calculating national income (Y) in the three-sector model is:
(a) Y = C + S
(b) Y = C + I
(c) Y = C + T
(d) Y = C + T + I

Answer:

(d) Y = C + T + I

Explanation:

In the three-sector model, national income (Y) is equal to consumption expenditure (C) plus taxes (T) plus investment (I). This is because all income earned by households is either consumed, saved, or paid in taxes and investment adds to the total income.

12. In the three-sector model, the total income earned by households is divided into three components: consumption expenditure (C), savings (S), and:
(a) Taxes (T)
(b) Investment (I)
(c) Exports (X)
(d) Government expenditure (G)

Answer:

(a) Taxes (T)

Explanation:

In the three-sector model, the total income earned by households is divided into three components: consumption expenditure (C), savings (S), and taxes (T). The income that is not spent on consumption or saved is paid in taxes.

13. The equilibrium condition in the three-sector model occurs when:
(a) Total consumption equals total income
(b) Total savings equal total investment
(c) Total consumption plus total taxes equal total income
(d) Total exports equal total imports

Answer:

(c) Total consumption plus total taxes equal total income

Explanation:
The equilibrium condition in the three-sector model occurs when total consumption (C) plus total taxes (T) equal total income (Y). At equilibrium, the total income generated in the economy is either consumed, saved, or paid in taxes.

14. If, in the three-sector model, aggregate consumption and taxes are greater than aggregate income, it indicates that:
(a) The economy is in equilibrium
(b) The economy is in recession
(c) The economy is facing a surplus
(d) The economy is facing a deficit

Answer:
(d) The economy is facing a deficit

Explanation:
If aggregate consumption (C) and taxes (T) are greater than aggregate income (Y) in the three-sector model, it indicates that the economy is facing a deficit. This means that households are consuming and paying more in taxes than what they earn as income.

1.6.1 The Government Sector and Income Determination

1. In an economy, the government purchases of goods and services (G) are ₹ 500 billion, taxes (T) are ₹ 300 billion, transfer payments (TR) are ₹ 100 billion, and the disposable income (YD) is ₹ 1,500 billion. Calculate the level of government savings or dissavings.
(a) Government savings of ₹ 200 billion
(b) Government dissavings of ₹ 100 billion
(c) Government dissavings of ₹ 200 billion
(d) Government savings of ₹ 100 billion

Answer:
(c) Government dissavings of ₹ 200 billion

Solution:
Government savings or dissavings can be calculated using the formula:
Government Savings (or Dissavings) = Taxes (T) - Transfer Payments (TR) - Government Purchases (G)

Government Savings (or Dissavings) = ₹ 300 billion - ₹ 100 billion - ₹ 500 billion
Government Savings (or Dissavings) = ₹ 300 billion - ₹ 600 billion
Government Savings (or Dissavings) = -₹ 300 billion
Since the result is negative, it indicates that the government is running a dissavings or deficit of ₹ 200 billion.
So, the correct answer is: (c) Government dissavings of ₹ 200 billion.

2. In an economy, the government increases its spending on infrastructure projects and welfare programs. As a result, the government expenditure (G) increases by ₹ 100 billion. How will this increase in government expenditure affect the equilibrium level of income in the economy, assuming the marginal propensity to consume (MPC) is 0.8?
(a) The equilibrium level of income will increase by ₹ 100 billion.
(b) The equilibrium level of income will decrease by ₹ 100 billion.
(c) The equilibrium level of income will increase by ₹ 500 billion.
(d) The equilibrium level of income will decrease by ₹ 500 billion.

Answer:
(c) The equilibrium level of income will increase by ₹ 500 billion.

Solution:
The increase in government expenditure will directly contribute to the aggregate demand (AD) in the economy. The change in equilibrium income (ΔY) can be calculated using the expenditure multiplier (k), which is given by:
k = 1 / (1 - MPC)
where MPC is the marginal propensity to consume. In this case, the MPC is 0.8, so the expenditure multiplier is:
k = 1 / (1 - 0.8) = 1 / 0.2 = 5
Now, we can calculate the change in equilibrium income (ΔY) using the expenditure multiplier:
ΔY = k * ΔG
ΔY = 5 * ₹ 100 billion
ΔY = ₹ 500 billion
So, the increase in government expenditure by ₹ 100 billion will lead to an increase in the equilibrium level of income by ₹ 500 billion.

3. In an economy, the government increases its spending on infrastructure projects and welfare programs. As a result, the government expenditure (G) increases by ₹ 200 billion. How will this increase in government expenditure affect the equilibrium level of income (Y) in the economy, assuming a simple Keynesian model?
   (a) The equilibrium level of income (Y) will increase by ₹ 200 billion.
   (b) The equilibrium level of income (Y) will decrease by ₹ 200 billion.
   (c) The equilibrium level of income (Y) will not change.
   (d) The equilibrium level of income (Y) will change, but the direction of change cannot be determined without more information.

Answer:

(a) The equilibrium level of income (Y) will increase by ₹ 200 billion.

Solution:

In a simple Keynesian model, an increase in government expenditure (G) will have a multiplier effect on the equilibrium level of income (Y). The multiplier effect arises because an increase in government expenditure leads to an increase in aggregate demand, which in turn leads to an increase in production and income.

The formula for the multiplier effect is given by:

Multiplier = 1 / (1 - MP(c)

Where MPC is the marginal propensity to consume.

Since the question doesn't provide the value of MPC, we assume that MPC is 0.8 (which means that 80% of any increase in income will be consume (d).

With MPC = 0.8, the multiplier will be:

Multiplier = 1 / (1 - 0.8) = 1 / 0.2 = 5

Now, if the government increases its expenditure (G) by ₹ 200 billion, the increase in income (Y) will be:

Increase in income (Y) = Multiplier * Increase in government expenditure (G)

Increase in income (Y) = 5 * ₹ 200 billion = ₹ 1,000 billion

So, the equilibrium level of income (Y) will increase by ₹ 200 billion due to the increase in government expenditure.

4. In an economy, the government purchases (G) are ₹ 500 billion, taxes (T) are ₹ 300 billion, transfer payments (TR) are ₹ 100 billion, and the disposable income (YD) is ₹ 1,800 billion. Calculate the level of government savings or dissavings (Sg).
   (a) Government savings (Sg) = ₹ 100 billion
   (b) Government savings (Sg) = -₹ 100 billion
   (c) Government savings (Sg) = ₹ 300 billion
   (d) Government savings (Sg) = -₹ 300 billion

Answer:

(b) Government savings (Sg) = -₹ 100 billion

Solution:

Government savings or dissavings (Sg) can be calculated using the formula:

Sg = (T + TR) - G

Sg = (₹ 300 billion + ₹ 100 billion) - ₹ 500 billion

Sg = ₹ 400 billion - ₹ 500 billion

Sg = -₹ 100 billion

Since the result is negative, it indicates that the government is running a deficit or dissaving of ₹ 100 billion.

So, the correct answer is (b) Government savings (Sg) = -₹ 100 billion.

1.7 Determination of Equilibrium Income: Four Sector Model

1. In the four-sector model, the total income earned by households is divided into four components: consumption expenditure (C), savings (S), taxes (T), and:
   (a) Exports (X)
   (b) Imports (M)
   (c) Investment (I)
   (d) Government expenditure (G)

Answer:

(c) Investment (I)

Explanation:

In the four-sector model, the total income earned by households is divided into four components: consumption expenditure (C), savings (S), taxes (T), and investment (I). Investment represents the amount businesses invest in new capital goods.

2. The equilibrium condition in the four-sector model occurs when:
   (a) Total consumption equals total income
   (b) Total savings equal total investment
   (c) Total consumption plus total taxes equal total income
   (d) Total exports equal total imports

   Answer:
   (c) Total consumption plus total taxes equal total income

   Explanation:
   The equilibrium condition in the four-sector model occurs when total consumption (C) plus total taxes (T) equals total income (Y). At equilibrium, the total income generated in the economy is either consumed, saved, paid in taxes, or invested.

3. If, in the four-sector model, aggregate consumption and taxes are greater than aggregate income, it indicates that:
   (a) The economy is in equilibrium
   (b) The economy is in recession
   (c) The economy is facing a surplus
   (d) The economy is facing a deficit

   Answer:
   (d) The economy is facing a deficit

   Explanation:
   If aggregate consumption (C) and taxes (T) are greater than aggregate income (Y) in the four-sector model, it indicates that the economy is facing a deficit. This means that households are consuming and paying more in taxes than what they earn as income.

4. In the four-sector model, the net exports (NX) component represents:
   (a) Total consumption by households
   (b) Total government expenditure
   (c) Total investment by firms
   (d) The difference between exports (X) and imports (M)

   Answer:
   (d) The difference between exports (X) and imports (M)

   Explanation:
   In the four-sector model, the net exports (NX) component represents the difference between exports (X) and imports (M). If exports exceed imports ($NX > 0$), the economy has a trade surplus, and if imports exceed exports ($NX < 0$), the economy has a trade deficit.

5. The formula for calculating national income (Y) in the four-sector model is:
   (a) $Y = C + S$
   (b) $Y = C + T$
   (c) $Y = C + T + I$
   (d) $Y = C + T + I + NX$

   Answer:
   (d) $Y = C + T + I + NX$

   Explanation:
   In the four-sector model, national income (Y) is equal to consumption expenditure (C) plus taxes (T) plus investment (I) plus net exports (NX). This formula accounts for all the components that determine the total income earned in the economy.

6. In the four-sector model, the four main sectors of the economy are:
   (a) Households, firms (businesses), government, and foreign trade
   (b) Households, firms (businesses), government, and financial institutions
   (c) Households, firms (businesses), government, and banks
   (d) Households, firms (businesses), government, and central bank

   Answer:
   (a) Households, firms (businesses), government, and foreign trade

   Explanation:
   In the four-sector model, the economy consists of four main sectors - households, firms (businesses), government, and foreign trade. Households are the consumers, firms are the producers, government represents public expenditure, and foreign trade represents international transactions.

7. In the four-sector model, the total income earned by households is divided into four components: consumption expenditure ((c), savings (S), taxes (T), and:
   (a) Imports (M)
   (b) Exports (X)
   (c) Government expenditure (G)
   (d) Investments (I)

   Answer:
   (b) Exports (X)

   Explanation:
   In the four-sector model, the total income earned by households is divided into four components: consumption expenditure (C), savings (S), taxes (T), and exports (X). Exports represent the income earned from foreign trade.

8. The equilibrium condition in the four-sector model occurs when:
   (a) Total consumption plus total taxes equal total income
   (b) Total consumption plus total investment equal total income
   (c) Total savings plus total investment equal total income
   (d) Total exports equal total imports

   Answer:
   (c) Total savings plus total investment equal total income

   Explanation:
   The equilibrium condition in the four-sector model occurs when total savings (S) plus total investment (I) equal total income (Y). At equilibrium, the total income generated in the economy is either consumed, saved, or invested.

9. If, in the four-sector model, aggregate consumption, taxes, and imports are greater than aggregate income, it indicates that:
   (a) The economy is in equilibrium
   (b) The economy is in recession
   (c) The economy is facing a surplus
   (d) The economy is facing a deficit

   Answer:
   (d) The economy is facing a deficit

   Explanation:
   If aggregate consumption (C), taxes (T), and imports (M) are greater than aggregate income (Y) in the four-sector model, it indicates that the economy is facing a deficit. This means that households are consuming, paying taxes, and importing more than what they earn as income.

10. The formula for calculating national income (Y) in the four-sector model is:
   (a) Y = C + S
   (b) Y = C + I
   (c) Y = C + T + X
   (d) Y = C + T + I + X - M

   Answer:
   (d) Y = C + T + I + X - M

   Explanation:
   In the four-sector model, national income (Y) is equal to consumption expenditure (C) plus taxes (T) plus investment (I) plus exports (X) minus imports (M). This formula accounts for all components of income and expenditure in the economy.

1.8 Conclusion

1. According to the Keynesian theory, during an economic recession, the government should:
   (a) Decrease government spending to reduce budget deficits.
   (b) Increase taxes to control inflation.
   (c) Increase government spending to stimulate aggregate demand.
   (d) Decrease interest rates to encourage private investment.

   Answer:
   (c) Increase government spending to stimulate aggregate demand.

   Explanation:
   According to the Keynesian theory, during an economic recession, the government should increase government spending to stimulate aggregate demand. This increase in government expenditure will help boost economic activity and create demand for goods and services, leading to higher employment and economic growth.

2. The Keynesian theory emphasizes that in times of economic downturns, the primary cause of unemployment is:
   (a) Technological advancements leading to job losses.
   (b) Structural changes in the economy.
   (c) Insufficient aggregate demand.
   (d) Excessive government intervention.

   Answer:
   (c) Insufficient aggregate demand.

   Explanation:
   The Keynesian theory emphasizes that in times of economic downturns, the primary cause of unemployment is insufficient aggregate demand. When overall demand for goods and services is low, firms reduce production and lay off workers, leading to higher unemployment.

3. The concept of the "Multiplier Effect" in the Keynesian theory suggests that:
   (a) Government spending has a larger impact on national income than changes in taxes.
   (b) A change in investment leads to a proportionate change in national income.
   (c) Increases in exports result in higher economic growth and employment.
   (d) Changes in consumption have a direct and immediate impact on investment.

   Answer:
   (b) A change in investment leads to a proportionate change in national income.

   Explanation:
   The concept of the "Multiplier Effect" in the Keynesian theory suggests that a change in investment leads to a proportionate change in national income. It demonstrates how an initial change in investment can set off a chain reaction of increased spending, leading to a larger overall impact on national income.

4. According to the Keynesian theory, during periods of high inflation, the government should focus on:
   (a) Increasing government spending to boost aggregate demand.
   (b) Reducing taxes to encourage consumption.
   (c) Decreasing money supply and raising interest rates to control spending.
   (d) Encouraging private investment through tax incentives.

   Answer:
   (c) Decreasing money supply and raising interest rates to control spending.

   Explanation:
   According to the Keynesian theory, during periods of high inflation, the government should focus on decreasing money supply and raising interest rates to control spending. These measures help to reduce aggregate demand, curb inflationary pressures, and stabilize the economy.

5. The Keynesian theory highlights that during economic downturns, there may be a role for the government to engage in:
   (a) Active fiscal and monetary policies to stabilize the economy.
   (b) Laissez-faire and minimal government intervention.
   (c) Decreasing public expenditure to reduce budget deficits.
   (d) Reducing public debt to promote economic growth.

   Answer:
   (a) Active fiscal and monetary policies to stabilize the economy.

   Explanation:
   The Keynesian theory highlights that during economic downturns, there may be a role for the government to engage in active fiscal and monetary policies to stabilize the economy. These policies involve adjustments in government spending, taxation, and money supply to address fluctuations in aggregate demand and promote economic stability.

6. The conclusion of the Keynesian theory of determination of national income is that:
   (a) The government should play a minimal role in the economy.
   (b) Government intervention is necessary to stabilize the economy and achieve full employment.

(c) The economy will always be in a state of equilibrium without any government intervention.
(d) Monetary policy is the most effective tool to control inflation and unemployment.

Answer:

(b) Government intervention is necessary to stabilize the economy and achieve full employment.

Explanation:

The Keynesian theory concludes that during periods of economic downturns, the government should use fiscal policy (government spending and taxation) to stimulate aggregate demand and stabilize the economy. By increasing government spending during recessions, the government can create more jobs and boost economic activity to achieve full employment.

7. According to the Keynesian theory, during times of economic recession, the government should:
(a) Decrease taxes to boost consumer spending.
(b) Decrease government spending to reduce budget deficits.
(c) Increase taxes to reduce inflation.
(d) Increase government spending to stimulate aggregate demand.

Answer:

(d) Increase government spending to stimulate aggregate demand.

Explanation:

During times of economic recession, the Keynesian theory recommends that the government should increase its spending to stimulate aggregate demand. This increased government spending will create more jobs, boost consumer spending, and help the economy recover from the recession.

8. The Keynesian theory suggests that changes in aggregate demand can lead to fluctuations in:
(a) The exchange rate. (b) Interest rates.
(c) Unemployment and inflation. (d) Stock market prices.

Answer:

(c) Unemployment and inflation.

Explanation:

The Keynesian theory highlights that changes in aggregate demand can lead to fluctuations in unemployment and inflation. During periods of low aggregate demand, there is a risk of higher unemployment, and during periods of high aggregate demand, there is a risk of inflationary pressures.

9. The primary focus of the Keynesian theory is on:
(a) Long-term economic growth.
(b) Achieving price stability.
(c) Short-run economic fluctuations and stabilizing the economy.
(d) Increasing international trade.

Answer:

(c) Short-run economic fluctuations and stabilizing the economy.

Explanation:

The Keynesian theory primarily focuses on short-run economic fluctuations and how to stabilize the economy during periods of recession or depression. It emphasizes the importance of government intervention to achieve full employment and economic stability.

10. The Keynesian theory influenced the development of economic policies during:
(a) The Great Depression in the 1930s.
(b) The Industrial Revolution in the 18th century.
(c) The Renaissance period in Europe.
(d) The post-World War II era.

Answer:

(a) The Great Depression in the 1930s.

Explanation:

The Keynesian theory gained prominence during the Great Depression in the 1930s when John Maynard Keynes published his seminal work, "The General Theory of Employment, Interest, and Money." It had a significant impact on economic policies aimed at addressing the economic challenges of the Great Depression.

Additional Questions Bank

1.1 Introduction

Sure, here are some multiple-choice questions (MCQs) related to the introduction of the Keynesian theory of determination of national income:

1. The Keynesian theory of determination of national income was proposed by:
   (a) Adam Smith
   (b) John Maynard Keynes
   (c) Milton Friedman
   (d) Friedrich Hayek
2. According to the Keynesian theory, the level of national income is primarily determined by:
   (a) Aggregate demand in the economy
   (b) Aggregate supply in the economy
   (c) The government's fiscal policy
   (d) The central bank's monetary policy
3. The central idea of the Keynesian theory is that:
   (a) Supply creates its own demand in the economy
   (b) Savings and investment are equal in the long run
   (c) The economy can experience prolonged periods of unemployment
   (d) Government intervention is unnecessary in a free-market economy
4. Keynes argued that during economic downturns, the government should:
   (a) Reduce taxes and increase government spending
   (b) Increase taxes and reduce government spending
   (c) Allow market forces to correct the imbalances in the economy
   (d) Privatize state-owned enterprises to stimulate economic growth
5. The concept of "effective demand" in the Keynesian theory refers to:
   (a) The total demand for goods and services in the economy
   (b) The demand for goods and services by the government sector
   (c) The demand for exports and imports in the economy
   (d) The demand for consumer goods only, excluding investment

6. Keynesian policies are designed to address:
   (a) Short-run fluctuations in the business cycle
   (b) Long-run structural issues in the economy
   (c) Inflationary pressures in the economy
   (d) Excessive government debt and deficits
7. In the Keynesian theory, if aggregate demand is insufficient to achieve full employment, the result will be:
   (a) Inflation
   (b) Deflation
   (c) Recession or unemployment
   (d) Economic growth and stability
8. The Keynesian theory gained prominence during which historical period?
   (a) The Great Depression of the 1930s
   (b) The Industrial Revolution of the 18th century
   (c) The Renaissance era in Europe
   (d) The dot-com bubble of the late 1990s

1.2 Circular Flow in a Simple Two-sector Model

Certainly! Here are some multiple-choice questions (MCQs) related to the circular flow in a simple two-sector model:

1. In a simple two-sector model of the economy, the two main sectors are:
   (a) Household and government
   (b) Household and business
   (c) Business and government
   (d) Household and financial
2. The circular flow model illustrates the flow of:
   (a) Goods and services and money between households and firms
   (b) Goods and services and money between households and the government
   (c) Goods and services and money between businesses and the government
   (d) Goods and services and money between firms and financial institutions

3. In the circular flow model, households are the:
   (a) Buyers of goods and services and sellers of factors of production
   (b) Buyers of goods and services and buyers of factors of production
   (c) Sellers of goods and services and sellers of factors of production
   (d) Sellers of goods and services and buyers of factors of production
4. Which of the following represents the flow of money in the circular flow model? .
   (a) Money flows from households to businesses as payment for goods and services
   (b) Money flows from businesses to households as payment for factors of production
   (c) Money flows from businesses to the government as taxes
   (d) Money flows from households to the government as taxes
5. In the circular flow model, households receive income through:
   (a) Profits earned from business activities
   (b) Government subsidies and transfers
   (c) Wages, salaries, and rent for providing factors of production
   (d) Interest earned from financial investments
6. The circular flow model assumes that:
   (a) There is no saving or investment in the economy
   (b) The government does not play a role in the economy
   (c) There are no leakages or injections in the flow of income
   (d) The economy is closed, with no foreign trade
7. Leakage in the circular flow model refers to:
   (a) Money flowing out of the economy due to imports
   (b) Money flowing into the economy due to exports
   (c) Savings and taxes that reduce the flow of income
   (d) Government spending that increases the flow of income
8. Injection in the circular flow model refers to:
   (a) Money flowing into the economy due to exports
   (b) Money flowing out of the economy due to imports
   (c) Government spending and investments that increase the flow of income
   (d) Savings and taxes that reduce the flow of income

1.3 Basic Concepts and Functions

Certainly! Here are some multiple-choice questions (MCQs) related to basic concepts and functions in economics:

1. Economics is the study of:
   (a) How to maximize individual profits
   (b) How to achieve economic equality among individuals
   (c) How societies allocate scarce resources to satisfy unlimited wants
   (d) How to control inflation and unemployment in the economy
2. The basic economic problem arises because:
   (a) Governments are inefficient in resource allocation
   (b) Human wants are unlimited, but resources are limited
   (c) There is a surplus of goods and services in the market
   (d) Consumers' preferences change frequently
3. The concept of opportunity cost refers to:
   (a) The monetary cost of an economic decision
   (b) The highest-valued alternative that must be given up when a choice is made
   (c) The additional cost incurred when producing one more unit of a good
   (d) The total cost of production of a firm
4. In economics, the term "demand" refers to:
   (a) The quantity of a good or service that producers are willing to supply
   (b) The quantity of a good or service that consumers are willing and able to buy at a given price
   (c) The price at which producers are willing to sell a good or service
   (d) The price at which consumers are willing and able to buy a good or service
5. The law of supply states that:
   (a) As the price of a good or service increases, the quantity demanded will increase
   (b) As the price of a good or service increases, the quantity supplied will decrease

(c) As the price of a good or service decreases, the quantity demanded will decrease
(d) As the price of a good or service decreases, the quantity supplied will increase

6. Which of the following is a function of money in an economy?
(a) To regulate imports and exports
(b) To control inflation and deflation
(c) To serve as a medium of exchange, unit of account, and store of value
(d) To determine the distribution of income and wealth

7. In a market economy, the allocation of resources is primarily determined by:
(a) The government through central planning
(b) Consumer preferences and market forces of supply and demand
(c) Labor unions and collective bargaining
(d) International trade agreements and treaties

8. The production possibilities frontier (PPF) represents:
(a) The maximum quantity of goods and services that a country can produce using all available resources efficiently
(b) The minimum level of production a country must achieve to meet its basic needs
(c) The total output of a country's economy in a given time period
(d) The income distribution among different income groups in an economy

1.4 The Two-sector Model of National Income Determination

Sure! Here are some multiple-choice questions (MCQs) related to the two-sector model of national income determination:

1. In the two-sector model of national income determination, the two main sectors are:
(a) Household and government
(b) Household and business
(c) Business and government
(d) Government and foreign trade

2. The two-sector model simplifies the economy by considering the interactions between:
(a) Households and businesses only
(b) Households and the government only
(c) Businesses and the government only
(d) Households and the foreign sector only

3. In the two-sector model, households are the main:
(a) Producers of goods and services
(b) Consumers of goods and services
(c) Suppliers of factors of production
(d) Investors in the economy

4. The two-sector model assumes that all the income earned by households is either:
(a) Spent on consumption or saved
(b) Spent on consumption or invested
(c) Spent on imports or exports
(d) Spent on consumption or taxes

5. Investment in the two-sector model refers to:
(a) The purchase of financial assets by households
(b) The purchase of physical capital goods by businesses
(c) The government's spending on infrastructure projects
(d) The government's spending on social welfare programs

6. Savings in the two-sector model is equal to:
(a) Investment
(b) Consumption
(c) Income earned by households
(d) Government spending

7. The two-sector model assumes that there is no:
(a) Government intervention in the economy
(b) Unemployment or inflation
(c) Saving or investment in the economy
(d) International trade or foreign sector interaction

8. In the two-sector model, the equilibrium condition is achieved when:
   (a) Savings are equal to consumption
   (b) Investment is equal to consumption
   (c) Investment is equal to savings
   (d) Savings are equal to government spending

1.5 The Investment Multiplier

Certainly! Here are some multiple-choice questions (MCQs) related to the investment multiplier:

1. The investment multiplier is a concept used in economics to measure:
   (a) The impact of changes in investment on the overall economy
   (b) The efficiency of the financial sector in generating profits
   (c) The effectiveness of government spending on economic growth
   (d) The correlation between inflation and unemployment
2. The investment multiplier is calculated as the:
   (a) Change in investment divided by the change in national income
   (b) Change in national income divided by the change in investment
   (c) Change in consumption divided by the change in investment
   (d) Change in government spending divided by the change in investment
3. A higher investment multiplier implies that:
   (a) Changes in investment have a larger impact on the overall economy
   (b) Changes in investment have a smaller impact on the overall economy
   (c) The economy is in a recessionary phase
   (d) The economy is in an inflationary phase
4. The investment multiplier process works through:
   (a) Changes in consumer spending due to changes in investment
   (b) Changes in government spending due to changes in investment
   (c) Changes in aggregate demand due to changes in investment
   (d) Changes in aggregate supply due to changes in investment
5. The value of the investment multiplier is influenced by the:
   (a) Level of government regulation in the economy
   (b) Level of unemployment in the economy

   (c) Marginal propensity to consume (MPC) and the marginal propensity to save (MPS)
   (d) Exchange rate of the national currency
6. In an economy with a high investment multiplier, a decrease in investment can lead to:
   (a) A significant decrease in national income and output
   (b) An increase in consumer spending to compensate for the decrease in investment
   (c) An increase in government spending to compensate for the decrease in investment
   (d) No significant impact on the overall economy
7. The investment multiplier is a key concept in understanding the impact of:
   (a) Fiscal policy on economic growth
   (b) Monetary policy on interest rates
   (c) Foreign trade on exchange rates
   (d) Supply-side policies on unemployment
8. The investment multiplier is a theoretical concept that assumes:
   (a) Investment has a fixed impact on the economy
   (b) The economy is in a constant state of equilibrium
   (c) There are no leakages in the circular flow of income
   (d) All other factors in the economy remain constant

1.6 Determination of Equilibrium Income: Three Sector Model

Sure! Here are some multiple-choice questions (MCQs) related to the determination of equilibrium income in a three-sector model:

1. In a three-sector model of national income determination, the three main sectors are:
   (a) Household, government, and foreign trade
   (b) Household, business, and government
   (c) Business, government, and foreign trade
   (d) Household, financial, and foreign trade

2. The three-sector model expands the two-sector model by incorporating the role of:
   (a) Government and imports only
   (b) Government and exports only
   (c) Government and both imports and exports
   (d) Foreign trade and exports only
3. In the three-sector model, government spending includes:
   (a) Imports and exports of goods and services
   (b) Taxes and transfers to households
   (c) Investments in physical capital by businesses
   (d) Savings and financial investments
4. Equilibrium income in the three-sector model is achieved when:
   (a) Aggregate demand is greater than aggregate supply
   (b) Aggregate demand is less than aggregate supply
   (c) Aggregate demand is equal to aggregate supply
   (d) Aggregate demand is equal to consumption
5. The equilibrium condition in the three-sector model is represented as:
   (a) Aggregate demand (AD) = Exports (X) + Government spending (G)
   (b) Aggregate demand (AD) = Consumption (C) + Government spending (G) + Savings (S)
   (c) Aggregate demand (AD) = Consumption (C) + Investment (I) + Government spending (G)
   (d) Aggregate demand (AD) = Consumption (C) + Investment (I) + Government spending (G) - Imports (M)
6. In the three-sector model, leakage refers to:
   (a) Money flowing into the economy due to exports
   (b) Money flowing out of the economy due to imports
   (c) Taxes and savings that reduce the flow of income
   (d) Government spending that increases the flow of income
7. The injection in the three-sector model refers to:
   (a) Money flowing out of the economy due to imports
   (b) Money flowing into the economy due to exports
   (c) Government spending and investments that increase the flow of income
   (d) Savings and taxes that reduce the flow of income

8. In the three-sector model, if aggregate demand exceeds aggregate supply, it leads to:
   (a) A surplus in the economy
   (b) An increase in government borrowing
   (c) Inflationary pressures in the economy
   (d) A decrease in national income

1.7 Determination of Equilibrium Income: Four Sector Model

Certainly! Here are some multiple-choice questions (MCQs) related to the determination of equilibrium income in a four-sector model:

1. In a four-sector model of national income determination, the four main sectors are:
   (a) Household, government, business, and foreign trade
   (b) Household, government, business, and financial
   (c) Household, government, business, and exports
   (d) Business, government, foreign trade, and financial
2. The four-sector model expands the three-sector model by incorporating the role of:
   (a) Government and imports only
   (b) Government and exports only
   (c) Foreign trade and exports only
   (d) Financial sector and imports only
3. In the four-sector model, net exports (NX) represent the difference between:
   (a) Government spending (G) and taxes (T)
   (b) Exports (X) and imports (M)
   (c) Savings (S) and investments (I)
   (d) Consumption (C) and investment (I)
4. Equilibrium income in the four-sector model is achieved when:
   (a) Aggregate demand is greater than aggregate supply
   (b) Aggregate demand is less than aggregate supply
   (c) Aggregate demand is equal to aggregate supply
   (d) Aggregate demand is equal to consumption

5. The equilibrium condition in the four-sector model is represented as:
   (a) Aggregate demand (AD) = Consumption (C) + Government spending (G) + Savings (S)
   (b) Aggregate demand (AD) = Consumption (C) + Investment (I) + Government spending (G) + Net exports (NX)
   (c) Aggregate demand (AD) = Consumption (C) + Investment (I) + Government spending (G) - Net exports (NX)
   (d) Aggregate demand (AD) = Consumption (C) + Investment (I) + Government spending (G) - Taxes (T)
6. In the four-sector model, the net exports (NX) are negative when:
   (a) Imports exceed exports
   (b) Exports exceed imports
   (c) Government spending exceeds taxes
   (d) Savings exceed investments
7. The leakage in the four-sector model refers to:
   (a) Money flowing into the economy due to exports
   (b) Money flowing out of the economy due to imports
   (c) Taxes, savings, and imports that reduce the flow of income
   (d) Government spending and investments that increase the flow of income
8. The injection in the four-sector model refers to:
   (a) Money flowing out of the economy due to imports
   (b) Money flowing into the economy due to exports
   (c) Government spending, exports, and investments that increase the flow of income
   (d) Taxes, savings, and imports that reduce the flow of income

1.8 Conclusion

Certainly! Here are some multiple-choice questions (MCQs) related to the conclusion of the Keynesian theory of determination of national income:

1. The Keynesian theory emphasizes the role of __________ in influencing national income.
   (a) Aggregate supply (b) Government policies
   (c) Foreign trade (d) Business investments

2. According to the Keynesian theory, during periods of economic downturns, the government should use __________ to stimulate economic growth.
   (a) Monetary policy (b) Supply-side policies
   (c) Fiscal policy (d) Trade policies
3. The concept of "effective demand" in the Keynesian theory highlights the importance of:
   (a) Government spending on infrastructure projects
   (b) The total demand for goods and services in the economy
   (c) The level of savings and investments in the economy
   (d) The role of foreign trade in influencing national income
4. The Keynesian theory suggests that if there is insufficient aggregate demand in the economy, the government should:
   (a) Reduce government spending and lower taxes
   (b) Increase government spending and lower taxes
   (c) Increase interest rates to encourage savings
   (d) Decrease interest rates to promote borrowing and investment
5. In the Keynesian model, full employment equilibrium can only be achieved with:
   (a) An increase in government regulations and control
   (b) The proper functioning of the financial sector
   (c) The active role of the government in managing aggregate demand
   (d) A balanced budget and reduced government intervention
6. The Keynesian theory gained popularity during the:
   (a) Great Depression of the 1930s
   (b) Industrial Revolution of the 18th century
   (c) Renaissance era in Europe
   (d) Dot-com bubble of the late 1990s
7. Keynes argued that in the long run:
   (a) Government intervention is unnecessary in the economy
   (b) Supply creates its own demand
   (c) The economy will automatically reach full employment
   (d) The impact of government policies on aggregate demand diminishes

8. The Keynesian theory's focus on aggregate demand and government intervention has had a significant influence on the development of modern:
   (a) Classical economics
   (b) Monetarist economics
   (c) Neoclassical economics
   (d) Macroeconomics

Answer

1.1 Introduction

1. (b) John Maynard Keynes
2. (a) Aggregate demand in the economy
3. (c) The economy can experience prolonged periods of unemployment
4. (a) Reduce taxes and increase government spending
5. (a) The total demand for goods and services in the economy
6. (a) Short-run fluctuations in the business cycle
7. (c) Recession or unemployment
8. (a) The Great Depression of the 1930s

1.2 Circular Flow in a Simple Two-sector Model

1. (b) Household and business
2. (a) Goods and services and money between households and firms
3. (a) Buyers of goods and services and sellers of factors of production
4. (a) Money flows from households to businesses as payment for goods and services
5. (c) Wages, salaries, and rent for providing factors of production
6. (c) There are no leakages or injections in the flow of income
7. (c) Savings and taxes that reduce the flow of income
8. (c) Government spending and investments that increase the flow of income

1.3 Basic Concepts and Functions

1. (c) How societies allocate scarce resources to satisfy unlimited wants
2. (b) Human wants are unlimited, but resources are limited
3. (b) The highest-valued alternative that must be given up when a choice is made
4. (b) The quantity of a good or service that consumers are willing and able to buy at a given price
5. (d) As the price of a good or service decreases, the quantity supplied will increase
6. (c) To serve as a medium of exchange, unit of account, and store of value
7. (b) Consumer preferences and market forces of supply and demand
8. (a) The maximum quantity of goods and services that a country can produce using all available resources efficiently

1.4 The Two-sector Model of National Income Determination

1. (b) Household and business
2. (a) Households and businesses only
3. (b) Consumers of goods and services
4. (a) Spent on consumption or saved
5. (b) The purchase of physical capital goods by businesses
6. (a) Investment
7. (d) International trade or foreign sector interaction
8. (c) Investment is equal to savings

1.5 The Investment Multiplier

1. (a) The impact of changes in investment on the overall economy
2. (b) Change in national income divided by the change in investment
3. (a) Changes in investment have a larger impact on the overall economy
4. (c) Changes in aggregate demand due to changes in investment
5. (c) Marginal propensity to consume (MPC) and the marginal propensity to save (MPS)
6. (a) A significant decrease in national income and output
7. (a) Fiscal policy on economic growth
8. (d) All other factors in the economy remain constant

1.6 Determination of Equilibrium Income: Three Sector Model

1. (b) Household, business, and government
2. (c) Government and both imports and exports
3. (b) Taxes and transfers to households
4. (c) Aggregate demand is equal to aggregate supply
5. (c) Aggregate demand (AD) = Consumption (C) + Investment (I) + Government spending (G)
6. (c) Taxes and savings that reduce the flow of income
7. (c) Government spending and investments that increase the flow of income
8. (c) Inflationary pressures in the economy

1.7 Determination of Equilibrium Income: Four Sector Model

1. (a) Household, government, business, and foreign trade
2. (a) Government and imports only
3. (b) Exports (X) and imports (M)
4. (c) Aggregate demand is equal to aggregate supply
5. (b) Aggregate demand (AD) = Consumption (C) + Investment (I) + Government spending (G) + Net exports (NX)
6. (a) Imports exceed exports
7. (c) Taxes, savings, and imports that reduce the flow of income
8. (c) Government spending, exports, and investments that increase the flow of income

1.8 Conclusion

1. (b) Government policies
2. (c) Fiscal policy
3. (b) The total demand for goods and services in the economy
4. (b) Increase government spending and lower taxes
5. (c) The active role of the government in managing aggregate demand
6. (a) Great Depression of the 1930s
7. (d) The impact of government policies on aggregate demand diminishes
8. (d) Macroeconomics

7 PUBLIC FINANCE

Unit:1 Fiscal Functions: An Overview, Centre and State Finance

Multiple Choice Questions

1. Introduction

1. What does fiscal policy refer to?
   (a) The government's policy on taxation and public expenditure.
   (b) The policy of the central bank to control the money supply.
   (c) The policy of promoting free trade and globalization.
   (d) The policy of regulating foreign direct investment.
   Answer:
   (a) The government's policy on taxation and public expenditure.
   Explanation:
   Fiscal policy refers to the government's use of taxation and public expenditure to influence the economy's overall economic activity. It is one of the key tools used by governments to achieve economic objectives such as economic growth, price stability, and full employment.
2. What is the primary objective of fiscal policy?
   (a) Controlling inflation
   (b) Achieving trade surplus
   (c) Reducing income inequality
   (d) Stabilizing financial markets
   Answer:
   (c) Reducing income inequality
   Explanation:
   The primary objective of fiscal policy is to reduce income inequality by promoting equitable distribution of wealth and income. This is achieved through various measures, including progressive taxation and targeted social welfare programs.

3. Which level of government is responsible for formulating and implementing fiscal policy in a federal system?
   (a) Local government
   (b) State government
   (c) Central government
   (d) Municipal government

   Answer:
   (c) Central government

   Explanation:
   In a federal system, the central government is responsible for formulating and implementing fiscal policy at the national level. The central government controls key macroeconomic policies, including taxation, public spending, and borrowing.

4. What is the role of the state government in fiscal policy?
   (a) Implementing monetary policy
   (b) Controlling inflation
   (c) Managing the country's foreign exchange reserves
   (d) Implementing certain tax and expenditure policies within the state

   Answer:
   (d) Implementing certain tax and expenditure policies within the state

   Explanation:
   The role of the state government in fiscal policy is to implement certain tax and expenditure policies within the state. State governments have the authority to levy and collect certain taxes and spend on state-specific programs and projects.

5. Which of the following is an example of an expansionary fiscal policy?
   (a) Increasing taxes to reduce inflation
   (b) Reducing government spending to control budget deficit
   (c) Increasing government spending and cutting taxes to stimulate economic growth
   (d) Implementing austerity measures to address recession

   Answer:
   (c) Increasing government spending and cutting taxes to stimulate economic growth

   Explanation:
   An expansionary fiscal policy involves increasing government spending and cutting taxes to boost aggregate demand and stimulate economic growth during periods of economic downturns or recession.

6. Fiscal functions refer to:
   (a) The functions performed by the central bank to control the money supply.
   (b) The functions performed by the government related to taxation, expenditure, and borrowing.
   (c) The functions performed by commercial banks to provide credit to the public.
   (d) The functions performed by the stock exchange to regulate financial markets.

   Answer:
   (b) The functions performed by the government related to taxation, expenditure, and borrowing.

   Explanation:
   Fiscal functions refer to the functions performed by the government in managing its finances, including taxation (revenue collection), government expenditure, and borrowing to meet budgetary requirements.

7. Fiscal policy is primarily concerned with:
   (a) Controlling the money supply and interest rates in the economy.
   (b) Regulating international trade and exchange rates.
   (c) Achieving price stability and controlling inflation.
   (d) Influencing the level of aggregate demand and economic activity.

   Answer:
   (d) Influencing the level of aggregate demand and economic activity.

   Explanation:
   Fiscal policy is primarily concerned with influencing the level of aggregate demand and economic activity in the economy through changes in government spending and taxation.

8. The central government's main source of revenue is derived from:
   (a) State taxes and fees.
   (b) Central excise duties and customs duties.
   (c) Corporate income taxes and personal income taxes.
   (d) Borrowing from international financial institutions.

   Answer:
   (c) Corporate income taxes and personal income taxes.

   Explanation:
   The central government's main source of revenue is derived from corporate income taxes and personal income taxes, along with other sources like customs duties, excise duties, and non-tax revenue.

9. The division of financial powers and responsibilities between the central government and state governments is outlined in:
   (a) The Fiscal Responsibility and Budget Management Act.
   (b) The Reserve Bank of India Act.
   (c) The Finance Commission's recommendations.
   (d) The Securities and Exchange Board of India Act.

   Answer:
   (c) The Finance Commission's recommendations.

   Explanation:
   The division of financial powers and responsibilities between the central government and state governments is outlined in the recommendations of the Finance Commission. The Finance Commission recommends the sharing of central taxes with the states and other fiscal matters.

10. A budget deficit occurs when:
   (a) Government revenues exceed government expenditures.
   (b) Government expenditures exceed government revenues.
   (c) Tax revenues are equal to government expenditures.
   (d) The fiscal deficit is equal to the revenue deficit.

   Answer:
   (b) Government expenditures exceed government revenues.

   Explanation:
   A budget deficit occurs when government expenditures exceed government revenues (tax revenues and non-tax revenues). It results in the government needing to borrow to cover the shortfall.

1.2 The Role of Government in an Economic System

1. In a market economy, the primary role of the government is to:
   (a) Own and control all the means of production.
   (b) Set prices and allocate resources.
   (c) Provide goods and services directly to consumers.
   (d) Ensure the functioning of markets and enforce property rights.

   Answer:
   (d) Ensure the functioning of markets and enforce property rights.

   Explanation:
   In a market economy, the primary role of the government is to ensure the functioning of markets, promote competition, and enforce property rights. It aims to create an environment where businesses can operate freely and consumers can make informed choices.

2. In a planned economy, the government:
   (a) Leaves all economic decisions to the private sector.
   (b) Controls all aspects of the economy, including production, distribution, and pricing.
   (c) Promotes international trade and exports.
   (d) Focuses on providing public goods and services only.

   Answer:
   (b) Controls all aspects of the economy, including production, distribution, and pricing.

   Explanation:
   In a planned economy, the government exercises extensive control over all aspects of the economy, including production, distribution, and pricing of goods and services. It is responsible for making all economic decisions.

3. The concept of "market failure" refers to:
   (a) The government's inability to efficiently allocate resources.
   (b) The inability of markets to achieve an equitable distribution of wealth.

(c) Situations where the market does not efficiently allocate resources to produce goods and services.
(d) The government's inability to provide public goods and services.

Answer:

(c) Situations where the market does not efficiently allocate resources to produce goods and services.

Explanation:

Market failure refers to situations where the market mechanism fails to efficiently allocate resources, leading to an inefficient distribution of goods and services. It may occur due to externalities, public goods, asymmetric information, or monopolies.

4. Fiscal policy is a tool used by the government to:
(a) Control the money supply and interest rates in the economy.
(b) Regulate international trade and exchange rates.
(c) Influence the level of economic activity and stabilize the economy through changes in government spending and taxation.
(d) Manage the balance of payments and foreign exchange reserves.

Answer:

(c) Influence the level of economic activity and stabilize the economy through changes in government spending and taxation.

Explanation:

Fiscal policy is a tool used by the government to influence the level of economic activity and stabilize the economy. It involves changes in government spending and taxation to impact aggregate demand and economic growth.

5. Which of the following is an example of a government providing a public good?
(a) A private company producing smartphones for sale in the market.
(b) A government-owned airline company operating international flights.
(c) A private university offering education services to students.
(d) A government building a public park for the community.

Answer:

(d) A government building a public park for the community.

Explanation:

A public good is a good or service that is non-excludable and non-rivalrous, meaning it is available to all individuals and one person's use does not diminish its availability to others. Building a public park is an example of the government providing a public good accessible to the entire community.

6. The primary function of the government in an economic system is to:
(a) Maximize profits for businesses.
(b) Ensure price stability in the market.
(c) Allocate and manage scarce resources.
(d) Promote international trade and exports.

Answer:

(c) Allocate and manage scarce resources.

Explanation:

The primary function of the government in an economic system is to allocate and manage scarce resources efficiently. It does so through various economic policies, regulations, and interventions to ensure equitable distribution and promote economic growth.

7. In a market economy, the role of the government is mostly:
(a) To control all aspects of production and distribution.
(b) To centralize economic decision-making in the hands of a few authorities.
(c) To provide goods and services directly to the public.
(d) To intervene selectively to correct market failures and ensure fair competition.

Answer:

(d) To intervene selectively to correct market failures and ensure fair competition.

Explanation:

In a market economy, the role of the government is mostly to intervene selectively in certain areas to correct market failures, ensure fair competition, and provide public goods and services that the private sector may not adequately provide.

8. Fiscal policy refers to the government's actions related to:
   (a) Controlling the money supply and interest rates.
   (b) Managing taxation and government spending.
   (c) Regulating international trade and exchange rates.
   (d) Setting employment targets and wage rates.

   Answer:

   (b) Managing taxation and government spending.

   Explanation:

   Fiscal policy refers to the government's actions related to managing taxation and government spending to influence the level of aggregate demand and stabilize the economy.

9. The concept of a "mixed economy" implies that:
   (a) The government owns and controls all means of production and distribution.
   (b) The economy is entirely market-driven without any government intervention.
   (c) The economy combines elements of both a market economy and a planned economy.
   (d) The government does not have any role in economic decision-making.

   Answer:

   (c) The economy combines elements of both a market economy and a planned economy.

   Explanation:

   In a mixed economy, the economic system combines elements of both a market economy and a planned economy. It allows for private enterprise and individual initiative while also allowing the government to intervene in certain areas to achieve social objectives and correct market failures.

10. An example of a government's microeconomic role is:
   (a) Implementing monetary policy to control inflation.
   (b) Managing the country's balance of trade and current account.
   (c) Regulating the labor market and setting minimum wages.
   (d) Setting targets for economic growth and GDP expansion.

   Answer:

   (c) Regulating the labor market and setting minimum wages.

   Explanation:

   Regulating the labor market and setting minimum wages are examples of the government's microeconomic role. It involves intervening in specific markets to address issues such as labor market imbalances and income inequality.

1.3 The Allocation Function

1. The allocation function in economics refers to:
   (a) The government's role in distributing subsidies to various industries.
   (b) The process of allocating resources among different uses to satisfy unlimited wants.
   (c) The role of financial institutions in allocating credit to the public.
   (d) The process of allocating goods and services among different regions of the country.

   Answer:

   (b) The process of allocating resources among different uses to satisfy unlimited wants.

   Explanation:

   The allocation function in economics refers to the process of allocating scarce resources among different uses to satisfy unlimited wants in the most efficient and equitable manner.

2. In a market economy, the allocation of resources is primarily determined by:
   (a) Central planning by the government.
   (b) Consumer preferences and demand.
   (c) The availability of natural resources.
   (d) The level of government spending.

   Answer:

   (b) Consumer preferences and demand.

   Explanation:

   In a market economy, the allocation of resources is primarily determined by consumer preferences and demand. Producers respond to consumer demand by allocating resources to produce goods and services that are in demand.

3. Which economic system relies heavily on central planning and government control to allocate resources?
(a) Market economy (b) Mixed economy
(c) Planned economy (d) Command economy

Answer:
(d) Command economy

Explanation:
In a command economy, the allocation of resources is heavily controlled by the government through central planning. The government decides what goods and services will be produced and in what quantities.

4. The price mechanism in a market economy plays a crucial role in resource allocation because it:
(a) Determines the level of government spending on public goods.
(b) Regulates international trade and exchange rates.
(c) Adjusts supply and demand to reach equilibrium prices.
(d) Allocates resources based on government subsidies.

Answer:
(c) Adjusts supply and demand to reach equilibrium prices.

Explanation:
The price mechanism in a market economy plays a crucial role in resource allocation by adjusting supply and demand to reach equilibrium prices. When demand is high, prices rise, signaling producers to allocate more resources to produce those goods.

5. The concept of opportunity cost is related to the allocation function in economics because it:
(a) Represents the value of the next best alternative foregone when a choice is made.
(b) Determines the level of government spending on public goods.
(c) Indicates the monetary cost of production for a firm.
(d) Measures the overall cost of inflation in the economy.

Answer:
(a) Represents the value of the next best alternative foregone when a choice is made.

Explanation:
The concept of opportunity cost is related to the allocation function in economics because it represents the value of the next best alternative foregone when a choice is made. When resources are allocated to produce one good, the opportunity cost is the potential benefit from producing the next best alternative.

6. The allocation function in an economic system refers to:
(a) How the government allocates its budget for different sectors.
(b) How resources are distributed among households and firms.
(c) How the central bank allocates credit to commercial banks.
(d) How foreign trade is regulated and controlled.

Answer:
(b) How resources are distributed among households and firms.

Explanation:
The allocation function in an economic system refers to how scarce resources are distributed among households and firms to produce goods and services. It involves deciding what and how much to produce, how to produce, and for whom to produce.

7. In a command economy, the allocation of resources is mainly decided by:
(a) Market forces and competitive forces.
(b) The interaction of buyers and sellers in the marketplace.
(c) Government authorities and central planners.
(d) The balance of trade and foreign exchange rates.

Answer:
(c) Government authorities and central planners.

Explanation:
In a command economy, the allocation of resources is mainly decided by government authorities and central planners. The government controls the production and distribution of goods and services, and resources are allocated based on government decisions.

8. The concept of "opportunity cost" is related to:
(a) The cost of producing one additional unit of a good or service.
(b) The cost of investing in capital goods.

(c) The cost of producing a good or service at the lowest possible cost.
(d) The cost of choosing one option over the next best alternative.

Answer:

(d) The cost of choosing one option over the next best alternative.

Explanation: The concept of "opportunity cost" refers to the cost of choosing one option over the next best alternative. It represents the value of the foregone opportunity when a decision is made.

9. Economic efficiency is achieved when:
(a) The government intervenes in resource allocation.
(b) Production is maximized, regardless of the distribution of goods.
(c) Resources are allocated to produce the highest quality goods.
(d) Resources are allocated to produce goods in a way that maximizes total welfare.

Answer:

(d) Resources are allocated to produce goods in a way that maximizes total welfare.

Explanation:

Economic efficiency is achieved when resources are allocated to produce goods and services in a way that maximizes total welfare or societal well-being. It considers both production efficiency and distribution efficiency.

1.4 The Redistribution Function

1. The redistribution function in an economic system refers to:
(a) The process of reallocating resources among different sectors of the economy.
(b) The role of the government in redistributing income and wealth among the population.
(c) The function of the central bank in regulating the money supply and interest rates.
(d) The process of reallocating resources between domestic and foreign markets.

Answer:

(b) The role of the government in redistributing income and wealth among the population.

Explanation:

The redistribution function in an economic system refers to the role of the government in redistributing income and wealth among the population to promote equity and reduce income inequality.

2. Which of the following is an example of a redistributive policy?
(a) Providing subsidies to domestic industries to boost exports.
(b) Implementing tax cuts to stimulate economic growth.
(c) Introducing progressive income tax rates to tax higher incomes at a higher rate.
(d) Reducing government spending to control budget deficits.

Answer:

(c) Introducing progressive income tax rates to tax higher incomes at a higher rate.

Explanation:

Introducing progressive income tax rates, where higher incomes are taxed at a higher rate, is an example of a redistributive policy. It aims to reduce income inequality by taxing the wealthy more than lower-income individuals.

3. The objective of the redistribution function is to:
(a) Maximize government revenue from taxation.
(b) Promote economic growth and increase GDP.
(c) Achieve a more equitable distribution of income and wealth.
(d) Encourage international trade and foreign investment.

Answer:

(c) Achieve a more equitable distribution of income and wealth.

Explanation:

The objective of the redistribution function is to achieve a more equitable distribution of income and wealth in society. It seeks to reduce income inequality and improve the standard of living for the less privileged.

4. Social welfare programs, such as unemployment benefits and food assistance, are examples of:
(a) Regressive policies that benefit higher-income individuals.
(b) Supply-side policies aimed at stimulating production.

(c) Redistributive policies that provide support to those in need.
(d) Demand-side policies that boost consumer spending.

Answer:

(c) Redistributive policies that provide support to those in need.

Explanation:

Social welfare programs, such as unemployment benefits and food assistance, are examples of redistributive policies. They aim to provide support and assistance to individuals and families in need, contributing to a more equitable distribution of resources.

5. A "means-tested" welfare program refers to a program that:
(a) Provides benefits to all individuals regardless of their income level.
(b) Is funded through progressive taxation.
(c) Targets benefits to individuals based on their income or financial need.
(d) Supports specific industries to boost economic growth.

Answer:

(c) Targets benefits to individuals based on their income or financial need.

Explanation:

A "means-tested" welfare program is one that targets benefits to individuals based on their income or financial need. These programs aim to provide support to those with lower incomes or facing financial hardship.

Here are some multiple-choice questions (MCQs) related to the redistribution function in an economic system, along with their answers and explanations:

6. The government's main tool for achieving redistribution is through:
(a) Fiscal policy, involving taxation and government spending.
(b) Monetary policy, involving controlling the money supply and interest rates.
(c) Exchange rate policies to promote international trade.
(d) Industrial policies to support specific industries.

Answer:

(a) Fiscal policy, involving taxation and government spending.

Explanation:

Fiscal policy, which involves the use of taxation and government spending, is the main tool used by the government to achieve redistribution. The government can impose progressive taxes and provide social welfare programs to redistribute income and wealth.

7. Which of the following policies is an example of redistribution function?
(a) A government policy aimed at promoting economic growth and investment.
(b) A government policy to control inflation through monetary measures.
(c) A progressive income tax system where higher-income individuals pay higher tax rates.
(d) A policy to encourage exports and boost foreign trade.

Answer:

(c) A progressive income tax system where higher-income individuals pay higher tax rates.

Explanation:

A progressive income tax system where higher-income individuals pay higher tax rates is an example of the redistribution function. It aims to redistribute income by imposing higher tax rates on those with higher incomes and using the revenue to support social welfare programs.

8. The objective of the redistribution function is to:
(a) Maximize government revenue through taxation.
(b) Encourage individuals to save and invest more.
(c) Achieve price stability and control inflation.
(d) Reduce income and wealth disparities among different segments of society.

Answer:

(d) Reduce income and wealth disparities among different segments of society.

Explanation:

The objective of the redistribution function is to reduce income and wealth disparities among different segments of society. It seeks to promote a fairer and more equitable distribution of resources to ensure social justice.

9. Universal basic income (UBI) is an example of:
   (a) An anti-inflationary measure.
   (b) A regressive tax policy.
   (c) A redistribution policy.
   (d) A trade promotion policy.

   Answer:

   (c) A redistribution policy.

   Explanation:

   Universal basic income (UBI) is an example of a redistribution policy. It involves providing a regular and unconditional income to all citizens, regardless of their income level, to reduce poverty and income inequality.

1.5 Stabilization Function

1. The stabilization function in an economic system refers to:
   (a) The government's role in stabilizing prices of essential goods and services.
   (b) The process of stabilizing the stock market and financial markets.
   (c) The government's efforts to stabilize the overall economy and counter economic fluctuations.
   (d) The stabilization of exchange rates in international trade.

   Answer:

   (c) The government's efforts to stabilize the overall economy and counter economic fluctuations.

   Explanation:

   The stabilization function in an economic system refers to the government's efforts to stabilize the overall economy and counter economic fluctuations. It involves using fiscal and monetary policies to address issues like inflation, unemployment, and economic recessions.

2. During periods of high inflation, the government's main focus in terms of stabilization function is usually on:
   (a) Increasing government spending to boost aggregate demand.
   (b) Implementing contractionary monetary policies to reduce money supply and control inflation.

   (c) Reducing taxes to increase disposable income and boost consumer spending.
   (d) Encouraging foreign trade to improve the trade balance.

   Answer:

   (b) Implementing contractionary monetary policies to reduce money supply and control inflation.

   Explanation:

   During periods of high inflation, the government's main focus in terms of stabilization function is usually on implementing contractionary monetary policies. These policies aim to reduce the money supply, increase interest rates, and control inflationary pressures in the economy.

3. In response to an economic recession, the government can use fiscal policy to stimulate the economy by:
   (a) Decreasing government spending and increasing taxes.
   (b) Decreasing taxes and increasing government spending.
   (c) Increasing interest rates and reducing government spending.
   (d) Decreasing interest rates and reducing government spending.

   Answer:

   (b) Decreasing taxes and increasing government spending.

   Explanation:

   In response to an economic recession, the government can use expansionary fiscal policy by decreasing taxes and increasing government spending. This approach helps boost aggregate demand and stimulate economic growth during a downturn.

4. The primary goal of the stabilization function is to achieve:
   (a) A balanced budget for the government.
   (b) Maximum economic growth and expansion.
   (c) Full employment and price stability.
   (d) Increased international trade and exports.

   Answer:

   (c) Full employment and price stability.

Explanation:
The primary goal of the stabilization function is to achieve full employment and price stability. This means keeping unemployment levels low while ensuring that inflation and deflation rates are moderate and controlled.

5. Automatic stabilizers in the economy refer to:
(a) Government policies that automatically stabilize the stock market during downturns.
(b) Economic factors that automatically offset economic fluctuations without government intervention.
(c) Government agencies responsible for regulating prices and wages.
(d) The stabilization of foreign exchange rates in international trade.

Answer:
(b) Economic factors that automatically offset economic fluctuations without government intervention.

Explanation:
Automatic stabilizers in the economy refer to economic factors that automatically offset economic fluctuations without the need for government intervention. Examples include progressive taxation and unemployment benefits, which tend to stabilize the economy during economic downturns.

6. During periods of economic recession, the government can use fiscal policy to:
(a) Increase taxes and reduce government spending to boost private investment.
(b) Increase government spending and reduce taxes to stimulate aggregate demand.
(c) Implement contractionary monetary policy to control inflation.
(d) Increase interest rates to encourage savings.

Answer:
(b) Increase government spending and reduce taxes to stimulate aggregate demand.

Explanation:
During periods of economic recession, the government can use expansionary fiscal policy by increasing government spending and reducing taxes to stimulate aggregate demand, boost economic activity, and counter the negative effects of the recession.

7. Inflation targeting is an example of:
(a) Fiscal policy to stabilize the economy.
(b) An exchange rate policy to control imports.
(c) A monetary policy to achieve price stability.
(d) Industrial policy to support the manufacturing sector.

Answer:
(c) A monetary policy to achieve price stability.

Explanation:
Inflation targeting is an example of a monetary policy aimed at achieving price stability. Central banks set specific inflation targets and use monetary tools like interest rates to control inflation and stabilize the economy.

8. Automatic stabilizers are government policies or programs that:
(a) Automatically increase government spending during economic downturns.
(b) Automatically reduce taxes during periods of economic growth.
(c) Require parliamentary approval for implementation.
(d) Are unrelated to economic conditions and fluctuations.

Answer:
(a) Automatically increase government spending during economic downturns.

Explanation:
Automatic stabilizers are government policies or programs that automatically increase government spending and/or decrease taxes during economic downturns. They help to stabilize the economy without requiring specific legislative actions.

Additional Question Bank

1.1 Introduction

As an AI language model, I can provide you with some multiple-choice questions (MCQs) related to Unit 1: Fiscal Functions: An Overview, Centre and State Finance - Introduction. Please note that these questions are based on general concepts related to fiscal functions and finance. Make sure to choose the correct answer from the options provided.

1. Which of the following best defines fiscal functions?
   (a) The management of public debt
   (b) The management of private debt
   (c) The management of monetary policy
   (d) The management of government finances
2. What is the primary source of revenue for the Central Government in India?
   (a) State taxes
   (b) Goods and Services Tax (GST)
   (c) Corporate taxes
   (d) Sales tax
3. Which of the following represents a capital receipt for the government?
   (a) Income tax
   (b) Goods and Services Tax (GST)
   (c) Borrowings from the World Bank
   (d) Customs duty
4. In India, who is responsible for the collection of most direct taxes?
   (a) State Governments
   (b) Local Governments (Panchayats)
   (c) Central Board of Direct Taxes (CBDT)
   (d) Reserve Bank of India (RBI)
5. Which type of budget shows the receipts and expenditures of both the Central and State Governments?
   (a) Consolidated Budget (b) Annual Financial Statement
   (c) Deficit Budget (d) Revenue Budget

1.2 The Role of Government in an Economic System

1. In a market-oriented economic system, the primary role of the government is to:
   (a) Own and operate key industries and businesses.
   (b) Regulate and control prices of goods and services.
   (c) Facilitate economic growth and stability while intervening minimally.
   (d) Implement strict trade barriers and tariffs.
2. Which of the following is an example of a fiscal policy measure undertaken by the government during an economic downturn?
   (a) Reducing interest rates to encourage borrowing and spending.
   (b) Decreasing the money supply to control inflation.
   (c) Implementing free trade agreements to promote international trade.
   (d) Privatizing state-owned enterprises to boost competition.
3. The government's role in providing public goods and services refers to:
   (a) The distribution of cash transfers to low-income individuals.
   (b) The provision of essential goods and services for the entire population.
   (c) The implementation of tax cuts to stimulate consumer spending.
   (d) The establishment of monopolies in critical industries.
4. Which economic system involves extensive government planning and control over resources and production?
   (a) Market economy
   (b) Mixed economy
   (c) Command economy
   (d) Traditional economy
5. During times of inflation, the government might employ which monetary policy measure to reduce the money supply?
   (a) Quantitative easing
   (b) Open market operations
   (c) Increasing government spending
   (d) Lowering reserve requirements for banks

Please note that the role of government in an economic system can vary depending on the specific country and its economic policies. These questions are for educational purposes and may not cover all aspects of the topic. Always refer to your course material and textbooks for comprehensive learning.

1.3 The Allocation Function

1. In a market-oriented economic system, the primary role of the government is to:
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Please note that the role of government in an economic system can vary depending on the specific country and its economic policies. These questions are for educational purposes and may not cover all aspects of the topic. Always refer to your course material and textbooks for comprehensive learning.

1.4 The Redistribution Function

1. The redistribution function in economics refers to:
   (a) The allocation of resources among different sectors of the economy
   (b) The transfer of wealth or income from one group to another
   (c) The process of increasing government spending on social welfare programs
   (d) The implementation of progressive taxation to fund public goods
2. The primary goal of the redistribution function is to:
   (a) Maximize profits for businesses
   (b) Promote economic growth and development
   (c) Reduce income inequality and poverty
   (d) Encourage consumer spending and investment
3. Which of the following is an example of the redistribution function in action?
   (a) A government investing in infrastructure development
   (b) A government providing subsidies to farmers
   (c) A progressive income tax system
   (d) A central bank controlling the money supply
4. In a progressive income tax system:
   (a) The tax rate decreases as income increases
   (b) The tax rate remains constant regardless of income levels
   (c) The tax rate increases as income increases
   (d) There are no taxes imposed on personal income
5. The redistribution function aims to achieve:
   (a) Economic efficiency and market equilibrium
   (b) A balanced budget for the government
   (c) An equitable distribution of wealth and income
   (d) Increased consumer spending and investment

6. Social welfare programs, such as unemployment benefits and food assistance, are examples of:
   (a) Progressive taxation
   (b) Redistribution of income
   (c) Government subsidies to businesses
   (d) Expansionary fiscal policies
7. One of the challenges in implementing the redistribution function is:
   (a) Balancing the budget and avoiding deficits
   (b) Ensuring that all individuals have equal incomes
   (c) Overreliance on government intervention in the economy
   (d) Ensuring that the redistribution does not discourage work and productivity
8. The redistribution function is often a subject of debate due to:
   (a) Its potential impact on economic growth and investment
   (b) Its positive impact on reducing inflation and unemployment
   (c) The ease of implementing progressive taxation
   (d) Its association with increased government spending on public goods

1.5 Stabilization Function

1. The stabilization function in economics refers to:
   (a) The government's role in redistributing wealth and income
   (b) The process of controlling inflation and unemployment in the economy
   (c) The allocation of resources among different sectors of the economy
   (d) The promotion of international trade and exports
2. The primary goal of the stabilization function is to:
   (a) Maximize profits for businesses
   (b) Achieve long-term economic growth and development
   (c) Maintain price stability and full employment
   (d) Increase government revenue through taxation
3. Which of the following is an example of the stabilization function in action?
   (a) The government implementing progressive taxation to reduce income inequality

   (b) A central bank adjusting interest rates to control inflation
   (c) A government investing in infrastructure development
   (d) The implementation of tariffs to protect domestic industries
4. In the context of the stabilization function, "price stability" refers to:
   (a) The constant level of prices for goods and services
   (b) A situation where prices are increasing moderately over time
   (c) The absence of inflation or deflation in the economy
   (d) A situation where prices are determined by market forces without government intervention
5. The stabilization function aims to achieve:
   (a) A balanced budget for the government
   (b) Full employment and stable economic growth
   (c) An equitable distribution of wealth and income
   (d) Increased consumer spending and investment
6. Monetary policy, such as changes in interest rates and open market operations, is an example of:
   (a) Fiscal policy to stabilize the economy
   (b) Redistribution of income to reduce poverty
   (c) The stabilization function in action
   (d) Supply-side policies to boost economic growth
7. One of the challenges in implementing the stabilization function is:
   (a) Achieving a balance between inflation and unemployment
   (b) Ensuring that all individuals have equal access to economic opportunities
   (c) Overreliance on government intervention in the economy
   (d) Managing fluctuations in the exchange rate
8. The stabilization function is often a subject of debate due to:
   (a) Its potential impact on income distribution and wealth inequality
   (b) The complexity of implementing monetary and fiscal policies
   (c) The conflict between short-term stabilization goals and long-term economic growth
   (d) The association with reduced government spending on public goods

Answer

1.1 Introduction

1. (d) The management of government finances
2. (b) Goods and Services Tax (GST)
3. (c) Borrowings from the World Bank
4. (c) Central Board of Direct Taxes (CBDT)
5. (a) Consolidated Budget

1.2 The Role of Government in an Economic System

1. (c) Facilitate economic growth and stability while intervening minimally.
2. (a) Reducing interest rates to encourage borrowing and spending.
3. (b) The provision of essential goods and services for the entire population.
4. (c) Command economy
5. (b) Open market operations

1.3 The Allocation Function

1. (c) Facilitate economic growth and stability while intervening minimally.
2. (a) Reducing interest rates to encourage borrowing and spending.
3. (b) The provision of essential goods and services for the entire population.
4. (c) Command economy
5. (b) Open market operations

1.4 The Redistribution Function

1. (b) The transfer of wealth or income from one group to another
2. (c) Reduce income inequality and poverty
3. (c) A progressive income tax system
4. (c) The tax rate increases as income increases
5. (c) An equitable distribution of wealth and income
6. (b) Redistribution of income

7. (d) Ensuring that the redistribution does not discourage work and productivity
8. (a) Its potential impact on economic growth and investment

Explanation:
Some argue that excessive redistribution through high taxes on income and wealth could discourage investment and entrepreneurship, potentially hindering economic growth. However, others believe that well-designed redistribution can reduce income inequality, leading to a more inclusive and sustainable economy.

1.5 Stabilization Function

1. (b) The process of controlling inflation and unemployment in the economy
2. (c) Maintain price stability and full employment
3. (b) A central bank adjusting interest rates to control inflation
4. (c) The absence of inflation or deflation in the economy
5. (b) Full employment and stable economic growth
6. (c) The stabilization function in action
7. (a) Achieving a balance between inflation and unemployment
8. (c) The conflict between short-term stabilization goals and long-term economic growth

Explanation:
Short-term stabilization goals, such as controlling inflation and reducing unemployment, may sometimes conflict with long-term economic growth objectives. Policymakers need to strike a balance between short-term stabilization measures and promoting sustainable economic growth in the long run.

7	PUBLIC FINANCE
Unit:2	Market Failure/Government Intervention to Correct Market Failure

Multiple Choice Questions

1.1 Introduction

1. Market failure occurs when:
   (a) The government intervenes in the market to regulate prices.
   (b) Demand for a product exceeds its supply in the market.
   (c) The market fails to allocate resources efficiently.
   (d) The government imposes taxes on goods and services.
   Answer:
   (c) The market fails to allocate resources efficiently.
   Explanation:
   Market failure occurs when the market fails to allocate resources efficiently, leading to an inefficient allocation of goods and services in the economy.
2. Which of the following is an example of market failure?
   (a) The production of a public good like street lighting.
   (b) The availability of luxury goods in the market.
   (c) The price increase of a product due to high demand.
   (d) The availability of goods and services through competition.
   Answer:
   (a) The production of a public good like street lighting.
   Explanation:
   The production of a public good like street lighting is an example of market failure because public goods are non-excludable and non-rivalrous, making it difficult for private markets to efficiently provide them.

3. Externalities refer to:
   (a) The costs and benefits that affect only the producers in the market.
   (b) The costs and benefits that affect both producers and consumers in the market.
   (c) The costs and benefits that affect only the consumers in the market.
   (d) The costs and benefits that have no impact on the market.
   Answer:
   (b) The costs and benefits that affect both producers and consumers in the market.
   Explanation:
   Externalities refer to the costs and benefits that affect both producers and consumers in the market but are not reflected in the market price, leading to an inefficient allocation of resources.
4. When a company pollutes the environment while producing goods, it is an example of:
   (a) Positive externality.
   (b) Negative externality.
   (c) Public good.
   (d) Market equilibrium.
   Answer:
   (b) Negative externality.
   Explanation:
   When a company pollutes the environment while producing goods, it is an example of a negative externality, as the pollution imposes costs on society that are not fully borne by the company.
5. Government intervention to correct market failure may involve:
   (a) Reducing taxes to encourage investment.
   (b) Providing subsidies to producers to lower costs.
   (c) Imposing price controls to regulate market prices.
   (d) Correcting externalities through taxes or subsidies.
   Answer:
   (d) Correcting externalities through taxes or subsidies.

Explanation:
Government intervention to correct market failure may involve correcting externalities through taxes on negative externalities or subsidies on positive externalities. This can help internalize the external costs or benefits and lead to a more efficient allocation of resources.

1.2 The Concept of Market Failure

1. Which of the following is an example of a positive externality?
   (a) Pollution from a factory affecting nearby residents' health negatively.
   (b) A new technology leading to increased productivity in an industry.
   (c) Overfishing in an unregulated fishery.
   (d) A decrease in consumer spending affecting local businesses negatively.

   Answer:
   (b) A new technology leading to increased productivity in an industry.

   Explanation:
   A positive externality occurs when a third party benefits from a market transaction. In this case, the new technology leading to increased productivity benefits the industry and possibly other related industries.

2. Which of the following is a cause of market failure?
   (a) Perfect competition in the market.
   (b) Government intervention to correct externalities.
   (c) Absence of public goods in the market.
   (d) Equilibrium between supply and demand.

   Answer:
   (c) Absence of public goods in the market.

   Explanation:
   The absence of public goods in the market is a cause of market failure. Public goods, such as national defense or street lighting, are non-excludable and non-rivalrous, making it difficult for the private sector to provide them efficiently.

3. Externalities refer to:
   (a) The costs and benefits faced by producers in the market.
   (b) The positive impacts of government policies on the economy.

   (c) The spillover effects of market transactions on third parties.
   (d) The ability of consumers to make informed decisions.

   Answer:
   (c) The spillover effects of market transactions on third parties.

   Explanation:
   Externalities are the spillover effects of market transactions on third parties who are not directly involved in the transaction. They can be positive (benefits) or negative (costs).

4. When a company pollutes a nearby river, causing harm to the environment and nearby communities, it is an example of:
   (a) Positive externality.
   (b) Negative externality.
   (c) Perfect competition.
   (d) Government intervention.

   Answer:
   (b) Negative externality.

   Explanation:
   The pollution caused by the company, leading to harm to the environment and nearby communities, is an example of a negative externality. The company is not bearing the full costs of its actions, and the negative impact spills over to others.

5. How can the government address market failure due to externalities?
   (a) By increasing taxes on the affected firms.
   (b) By providing subsidies to the affected firms.
   (c) By implementing regulations and standards.
   (d) By reducing public goods in the market.

   Answer:
   (c) By implementing regulations and standards.

   Explanation:
   The government can address market failure due to externalities by implementing regulations and standards on polluting firms or activities, encouraging them to internalize the external costs they impose on society.

6. Market failure occurs when:
   (a) The government intervenes excessively in the market.
   (b) The market is unable to allocate resources efficiently.
   (c) Producers dominate the market, leading to reduced competition.
   (d) Consumer demand exceeds the available supply of goods.

   Answer:

   (b) The market is unable to allocate resources efficiently.

   Explanation:

   Market failure occurs when the free market is unable to allocate resources efficiently, leading to suboptimal outcomes such as underproduction or overproduction of goods and services.

7. Which of the following is a cause of market failure?
   (a) Perfect competition in the market.
   (b) Externalities and public goods.
   (c) Government regulations promoting fair trade.
   (d) Decrease in consumer demand.

   Answer:

   (b) Externalities and public goods.

   Explanation:

   Externalities (e.g., pollution) and public goods (e.g., national defense) are examples of causes of market failure where the free market may not account for the full social costs or benefits of certain goods or services.

8. In the presence of negative externalities, the market tends to produce:
   (a) Less of the good than is socially optimal.
   (b) More of the good than is socially optimal.
   (c) The socially optimal level of the good.
   (d) The good in the most efficient manner.

   Answer:

   (b) More of the good than is socially optimal.

   Explanation:

   Negative externalities lead to overproduction of goods because the social cost of production is higher than the private cost borne by producers. As a result, the market produces more of the good than is socially desirable.

9. A public good is characterized by:
   (a) Rivalry in consumption and excludability.
   (b) Non-rivalry in consumption and excludability.
   (c) Rivalry in consumption and non-excludability.
   (d) Non-rivalry in consumption and non-excludability.

   Answer:

   (d) Non-rivalry in consumption and non-excludability.

   Explanation:

   A public good is non-rivalrous, meaning one person's use does not reduce the availability for others, and non-excludable, meaning individuals cannot be excluded from using it once provided.

1.3 Why do Markets Fail?

1. Which of the following is an example of a negative externality?
   (a) A new technology leading to increased productivity in an industry.
   (b) Pollution from a factory affecting nearby residents' health negatively.
   (c) A decrease in consumer spending affecting local businesses negatively.
   (d) Government subsidies encouraging the production of a specific good.

   Answer:

   (b) Pollution from a factory affecting nearby residents' health negatively.

   Explanation:

   A negative externality occurs when a third party is harmed by a market transaction. In this case, pollution from the factory negatively affects the health of nearby residents, which is a form of market failure.

2. Which of the following is a reason for market failure?
   (a) Perfect competition in the market.
   (b) Government regulations promoting fair trade.
   (c) Externalities and public goods.
   (d) Increase in consumer demand.

   Answer:

   (c) Externalities and public goods.

Explanation:
Externalities (e.g., pollution) and public goods (e.g., national defense) are reasons for market failure where the free market may not account for the full social costs or benefits of certain goods or services.

3. When a market is characterized by information asymmetry, it means that:
(a) Consumers have more information than producers.
(b) Producers have more information than consumers.
(c) Both consumers and producers have equal access to information.
(d) The market is perfectly efficient with no information gaps.
Answer:
(b) Producers have more information than consumers.
Explanation:
Information asymmetry occurs when one party in a transaction (usually producers) has more information than the other party (consumers). This can lead to adverse selection and moral hazard problems, contributing to market failure.

4. Public goods are non-excludable, which means:
(a) Individuals can be excluded from using them.
(b) They are available only to the public sector.
(c) They are available only to low-income individuals.
(d) Individuals cannot be excluded from using them.
Answer:
(d) Individuals cannot be excluded from using them.
Explanation:
Public goods are non-excludable, meaning individuals cannot be excluded from using them once they are provided. This characteristic creates a free-rider problem and leads to market failure.

5. Which of the following is a reason why markets fail?
(a) Perfect competition among firms.
(b) Absence of externalities.
(c) Adequate provision of public goods.
(d) Information asymmetry..
Answer:
(d) Information asymmetry.

Explanation:
Information asymmetry is a reason why markets fail. It occurs when one party in a transaction has more information than the other, leading to unequal knowledge and potentially unfair outcomes.

6. When external costs are not accounted for in the market price of a good, it leads to:
(a) Overproduction of the good.
(b) Underproduction of the good.
(c) Optimal production of the good.
(d) Equilibrium production of the good.
Answer:
(a) Overproduction of the good.
Explanation:
When external costs (negative externalities) are not considered in the market price, the production of the good tends to be higher than the socially optimal level, leading to overproduction.

7. Which of the following is a market failure caused by incomplete information?
(a) Perfect competition.
(b) Monopoly power.
(c) Moral hazard in insurance markets.
(d) Efficient allocation of resources.
Answer:
(c) Moral hazard in insurance markets.
Explanation:
Moral hazard in insurance markets is a market failure caused by incomplete information. It occurs when one party (insure(d) alters their behavior due to being protected against risk, and the other party (insurer) cannot fully monitor the actions.

8. Public goods are typically underprovided in the market because:
(a) They are non-excludable.
(b) They are rivalrous in consumption.

(c) The government doesn't regulate their production.
(d) Private firms find them unprofitable.

Answer:

(d) Private firms find them unprofitable.

Explanation: Public goods are typically underprovided in the market because private firms find it unprofitable to produce them. Since public goods are non-excludable and non-rivalrous, firms cannot charge individual consumers and may avoid production due to the inability to capture revenues.

9. Monopolies can lead to market failure because:
(a) They produce goods efficiently at lower prices.
(b) They have a larger market share.
(c) They restrict output and charge higher prices.
(d) They promote competition.

Answer:

(c) They restrict output and charge higher prices.

Explanation:

Monopolies can lead to market failure because they have the power to restrict output and charge higher prices due to their lack of competition. This can result in inefficient allocation of resources and reduced consumer welfare.

1.3.1 Market Power

1. What is market power?
(a) The ability of a company to set prices arbitrarily high
(b) The ability of a company to influence market outcomes
(c) The ability of a company to manipulate consumer preferences
(d) The ability of a company to engage in predatory pricing

Answer:

(b) The ability of a company to influence market outcomes

Explanation:

Market power refers to the ability of a firm or a group of firms to influence the market's price, output, or other market-related factors. Firms with market power can act independently of the market forces and have some control over price-setting and market outcomes.

2. Which of the following is an example of a perfectly competitive market?
(a) The market for smartphones with several dominant companies
(b) The market for agricultural products with many small-scale farmers
(c) The market for luxury watches with a few high-end brands
(d) The market for electric vehicles with one leading manufacturer

Answer:

(b) The market for agricultural products with many small-scale farmers

Explanation:

In a perfectly competitive market, there are many small buyers and sellers who deal with identical or homogeneous products. No single firm has market power, and the price is determined solely by the forces of supply and demand. The market for agricultural products, with numerous small-scale farmers selling similar goods, aligns with the characteristics of a perfectly competitive market.

3. A monopoly exists when:
(a) There is a single seller, and there are no close substitutes for the product.
(b) There are a few dominant sellers, and they collude to set prices.
(c) There are multiple sellers offering identical products.
(d) The government regulates the prices of goods in the market.

Answer:

(a) There is a single seller, and there are no close substitutes for the product.

Explanation:

A monopoly is a market structure where there is only one seller or producer of a product or service. There are no close substitutes available in the market, and the monopolistic firm has significant market power, allowing it to set prices and control the quantity supplied.

4. Which of the following is a characteristic of an oligopoly?
(a) Large number of sellers in the market
(b) Identical products offered by all firms
(c) Little to no barriers to entry for new firms
(d) Interdependence among the firms in the market

Answer:

(d) Interdependence among the firms in the market

Explanation:
An oligopoly is a market structure characterized by a small number of dominant firms that dominate the market. These firms are interdependent, meaning the actions of one firm directly impact the other firms in the market. Oligopolistic firms are constantly monitoring and reacting to their competitors' actions, especially regarding pricing and output decisions.

5. Which of the following strategies is typical of a monopolistic competition?
 (a) High barriers to entry for new firms
 (b) Identical products offered by all firms
 (c) Heavy reliance on non-price competition
 (d) Price-setting by a central authority

Answer:
(c) Heavy reliance on non-price competition

Explanation:
Monopolistic competition is a market structure where there are many firms selling differentiated products, which means the products are similar but not identical. To differentiate their products from competitors, firms rely on non-price competition, such as advertising, branding, product differentiation, and customer service. Unlike perfect competition, monopolistic competition does not involve identical products or price-taking behavior.

1.3.2 Externalities

1. What is an externality?
 (a) A situation where a company produces goods more efficiently than its competitors
 (b) A cost or benefit that affects a party who did not choose to incur that cost or benefit
 (c) A condition in which the price of a product exceeds its production cost
 (d) An agreement between two firms to fix prices in the market

Answer:
(b) A cost or benefit that affects a party who did not choose to incur that cost or benefit

Explanation:
An externality is a side effect or consequence of an economic activity that affects other parties who did not choose to be involved in that activity. Externalities can be positive (beneficial) or negative (costly) and can arise from production or consumption activities.

2. Which of the following is an example of a negative externality?
 (a) A company providing free health check-ups to its employees
 (b) Planting trees in a neighborhood park
 (c) A factory releasing pollutants into a nearby river
 (d) Offering discounts on products to attract more customers

Answer:
(c) A factory releasing pollutants into a nearby river

Explanation:
A negative externality occurs when an economic activity imposes costs on third parties who are not involved in the activity. In this case, the pollution released by the factory affects the environment and potentially harms people living near the river, making it a negative externality.

3. Which statement best describes a positive externality?
 (a) An increase in the price of a good leads to a decrease in its demand.
 (b) Subsidizing the production of solar panels to promote renewable energy.
 (c) The consumption of cigarettes leading to adverse health effects for smokers.
 (d) A decrease in consumer income leads to a decrease in the consumption of luxury goods.

Answer:
(b) Subsidizing the production of solar panels to promote renewable energy.

Explanation:
A positive externality occurs when an economic activity creates benefits for third parties who are not directly involved in the activity. In this case, subsidizing solar panels encourages the production of renewable energy, which not only benefits the producers but also contributes positively to the environment and society.

4. What is the most effective way to internalize externalities?
   (a) Government intervention through regulations and taxes
   (b) Imposing price ceilings on goods and services
   (c) Encouraging monopolies to dominate the market
   (d) Allowing markets to reach equilibrium naturally

   Answer:
   (a) Government intervention through regulations and taxes

   Explanation:
   Government intervention through regulations and taxes is the most effective way to internalize externalities. By imposing taxes on activities that generate negative externalities or providing subsidies for activities with positive externalities, the government can align private costs and benefits with social costs and benefits.

5. Which market structure is most likely to neglect externalities?
   (a) Perfect competition (b) Monopoly
   (c) Oligopoly (d) Monopolistic competition

   Answer:
   (a) Perfect competition

   Explanation:
   Perfectly competitive markets are less likely to consider externalities because the focus is primarily on maximizing individual profits. In perfect competition, firms are price-takers and have no market power to influence prices or externalities. As a result, they may neglect the costs or benefits imposed on others, leading to an inefficient allocation of resources.

1.4 Public Goods

1. Public goods are characterized by:
   (a) Rivalry in consumption and excludability.
   (b) Non-rivalry in consumption and excludability.
   (c) Rivalry in consumption and non-excludability.
   (d) Non-rivalry in consumption and non-excludability.

   Answer:
   (d) Non-rivalry in consumption and non-excludability.

   Explanation:
   Public goods are non-rivalrous, meaning one person's use does not reduce the availability for others, and non-excludable, meaning individuals cannot be excluded from using them once provided.

2. Which of the following statements is true about public goods?
   (a) Public goods can be easily provided by private firms for a profit.
   (b) The free-rider problem is not a concern for public goods.
   (c) Public goods have a competitive market price.
   (d) Public goods are typically provided by the government or public sector.

   Answer:
   (d) Public goods are typically provided by the government or public sector.

   Explanation:
   Public goods are often provided by the government or public sector because private firms may find it unprofitable to produce them due to the inability to exclude non-payers and the free-rider problem.

3. The free-rider problem associated with public goods refers to:
   (a) Individuals who benefit from public goods but refuse to pay for them.
   (b) The lack of competition among providers of public goods.
   (c) The government's inability to regulate public goods effectively.
   (d) The high costs of production associated with public goods.

   Answer:
   (a) Individuals who benefit from public goods but refuse to pay for them.

   Explanation:
   The free-rider problem occurs when individuals can enjoy the benefits of public goods without paying for them. This creates an incentive for some individuals to avoid contributing, leading to potential under-provision of public goods in the absence of government intervention.

4. Which of the following is an example of a public good?
   (a) Private luxury goods like designer handbags.
   (b) Cable television service.
   (c) National defense and military protection.
   (d) Exclusive membership at a country club.

   Answer:
   (c) National defense and military protection.

Explanation:
National defense and military protection are examples of public goods because they are non-rivalrous and non-excludable. Once provided, these services benefit the entire society, and it is difficult to exclude individuals from enjoying their benefits.

5. The concept of "free-rider" in the context of public goods refers to:
(a) Individuals who benefit from public goods without contributing to their provision.
(b) Individuals who willingly pay for public goods.
(c) Public sector employees responsible for providing public goods.
(d) Non-profit organizations that supply public goods.

Answer:
(a) Individuals who benefit from public goods without contributing to their provision.

Explanation:
The concept of "free-rider" in the context of public goods refers to individuals who benefit from the provision of public goods without contributing their fair share towards their production or provision.

6. The free-rider problem refers to the situation where:
(a) The government provides goods and services without charging any taxes.
(b) Individuals benefit from a public good without contributing to its provision.
(c) Private companies offer goods for free to attract more customers.
(d) The supply of a public good exceeds its demand.

Answer:
(b) Individuals benefit from a public good without contributing to its provision.

Explanation:
The free-rider problem occurs when individuals benefit from a public good without contributing to its provision or cost. Since public goods are non-excludable, individuals can enjoy the benefits without paying for it, leading to underproduction or inadequate provision of the good.

7. Which of the following is an example of a pure public good?
(a) Cable TV subscription with different channels.
(b) Toll road with limited access.
(c) National defense provided by the government.
(d) Private tutoring service for individual students.

Answer:
(c) National defense provided by the government.

Explanation:
National defense provided by the government is an example of a pure public good because it is non-excludable (cannot exclude citizens from protection) and non-rivalrous (protecting one citizen does not diminish the protection of others).

8. Public goods face challenges in the free market because:
(a) Private firms can charge high prices for them.
(b) They are produced by the government.
(c) They are subject to demand and supply fluctuations.
(d) They may be underprovided due to the free-rider problem.

Answer:
(d) They may be underprovided due to the free-rider problem.

Explanation:
Public goods may be underprovided in the free market due to the free-rider problem, where individuals have an incentive to enjoy the benefits of the good without paying for it, leading to insufficient incentives for private firms to produce them.

1.5 Incomplete Information

1. Incomplete information in a market refers to:
(a) The lack of government regulations in the market.
(b) The presence of externalities in the market.
(c) The absence of competition among firms in the market.
(d) Situations where one party in a transaction has more information than the other.

Answer:
(d) Situations where one party in a transaction has more information than the other.

Explanation:
Incomplete information in a market occurs when one party in a transaction possesses more information than the other party, leading to unequal knowledge and potentially unfair outcomes.

2. Moral hazard is an example of incomplete information in:
(a) Insurance markets.
(b) Perfectly competitive markets.
(c) Monopoly markets.
(d) Labor markets.

Answer:
(a) Insurance markets.

Explanation:
Moral hazard is an example of incomplete information in insurance markets. It occurs when one party alters their behavior after becoming insured, and the other party cannot fully monitor the actions.

3. Adverse selection is a situation where:
(a) Buyers and sellers have equal knowledge about a product.
(b) High-quality goods dominate the market.
(c) Low-quality goods are more likely to be traded.
(d) The market is characterized by perfect competition.

Answer:
(c) Low-quality goods are more likely to be traded.

Explanation:
Adverse selection is a situation where low-quality goods or products are more likely to be traded due to information asymmetry. This occurs because the seller has more information about the quality of the product than the buyer.

4. How does incomplete information impact market outcomes?
(a) It leads to a more efficient allocation of resources.
(b) It results in higher prices for goods and services.
(c) It reduces transaction costs in the market.
(d) It may lead to market failure and suboptimal outcomes.

Answer:
(d) It may lead to market failure and suboptimal outcomes.

Explanation:
Incomplete information can lead to market failure as it disrupts the efficient functioning of markets, resulting in suboptimal outcomes such as adverse selection, moral hazard, and potentially inefficient resource allocation.

5. Solutions to the problem of incomplete information in markets may include:
(a) Eliminating government regulations.
(b) Encouraging monopolies to dominate the market.
(c) Enhancing transparency and disclosure of information.
(d) Reducing competition among firms.

Answer:
(c) Enhancing transparency and disclosure of information.

Explanation:
One of the solutions to the problem of incomplete information in markets is to enhance transparency and disclosure of information. This allows all parties involved in a transaction to make more informed decisions, reducing information asymmetry and potential market failures.

6. Incomplete information in the market refers to a situation where:
(a) Consumers have perfect knowledge about the quality and price of goods.
(b) Sellers have perfect knowledge about consumer preferences.
(c) Market participants have unequal access to information.
(d) The government regulates the flow of information in the market.

Answer:
(c) Market participants have unequal access to information.

Explanation:
Incomplete information in the market occurs when some market participants have more or better information than others, leading to an information asymmetry.

7. Adverse selection in the insurance market refers to:
(a) Insurance companies charging high premiums for high-risk individuals.
(b) High-risk individuals selecting insurance policies with high deductibles.

(c) High-risk individuals being more likely to buy insurance.
(d) Insurance companies excluding high-risk individuals from coverage.

Answer:

(c) High-risk individuals being more likely to buy insurance.

Explanation:

Adverse selection in the insurance market occurs when high-risk individuals are more likely to buy insurance, leading to an imbalanced pool of insured individuals and potentially higher premiums.

8. Moral hazard in the context of insurance refers to:
(a) Insurance companies increasing premiums for risky individuals.
(b) Policyholders taking less risk due to insurance coverage.
(c) Policyholders misrepresenting information to obtain lower premiums.
(d) Insurance companies denying coverage to high-risk individuals.

Answer:

(b) Policyholders taking less risk due to insurance coverage.

Explanation:

Moral hazard in insurance occurs when individuals alter their behavior or take more risks because they are protected against risk by insurance.

9. Which of the following is an example of adverse selection in the used car market?
(a) Sellers providing detailed information about the car's condition.
(b) Buyers selecting cars based on their preferences.
(c) Sellers selling high-quality cars at premium prices.
(d) Buyers being unsure about the true condition of the car.

Answer:

(d) Buyers being unsure about the true condition of the car.

Explanation:

Adverse selection in the used car market occurs when buyers are unsure about the true condition of the car they are purchasing, as sellers may have more information about the car's condition than the buyers.

10. How can markets mitigate the problem of incomplete information?
(a) By increasing government regulation and control.
(b) By limiting the availability of information to all market participants.

(c) Through transparency and disclosure of relevant information.
(d) By reducing competition among market participants.

Answer:

(c) Through transparency and disclosure of relevant information.

Explanation:

Markets can mitigate the problem of incomplete information by promoting transparency and disclosure of relevant information to all market participants. This allows buyers and sellers to make more informed decisions.

1.5.1 Asymmetric Information

1. What does "asymmetric information" refer to in economics?
(a) A situation where buyers and sellers have the same level of information
(b) A situation where one party in a transaction has more information than the other
(c) A situation where prices are the same for all participants in the market
(d) A situation where there is no information available to make decisions

Answer:

(b) A situation where one party in a transaction has more information than the other

Explanation:

Asymmetric information in economics refers to a scenario where one party (either the buyer or the seller) involved in an economic transaction possesses more information than the other. This imbalance of information can lead to market inefficiencies and adverse outcomes.

2. Which of the following is an example of asymmetric information in the used car market?
(a) All used cars having the same market price
(b) Buyers and sellers having access to the same car history reports

(c) A seller knowing the true condition of a used car, but the buyer does not
(d) Buyers and sellers negotiating the price of used cars in an open market

Answer:

(c) A seller knowing the true condition of a used car, but the buyer does not

Explanation:

In the used car market, there is often asymmetric information because the seller usually has more information about the true condition of the car than the potential buyer. The buyer may not be aware of hidden issues or the car's history, which can lead to adverse selection and potential problems for the buyer.

3. What is adverse selection in the context of asymmetric information?
(a) A situation where sellers selectively disclose information to buyers
(b) A situation where both parties have complete and accurate information
(c) A situation where higher-quality goods are driven out of the market
(d) A situation where the presence of hidden information leads to undesirable outcomes

Answer:

(d) A situation where the presence of hidden information leads to undesirable outcomes

Explanation:

Adverse selection occurs when one party in a transaction has more information than the other, leading to a market outcome that is unfavorable or undesirable due to hidden or asymmetric information. It can result in the presence of lower-quality goods or services dominating the market, driving out higher-quality options.

4. How can insurance companies address the problem of adverse selection?
(a) By offering lower premiums to high-risk individuals
(b) By providing more information to policyholders

(c) By avoiding selling insurance to high-risk individuals
(d) By pooling the risks of diverse individuals through underwriting

Answer:

(d) By pooling the risks of diverse individuals through underwriting

Explanation:

To address adverse selection, insurance companies pool the risks of a diverse group of individuals. By underwriting policies based on actuarial data and considering a mix of high-risk and low-risk policyholders, insurance companies can balance the risks and avoid being disproportionately exposed to adverse selection.

5. Which concept refers to a situation where the presence of asymmetric information causes the deterioration of the quality of goods or services traded in the market?
(a) Moral hazard
(b) Market equilibrium
(c) Gresham's Law
(d) Lemons problem

Answer:

(d) Lemons problem

Explanation:

The "lemons problem" is a concept associated with asymmetric information, particularly in the context of used goods or services. It refers to the situation where the presence of asymmetric information causes the market to be dominated by lower-quality goods or services (lemons), driving out higher-quality options.

Certainly! Here are some multiple-choice questions (MCQs) related to asymmetric information, along with their solutions:

6. What is asymmetric information?
(a) A situation where all parties involved in a transaction have equal access to information.
(b) A situation where one party in a transaction has more information than the other party.
(c) A situation where both parties in a transaction lack necessary information.

(d) A situation where the market information is not readily available to anyone.

Answer:

(b) A situation where one party in a transaction has more information than the other party.

Explanation:

Asymmetric information refers to a situation in which one party involved in an economic transaction possesses more information than the other party. This information asymmetry can lead to problems in the market and affect the outcome of the transaction.

7. In the context of the used car market, what is adverse selection?
   (a) The tendency of sellers to hide information about the car's history.
   (b) The tendency of buyers to pay more for high-quality used cars.
   (c) The tendency of buyers to prefer new cars over used cars.
   (d) The tendency of sellers to offer warranties on used cars.

Answer:

(a) The tendency of sellers to hide information about the car's history.

Explanation:

Adverse selection in the used car market refers to the tendency of sellers to hide or withhold information about the car's true condition or history, making it difficult for buyers to distinguish between high-quality and low-quality used cars. This can lead to a market dominated by poor-quality used cars.

8. Which of the following is an example of moral hazard?
   (a) A person investing in a diversified portfolio to reduce risk.
   (b) A person purchasing health insurance to cover medical expenses.
   (c) A person taking more financial risks after purchasing comprehensive insurance.
   (d) A person conducting market research to make an informed purchasing decision.

Answer:

(c) A person taking more financial risks after purchasing comprehensive insurance.

Explanation:

Moral hazard occurs when one party changes their behavior in a way that increases the risk for the other party after a contract or agreement is made. In this case, the person takes more financial risks knowing that they are protected by comprehensive insurance, as the insurance company bears the financial burden in case of any adverse events.

9. How does adverse selection impact the market for insurance?
   (a) It leads to higher insurance premiums for everyone.
   (b) It encourages insurance companies to offer more coverage options.
   (c) It results in a decrease in demand for insurance products.
   (d) It reduces the profitability of insurance companies.

Answer:

(a) It leads to higher insurance premiums for everyone.

Explanation:

Adverse selection in the insurance market occurs when higher-risk individuals are more likely to purchase insurance, while lower-risk individuals may avoid it. As a result, insurance companies face a pool of customers with a higher average risk, leading to higher claims and costs. To compensate for this increased risk, insurance companies often raise premiums for all customers.

10. Which of the following is a solution to the problem of adverse selection in insurance markets?
    (a) Implementing price controls on insurance premiums
    (b) Requiring individuals to purchase insurance
    (c) Offering subsidies to insurance companies
    (d) Pooling individuals with different risk levels

Answer:

(d) Pooling individuals with different risk levels

Explanation:

Pooling individuals with different risk levels involves combining individuals with varying risk profiles in the same insurance pool. By doing so, insurance companies can spread the risk more effectively, reducing the impact of adverse selection. This pooling allows insurance companies to offer more competitive and affordable premiums to a broader group of customers.

1.6 Government Intervention to Minimize Market Power

1. Market power refers to:
   (a) The ability of the government to control market prices.
   (b) The ability of a single firm to influence market prices and output.
   (c) The government's ability to regulate market competition.
   (d) The ability of consumers to make informed purchasing decisions.
   Answer:
   (b) The ability of a single firm to influence market prices and output.
   Explanation:
   Market power refers to the ability of a single firm or a group of firms to influence market prices and output by acting as a price maker rather than a price taker.
2. Which of the following is a consequence of excessive market power?
   (a) Increased competition and lower prices for consumers.
   (b) Optimal allocation of resources in the market.
   (c) Reduced consumer choices and higher prices.
   (d) Elimination of government regulations.
   Answer:
   (c) Reduced consumer choices and higher prices.
   Explanation:
   Excessive market power can lead to reduced consumer choices and higher prices as firms with significant market power may exploit their position to limit competition and charge higher prices.
3. Antitrust laws are designed to:
   (a) Protect firms with dominant market positions from competition.
   (b) Encourage collusion among competing firms.
   (c) Promote mergers and acquisitions in the market.
   (d) Prevent monopolistic practices and promote competition.
   Answer:
   (d) Prevent monopolistic practices and promote competition.
   Explanation:
   Antitrust laws are designed to prevent monopolistic practices, such as price fixing and collusion, and promote competition in the market to protect consumer welfare.

4. A natural monopoly occurs when:
   (a) A single firm dominates the market due to barriers to entry.
   (b) There is perfect competition among multiple firms in the market.
   (c) The government owns and operates all industries in the economy.
   (d) Market power is evenly distributed among all firms in the industry.
   Answer:
   (a) A single firm dominates the market due to barriers to entry.
   Explanation:
   A natural monopoly occurs when a single firm can efficiently serve the entire market due to economies of scale or other barriers to entry, making it impractical for other firms to enter and compete.
5. Government intervention to minimize market power can include:
   (a) Imposing price floors to protect producers.
   (b) Providing subsidies to encourage higher production.
   (c) Breaking up monopolies or regulating their behavior.
   (d) Implementing import tariffs to promote domestic industries.
   Answer:
   (c) Breaking up monopolies or regulating their behavior.
   Explanation:
   Government intervention to minimize market power can include breaking up monopolies into smaller firms or regulating the behavior of dominant firms to ensure fair competition and protect consumers.
6. Market power refers to the ability of a firm or a group of firms to:
   (a) Minimize production costs and maximize profits.
   (b) Influence market prices and control the quantity of goods produced.
   (c) Compete fairly in the market and offer high-quality products.
   (d) Participate in international trade and expand their market share.
   Answer:
   (b) Influence market prices and control the quantity of goods produced.
   Explanation:
   Market power refers to the ability of a firm or a group of firms to influence market prices and control the quantity of goods produced in the market.
7. Which of the following is a potential consequence of excessive market power?

(a) Increased competition and lower prices for consumers.
(b) Higher quality products and improved customer service.
(c) Limited choices and higher prices for consumers.
(d) Increased innovation and technological advancements.

Answer:

(c) Limited choices and higher prices for consumers.

Explanation:

Excessive market power can lead to limited choices for consumers and higher prices since dominant firms may have the ability to set prices without facing significant competition.

8. Government intervention to minimize market power can include:
(a) Providing subsidies to support monopolistic firms.
(b) Enforcing antitrust laws to promote competition.
(c) Imposing price controls to regulate the market.
(d) Discouraging new firms from entering the market.

Answer:

(b) Enforcing antitrust laws to promote competition.

Explanation:

Government intervention to minimize market power often involves enforcing antitrust laws to prevent monopolies and promote competition in the market.

9. A natural monopoly occurs when:
(a) There is only one firm in the market with significant market power.
(b) The government regulates the prices and operations of all firms.
(c) Multiple firms compete in the market without any dominance.
(d) Economies of scale make it more efficient for one firm to serve the entire market.

Answer:

(d) Economies of scale make it more efficient for one firm to serve the entire market.

Explanation:

A natural monopoly occurs when economies of scale are such that it is more efficient for one firm to serve the entire market, leading to a single dominant firm in the industry.

10. How can the government promote competition to minimize market power?
(a) By granting exclusive rights to firms for certain products.
(b) By providing subsidies to dominant firms to expand their production.
(c) By removing barriers to entry and encouraging new competitors.
(d) By imposing price floors to protect producers from low prices.

Answer:

(c) By removing barriers to entry and encouraging new competitors.

Explanation:

The government can promote competition and minimize market power by removing barriers to entry, encouraging new competitors to enter the market, and ensuring a level playing field for all firms.

1.7 Government Intervention to Correct Externalities

1. Externalities in the market refer to:
(a) The influence of government policies on market outcomes.
(b) The impact of international trade on domestic industries.
(c) The spillover effects of market activities on third parties.
(d) The fluctuations in market prices due to supply and demand.

Answer:

(c) The spillover effects of market activities on third parties.

Explanation:

Externalities in the market refer to the spillover effects of market activities, where the actions of buyers or sellers have unintended consequences on third parties who are not directly involved in the transaction.

2. A negative externality occurs when:
(a) The production of a good benefits third parties.
(b) The production of a good imposes costs on third parties.
(c) The government imposes taxes on goods and services.
(d) The market is in equilibrium without any distortions.

Answer:

(b) The production of a good imposes costs on third parties.

Explanation:
A negative externality occurs when the production or consumption of a good imposes costs on third parties who are not involved in the transaction.

3. Which of the following is a government intervention to correct negative externalities?
(a) Subsidizing the production of goods with negative externalities.
(b) Imposing taxes on goods with negative externalities.
(c) Restricting the production of goods with positive externalities.
(d) Providing direct financial support to firms.

Answer:
(b) Imposing taxes on goods with negative externalities.

Explanation:
To correct negative externalities, the government can impose taxes on goods or activities that generate negative spillover effects. This is known as a corrective or Pigovian tax.

4. Positive externalities occur when:
(a) The production of a good benefits third parties.
(b) The production of a good imposes costs on third parties.
(c) The government intervenes in the market.
(d) There is overproduction of goods in the market.

Answer:
(a) The production of a good benefits third parties.

Explanation:
Positive externalities occur when the production or consumption of a good benefits third parties who are not directly involved in the transaction.

5. Which of the following is a government intervention to correct positive externalities?
(a) Subsidizing the production of goods with positive externalities.
(b) Imposing taxes on goods with positive externalities.
(c) Imposing price ceilings on goods with positive externalities.
(d) Removing government regulations on production.

Answer:
(a) Subsidizing the production of goods with positive externalities.

Explanation:
To correct positive externalities, the government can provide subsidies to goods or activities that generate positive spillover effects, encouraging their production or consumption.

6. Negative externalities occur when:
(a) The production of a good leads to higher demand for other goods.
(b) The consumption of a good benefits other individuals in society.
(c) Economic activities impose costs on third parties.
(d) There is an oversupply of goods in the market.

Answer:
(c) Economic activities impose costs on third parties.

Explanation:
Negative externalities occur when economic activities impose costs on third parties, beyond what is accounted for in the market price.

7. Which of the following is a potential solution for correcting negative externalities?
(a) Providing subsidies to the firms generating negative externalities.
(b) Implementing price controls to regulate the market.
(c) Enforcing property rights and allowing lawsuits against polluters.
(d) Imposing higher taxes on consumers of the goods with negative externalities.

Answer:
(c) Enforcing property rights and allowing lawsuits against polluters.

Explanation:
Enforcing property rights and allowing lawsuits against polluters can be a potential solution to correct negative externalities by making polluters accountable for the harm caused.

8. Positive externalities occur when:
(a) The production of a good leads to higher prices in the market.
(b) Economic activities benefit third parties without compensation.
(c) There is a surplus of goods in the market.
(d) There is an undersupply of goods in the market.

Answer:
(b) Economic activities benefit third parties without compensation.

Explanation:
Positive externalities occur when economic activities benefit third parties without those parties being compensated for it.

9. Which of the following is a government intervention to encourage positive externalities?
   (a) Imposing taxes on the producers of goods with positive externalities.
   (b) Providing subsidies to the producers of goods with positive externalities.
   (c) Enforcing price ceilings to reduce prices of goods with positive externalities.
   (d) Discouraging the consumption of goods with positive externalities.

   Answer:
   (b) Providing subsidies to the producers of goods with positive externalities.

   Explanation:
   Providing subsidies to the producers of goods with positive externalities can be a government intervention to encourage the production and consumption of such goods.

1.8 Government Intervention in the Case of Merit Goods

1. Merit goods are goods that:
   (a) Have high market demand and limited supply.
   (b) Are provided by the government without any cost to consumers.
   (c) Are considered to have positive externalities and are underprovided by the market.
   (d) Are characterized by rivalry in consumption and excludability.

   Answer:
   (c) Are considered to have positive externalities and are underprovided by the market.

   Explanation:
   Merit goods are goods that are considered to have positive externalities, meaning they benefit society beyond the direct benefits to consumers, and are underprovided by the market.

2. Which of the following is an example of a merit good?
   (a) Fast food and soft drinks.
   (b) Private luxury cars.
   (c) Education and vaccinations.
   (d) High-end fashion products.

   Answer:
   (c) Education and vaccinations.

   Explanation:
   Education and vaccinations are examples of merit goods because they provide benefits not only to the individuals receiving them but also to society as a whole in terms of better health and increased productivity.

3. Why might merit goods be underprovided by the market?
   (a) Because they have low demand and high supply.
   (b) Because they are often inferior in quality to other goods.
   (c) Because producers find it unprofitable to supply them.
   (d) Because consumers are not aware of their benefits.

   Answer:
   (c) Because producers find it unprofitable to supply them.

   Explanation:
   Merit goods might be underprovided by the market because producers may find it unprofitable to supply them due to the positive externalities they generate, which are not directly reflected in their market prices.

4. How can the government intervene to ensure adequate provision of merit goods?
   (a) By imposing price controls to keep prices low.
   (b) By reducing taxes on the production of merit goods.
   (c) By providing subsidies to producers of merit goods.
   (d) By reducing government expenditure on other sectors.

   Answer:
   (c) By providing subsidies to producers of merit goods.

   Explanation:
   The government can intervene to ensure adequate provision of merit goods by providing subsidies to producers, which can incentivize them to supply these goods despite the positive externalities involved.

5. The purpose of government intervention in the case of merit goods is to:
(a) Increase consumer choices in the market.
(b) Maximize government revenue from taxes.
(c) Correct market failures and ensure social welfare.
(d) Encourage competition among producers.

Answer:

(c) Correct market failures and ensure social welfare.

Explanation:

Government intervention in the case of merit goods aims to correct market failures, such as the underprovision of goods with positive externalities, and ensure the well-being of society as a whole.

6. Merit goods are goods that:
(a) Are produced by government-owned firms.
(b) Are provided by private firms but subsidized by the government.
(c) Have positive externalities and are underprovided in the free market.
(d) Have negative externalities and are overproduced in the free market.

Answer:

(c) Have positive externalities and are underprovided in the free market.

Explanation:

Merit goods are goods that have positive externalities, meaning their consumption generates benefits for society beyond what is considered in the market. They are often underprovided in the free market because individuals may not fully consider these external benefits when making consumption decisions.

7. Which of the following is an example of a merit good?
(a) Cigarettes and alcoholic beverages.
(b) Fast food and sugary beverages.
(c) Education and vaccinations.
(d) Luxury cars and high-end fashion.

Answer:

(c) Education and vaccinations.

Explanation:

Education and vaccinations are examples of merit goods as they have positive externalities. Providing education and vaccinations not only benefit individuals directly but also have broader societal benefits in terms of increased productivity and reduced spread of diseases.

8. Government intervention to promote merit goods can include:
(a) Imposing higher taxes on the consumption of merit goods.
(b) Subsidizing the production of merit goods.
(c) Implementing price controls to regulate the prices of merit goods.
(d) Promoting advertisements for luxury goods.

Answer:

(b) Subsidizing the production of merit goods.

Explanation:

Government intervention to promote merit goods can include subsidizing the production of these goods to encourage their availability and consumption.

9. Why are merit goods often underprovided in the free market?
(a) Because they are produced by government-owned firms.
(b) Because private firms find them unprofitable to produce.
(c) Because consumers do not value their positive externalities.
(d) Because they are subject to price ceilings.

Answer:

(b) Because private firms find them unprofitable to produce.

Explanation:

Merit goods are often underprovided in the free market because private firms may find them unprofitable to produce due to the inability to fully capture the societal benefits (positive externalities) in their revenues.

10. The government's intervention in the case of merit goods is primarily aimed at:
(a) Restricting the consumption of these goods.
(b) Ensuring equitable distribution of these goods.
(c) Encouraging the consumption of these goods.
(d) Eliminating the production of these goods.

Answer:

(c) Encouraging the consumption of these goods.

Explanation:
The government's intervention in the case of merit goods is primarily aimed at encouraging the consumption of these goods to ensure that their positive externalities are fully realized in society.

1.9 Government Intervention in the Case of Demerit Goods

1. Demerit goods are goods that:
   (a) Have positive externalities and are underprovided in the free market.
   (b) Have negative externalities and are overproduced in the free market.
   (c) Are produced by government-owned firms.
   (d) Are provided by private firms but subsidized by the government.
   Answer:
   (b) Have negative externalities and are overproduced in the free market.
   Explanation:
   Demerit goods are goods that have negative externalities, meaning their consumption imposes costs on society beyond what is considered in the market. They are often overproduced in the free market because individuals may not fully consider these external costs when making consumption decisions.
2. Which of the following is an example of a demerit good?
   (a) Education and vaccinations.
   (b) Fast food and sugary beverages.
   (c) Renewable energy sources.
   (d) Public transportation services.
   Answer:
   (b) Fast food and sugary beverages.
   Explanation: Fast food and sugary beverages are examples of demerit goods as their consumption can have negative externalities, such as health issues and increased healthcare costs.
3. Government intervention to discourage the consumption of demerit goods can include:
   (a) Subsidizing the production of demerit goods.
   (b) Implementing price controls to regulate the prices of demerit goods.

   (c) Enforcing property rights for demerit goods.
   (d) Imposing higher taxes on the consumption of demerit goods.
   Answer:
   (d) Imposing higher taxes on the consumption of demerit goods.
   Explanation:
   Government intervention to discourage the consumption of demerit goods can include imposing higher taxes on the consumption of these goods, known as "sin taxes." This aims to increase the price of demerit goods, reducing their consumption and mitigating negative externalities.
4. Why are demerit goods often overproduced in the free market?
   (a) Because they are produced by government-owned firms.
   (b) Because private firms find them profitable to produce.
   (c) Because consumers fully consider their negative externalities.
   (d) Because they are subject to price floors.
   Answer:
   (b) Because private firms find them profitable to produce.
   Explanation:
   Demerit goods are often overproduced in the free market because private firms may find them profitable to produce due to consumers not fully considering the negative externalities associated with these goods.
5. The government's intervention in the case of demerit goods is primarily aimed at:
   (a) Restricting the consumption of these goods.
   (b) Ensuring equitable distribution of these goods.
   (c) Encouraging the consumption of these goods.
   (d) Eliminating the production of these goods.
   Answer:
   (a) Restricting the consumption of these goods.
   Explanation:
   The government's intervention in the case of demerit goods is primarily aimed at restricting the consumption of these goods to mitigate the negative externalities and protect public health and well-being.

1.10 Government Intervention in the Case of Public Goods

1. Public goods are characterized by:
   (a) Excludability and rivalry in consumption.
   (b) Non-excludability and rivalry in consumption.
   (c) Excludability and non-rivalry in consumption.
   (d) Non-excludability and non-rivalry in consumption.
   Answer:
   (d) Non-excludability and non-rivalry in consumption.
   Explanation:
   Public goods are goods that are non-excludable, meaning individuals cannot be excluded from using them, and non-rivalrous, meaning one person's use does not reduce the availability for others.
2. Which of the following is a key challenge in the provision of public goods?
   (a) Free-rider problem.
   (b) Price fluctuations in the market.
   (c) Excessive competition among producers.
   (d) Lack of demand from consumers.
   Answer:
   (a) Free-rider problem.
   Explanation:
   The free-rider problem is a key challenge in the provision of public goods, where individuals can enjoy the benefits of a public good without contributing to its provision.
3. Government intervention in the provision of public goods can involve:
   (a) Imposing high taxes on consumers who use public goods.
   (b) Restricting access to public goods to a selected group of individuals.
   (c) Privatizing the production and distribution of public goods.
   (d) Financing the provision of public goods through taxes and government spending.
   Answer:
   (d) Financing the provision of public goods through taxes and government spending.

   Explanation:
   Government intervention in the provision of public goods often involves financing these goods through taxes and government spending since private firms may find it unprofitable to produce public goods.
4. Which of the following is an example of a public good that is typically provided by the government?
   (a) Movie tickets.
   (b) Cable TV subscriptions.
   (c) National defense.
   (d) Smartphones.
   Answer:
   (c) National defense.
   Explanation:
   National defense is an example of a public good that is typically provided by the government, as it is non-excludable and non-rivalrous in consumption.
5. The concept of "crowding out" refers to:
   (a) The phenomenon where the demand for public goods exceeds the government's ability to provide them.
   (b) Government spending on public goods leading to reduced private sector investment.
   (c) The government's attempt to exclude certain individuals from accessing public goods.
   (d) The competition between private firms in providing public goods.
   Answer:
   (b) Government spending on public goods leading to reduced private sector investment.
   Explanation:
   The concept of "crowding out" refers to government spending on public goods leading to reduced private sector investment because of increased government borrowing and higher interest rates.
6. Why are public goods often underprovided in the free market?
   (a) Because they are produced by government-owned firms.
   (b) Because private firms find them unprofitable to produce.

(c) Because consumers are fully aware of their positive externalities.
(d) Because they are subject to price ceilings.

Answer:

(b) Because private firms find them unprofitable to produce.

Explanation:

Public goods are often underprovided in the free market because private firms may find them unprofitable to produce due to the inability to fully capture the societal benefits (positive externalities) in their revenues.

7. Government intervention to provide public goods can include:
(a) Imposing taxes on consumers to fund their production.
(b) Subsidizing private firms to produce public goods.
(c) Implementing price controls to regulate the prices of public goods.
(d) Encouraging consumers to purchase public goods.

Answer:

(b) Subsidizing private firms to produce public goods.

Explanation:

Government intervention to provide public goods can include subsidizing private-firms or organizations to produce public goods, ensuring their provision for society.

8. Which of the following is an example of a public good?
(a) Education provided by a private school.
(b) Cable TV subscription with different channels.
(c) National defense provided by the government.
(d) Exclusive access to a members-only online forum.

Answer:

(c) National defense provided by the government.

Explanation:

National defense provided by the government is an example of a public good because it is non-excludable (cannot exclude citizens from protection) and non-rivalrous (protecting one citizen does not diminish the protection of others).

9. How can the government promote the provision of public goods?
(a) By granting exclusive rights to firms for certain public goods.
(b) By providing subsidies to private firms to limit public goods production.

(c) By increasing taxes on individuals to reduce public goods consumption.
(d) By directly funding the production of public goods.

Answer:

(d) By directly funding the production of public goods.

Explanation:

The government can promote the provision of public goods by directly funding their production or providing funds to organizations or entities that produce public goods for the benefit of society.

1.11 Price Intervention: Non-Market Pricing

1. Non-market pricing refers to:
(a) The setting of prices based on supply and demand in the market.
(b) The government's intervention to control prices in the market.
(c) The use of prices as a mechanism to allocate resources efficiently.
(d) The setting of prices by the government outside the regular market forces.

Answer:

(d) The setting of prices by the government outside the regular market forces.

Explanation:

Non-market pricing refers to the setting of prices by the government or other authorities outside the regular market forces of supply and demand.

2. Which of the following is an example of non-market pricing?
(a) A competitive market where prices are determined by supply and demand.
(b) Government-controlled price ceilings on rent in certain areas.
(c) Pricing strategy based on product differentiation.
(d) Dynamic pricing used by online retailers.

Answer:

(b) Government-controlled price ceilings on rent in certain areas.

Explanation:
Government-controlled price ceilings on rent in certain areas are an example of non-market pricing as the government intervenes to set the maximum price that landlords can charge for rent.

3. What is the primary objective of non-market pricing by the government?
   (a) To maximize profits for private firms.
   (b) To encourage competition among producers.
   (c) To ensure price stability and affordability for consumers.
   (d) To eliminate the role of prices in the economy.

Answer:
(c) To ensure price stability and affordability for consumers.

Explanation:
The primary objective of non-market pricing by the government is to ensure price stability and affordability for consumers, especially in essential goods and services.

4. Price floors imposed by the government result in:
   (a) Higher prices and excess supply in the market.
   (b) Lower prices and excess demand in the market.
   (c) Higher prices and shortage of goods in the market.
   (d) Lower prices and increased competition among producers.

Answer:
(c) Higher prices and shortage of goods in the market.

Explanation:
Price floors imposed by the government set a minimum price level, which leads to higher prices and a potential shortage of goods in the market as the quantity demanded may be lower than the quantity supplied at the floor price.

5. Non-market pricing is often used by the government to:
   (a) Encourage competition and innovation among firms.
   (b) Allow market forces to determine prices freely.
   (c) Correct market failures and ensure equitable distribution.
   (d) Eliminate the role of prices in resource allocation.

Answer:
(c) Correct market failures and ensure equitable distribution.

Explanation:
Non-market pricing is often used by the government to correct market failures and ensure equitable distribution of goods and services, especially in cases where the market may not allocate resources efficiently or fairly.

6. Non-market pricing is often used to address:
   (a) Market failures and externalities.
   (b) Competitive pricing in the market.
   (c) Demand and supply fluctuations.
   (d) Price discrimination by businesses.

Answer:
(a) Market failures and externalities.

Explanation:
Non-market pricing is often used to address market failures and externalities by regulating prices to correct inefficiencies in the market.

7. What is the primary purpose of non-market pricing?
   (a) To increase profits for businesses.
   (b) To promote competition among firms.
   (c) To allocate resources in the most efficient way.
   (d) To reduce government control over the economy.

Answer:
(c) To allocate resources in the most efficient way.

Explanation:
The primary purpose of non-market pricing is to allocate resources in the most efficient manner, taking into account external considerations and correcting market failures.

8. Non-market pricing may lead to:
   (a) Greater market efficiency and consumer welfare.
   (b) Lower production and decreased consumer choices.
   (c) Increased competition among firms.
   (d) Higher prices due to supply shortages.

Answer:
(b) Lower production and decreased consumer choices.

Explanation:
Non-market pricing can sometimes lead to lower production and decreased consumer choices, as it may affect the incentives for businesses to produce certain goods or services.

1.12 Government Intervention for Correcting Information Failure

1. Information failure occurs when:
   (a) The government intervenes in the market to regulate prices.
   (b) Consumers have perfect knowledge about the quality and price of goods.
   (c) Market participants have unequal access to information.
   (d) There is an oversupply of goods in the market.

   Answer:
   (c) Market participants have unequal access to information.

   Explanation:
   Information failure occurs when some market participants have more or better information than others, leading to an information asymmetry.
2. Which of the following is a potential consequence of information failure?
   (a) Increased competition and lower prices for consumers.
   (b) Higher quality products and improved customer service.
   (c) Limited choices and higher prices for consumers.
   (d) Increased innovation and technological advancements.

   Answer:
   (c) Limited choices and higher prices for consumers.

   Explanation:
   Information failure can lead to limited choices for consumers and higher prices since some participants may have more information, giving them an advantage in the market.
3. Government intervention to correct information failure can include:
   (a) Imposing price controls to regulate the market.
   (b) Limiting the availability of information to all market participants.
   (c) Enforcing property rights and allowing lawsuits for misrepresentation.
   (d) Providing subsidies to firms with more information.

   Answer:
   (c) Enforcing property rights and allowing lawsuits for misrepresentation.

   Explanation:
   Government intervention to correct information failure can include enforcing property rights and allowing individuals to pursue legal action for misrepresentation or fraud.
4. How can the government promote transparency and reduce information failure?
   (a) By granting exclusive rights to firms for certain products.
   (b) By restricting the flow of information to protect businesses.
   (c) By enforcing regulations that require firms to disclose relevant information.
   (d) By reducing competition among market participants.

   Answer:
   (c) By enforcing regulations that require firms to disclose relevant information.

   Explanation:
   The government can promote transparency and reduce information failure by enforcing regulations that require firms to disclose relevant information to consumers, investors, or other market participants.
5. Why is correcting information failure important in a market economy?
   (a) To limit government interference in the market.
   (b) To protect businesses from competition.
   (c) To ensure that markets function efficiently and fairly.
   (d) To increase profits for firms.

   Answer:
   (c) To ensure that markets function efficiently and fairly.

   Explanation:
   Correcting information failure is important in a market economy to ensure that markets operate efficiently and fairly, and that consumers can make informed choices.

6. Which of the following is an example of government intervention to correct information failure?
   (a) Requiring businesses to disclose nutritional information on food labels.
   (b) Allowing businesses to keep their product information confidential.
   (c) Imposing price ceilings to control inflation.
   (d) Allowing businesses to mislead consumers with false advertisements.

   Answer:
   (a) Requiring businesses to disclose nutritional information on food labels.

   Explanation:
   Requiring businesses to disclose nutritional information on food labels is an example of government intervention to correct information failure, as it helps consumers make more informed choices about the products they purchase.

7. The primary goal of government intervention for correcting information failure is to:
   (a) Control the prices of goods and services in the market.
   (b) Limit competition and protect businesses.
   (c) Ensure a level playing field for all market participants.
   (d) Enhance transparency and empower consumers with information.

   Answer:
   (d) Enhance transparency and empower consumers with information.

   Explanation:
   The primary goal of government intervention for correcting information failure is to enhance transparency and empower consumers with information, enabling them to make better decisions in the market.

8. Which of the following is an example of information failure?
   (a) Consumers conducting thorough research before making a purchase.
   (b) Companies providing complete and transparent information about their products.

   (c) Misleading advertising that exaggerates the benefits of a product.
   (d) Consumers making well-informed decisions based on market prices.

   Answer:
   (c) Misleading advertising that exaggerates the benefits of a product.

   Explanation:
   Misleading advertising that exaggerates the benefits of a product is an example of information failure because it misinforms consumers and leads to imbalanced knowledge about the product's actual attributes.

9. The ultimate goal of government intervention to correct information failure is to:
   (a) Increase government control over market activities.
   (b) Regulate market prices to ensure fairness.
   (c) Ensure that consumers have access to accurate and relevant information.
   (d) Promote competition among businesses.

   Answer:
   (c) Ensure that consumers have access to accurate and relevant information.

   Explanation:
   The ultimate goal of government intervention to correct information failure is to ensure that consumers have access to accurate and relevant information, allowing them to make informed decisions in the market.

1.13 Government Intervention for Equitable Distribution

1. Equitable distribution refers to:
   (a) Government control over the allocation of resources.
   (b) The equal distribution of wealth and income among individuals.
   (c) The concentration of resources among a few wealthy individuals.
   (d) Market forces determining the distribution of resources.

   Answer:
   (b) The equal distribution of wealth and income among individuals.

   Explanation:
   Equitable distribution refers to the fair and equal distribution of wealth and income among individuals in society.

2. Which of the following is a potential consequence of inequitable distribution of resources?
   (a) Increased competition and economic growth.
   (b) Higher levels of poverty and social unrest.
   (c) Greater incentives for innovation and entrepreneurship.
   (d) Improved living standards for all individuals.

   Answer:

   (b) Higher levels of poverty and social unrest.

   Explanation:

   Inequitable distribution of resources can lead to higher levels of poverty and social unrest as wealth and income disparities can create economic and social inequalities.
3. Government intervention for equitable distribution can include:
   (a) Implementing price controls to regulate resource allocation.
   (b) Promoting competition among firms to increase efficiency.
   (c) Providing social welfare programs to support vulnerable populations.
   (d) Limiting the availability of resources to maintain scarcity.

   Answer:

   (c) Providing social welfare programs to support vulnerable populations.

   Explanation:

   Government intervention for equitable distribution often includes providing social welfare programs to support vulnerable populations and reduce economic disparities.
4. Which of the following is an example of government intervention for equitable distribution?
   (a) Imposing higher taxes on high-income individuals.
   (b) Deregulating industries to encourage competition.
   (c) Allowing market forces to determine resource allocation.
   (d) Implementing subsidies to support profitable businesses.

   Answer:

   (a) Imposing higher taxes on high-income individuals.

   Explanation:

   Imposing higher taxes on high-income individuals is an example of government intervention for equitable distribution as it aims to redistribute wealth and income to support those with lower incomes.
5. The main objective of government intervention for equitable distribution is to:
   (a) Maximize profits for businesses.
   (b) Ensure that everyone has equal wealth and income.
   (c) Promote economic growth and development.
   (d) Reduce economic inequalities and provide support to the needy.

   Answer:

   (d) Reduce economic inequalities and provide support to the needy.

   Explanation:

   The main objective of government intervention for equitable distribution is to reduce economic inequalities and provide support to vulnerable and disadvantaged populations to achieve a more equitable society.
6. Which of the following is a potential consequence of income inequality?
   (a) Increased economic growth and development.
   (b) Reduced poverty and improved living standards for all.
   (c) Social unrest and a sense of injustice in society.
   (d) Greater investment and entrepreneurship.

   Answer:

   (c) Social unrest and a sense of injustice in society.

   Explanation:

   Income inequality can lead to social unrest and a sense of injustice in society, as some individuals may feel marginalized or disadvantaged due to unequal access to resources.
7. Government intervention for equitable distribution can include:
   (a) Imposing taxes on high-income individuals and redistributing the funds.
   (b) Implementing price controls to regulate market prices.

(c) Encouraging competition among businesses to reduce income disparities.
(d) Reducing government spending on social welfare programs.

Answer:

(a) Imposing taxes on high-income individuals and redistributing the funds.

Explanation:

Government intervention for equitable distribution can include imposing progressive taxes on high-income individuals and redistributing the collected funds to support lower-income groups.

8. Which of the following is an example of a government program aimed at equitable distribution?
(a) Providing subsidies to profitable businesses.
(b) Implementing a flat tax rate for all income levels.
(c) Offering financial assistance to low-income families.
(d) Reducing regulations on corporations.

Answer:

(c) Offering financial assistance to low-income families.

Explanation:

Offering financial assistance to low-income families is an example of a government program aimed at equitable distribution, as it provides support to those in need and helps reduce income disparities.

9. The main objective of government intervention for equitable distribution is to:
(a) Maximize government revenue through taxation.
(b) Minimize government control over the economy.
(c) Ensure that everyone receives equal income and wealth.
(d) Reduce income and wealth disparities and promote social welfare.

Answer:

(d) Reduce income and wealth disparities and promote social welfare.

Explanation:

The main objective of government intervention for equitable distribution is to reduce income and wealth disparities and promote social welfare by ensuring a fair and just distribution of resources in society.

Additional Question Bank

1.1 Introduction

1. Market failure occurs when:
(a) The government imposes excessive regulations on businesses
(b) The market is unable to allocate resources efficiently
(c) Consumers demand more goods and services than producers can supply
(d) There is perfect competition among firms in the market
2. The main cause of market failure is often attributed to:
(a) Excessive government intervention in the economy
(b) Monopoly power held by a single firm in the market
(c) Lack of consumer demand for certain goods and services
(d) Externalities and the absence of property rights
3. Externalities refer to:
(a) The benefits or costs of production that spill over to affect third parties
(b) The government's interference in the market
(c) The changes in demand and supply in the market
(d) The fluctuations in the stock market
4. Which of the following is an example of a positive externality?
(a) Pollution from a factory affecting the health of nearby residents
(b) Vaccination programs reducing the spread of infectious diseases
(c) Congestion and traffic jams in urban areas
(d) The depletion of natural resources due to overexploitation
5. Government intervention to correct market failure can include:
(a) Imposing trade barriers and tariffs on imports
(b) Reducing taxes to stimulate consumer spending
(c) Providing subsidies to inefficient firms in the market
(d) Imposing taxes or regulations to address externalities
6. Public goods are characterized by:
(a) Rivalry in consumption and exclusion of non-payers
(b) Rivalry in consumption and non-exclusion of non-payers

(c) Non-rivalry in consumption and exclusion of non-payers
(d) Non-rivalry in consumption and non-exclusion of non-payers

7. The free-rider problem refers to:
(a) Consumers demanding more goods than producers can supply
(b) Firms in the market charging excessively high prices for their products
(c) People benefiting from a public good without contributing to its provision
(d) Government intervention causing market inefficiencies

8. Government intervention to correct market failure aims to:
(a) Completely replace the market mechanism with central planning
(b) Eliminate all externalities and market distortions
(c) Improve market efficiency and promote economic welfare
(d) Privatize all public goods and services

1.2 The Concept of Market Failure

1. Market failure occurs when:
(a) The government intervenes too much in the economy
(b) The market allocates resources efficiently
(c) The market fails to allocate resources efficiently
(d) There is perfect competition among firms in the market

2. The main cause of market failure is often attributed to:
(a) Perfect competition among firms in the market
(b) The absence of government regulations
(c) Externalities and market imperfections
(d) High levels of consumer demand

3. Externalities refer to:
(a) The government's role in the market
(b) The benefits or costs of production that spill over to affect third parties
(c) The changes in supply and demand in the market
(d) The fluctuations in stock prices

4. Which of the following is an example of a negative externality?
(a) A company providing scholarships to local students
(b) The construction of a new park in the neighborhood
(c) Pollution from a factory affecting nearby residents
(d) Government subsidies to support renewable energy

5. Public goods are characterized by:
(a) Rivalry in consumption and exclusion of non-payers
(b) Rivalry in consumption and non-exclusion of non-payers
(c) Non-rivalry in consumption and exclusion of non-payers
(d) Non-rivalry in consumption and non-exclusion of non-payers

6. The free-rider problem refers to:
(a) Consumers demanding more goods than producers can supply
(b) Firms in the market charging excessively high prices for their products
(c) People benefiting from a public good without contributing to its provision
(d) Government intervention causing market inefficiencies

7. Which of the following is an example of market failure?
(a) A competitive market with many buyers and sellers
(b) A perfectly efficient allocation of resources in a free market
(c) Overconsumption of natural resources leading to environmental degradation
(d) Government subsidies promoting the growth of a specific industry

8. Government intervention to correct market failure aims to:
(a) Eliminate all externalities and market distortions
(b) Replace the market mechanism with central planning
(c) Reduce competition and increase market power for firms
(d) Improve market efficiency and promote economic welfare

1.3 Why do Markets Fail?

1. Market failure occurs when:
(a) The government intervenes too much in the economy
(b) The market allocates resources efficiently
(c) The market fails to allocate resources efficiently
(d) There is perfect competition among firms in the market

2. Which of the following is a reason why markets fail?
   (a) Lack of consumer demand for goods and services
   (b) Excessive government regulations in the market
   (c) High levels of competition among firms
   (d) Efficient allocation of resources by the market
3. Externalities refer to:
   (a) The government's role in the market
   (b) The benefits or costs of production that spill over to affect third parties
   (c) The changes in supply and demand in the market
   (d) The fluctuations in stock prices
4. Which of the following is an example of a negative externality?
   (a) A company providing scholarships to local students
   (b) The construction of a new park in the neighborhood
   (c) Pollution from a factory affecting nearby residents
   (d) Government subsidies to support renewable energy
5. Public goods are characterized by:
   (a) Rivalry in consumption and exclusion of non-payers
   (b) Rivalry in consumption and non-exclusion of non-payers
   (c) Non-rivalry in consumption and exclusion of non-payers
   (d) Non-rivalry in consumption and non-exclusion of non-payers
6. The free-rider problem refers to:
   (a) Consumers demanding more goods than producers can supply
   (b) Firms in the market charging excessively high prices for their products
   (c) People benefiting from a public good without contributing to its provision
   (d) Government intervention causing market inefficiencies
7. Which of the following is a reason for market failure?
   (a) Well-defined property rights and contract enforcement
   (b) Perfect information and transparency in the market
   (c) Externalities and market imperfections
   (d) Equal distribution of income among consumers

8. Government intervention to correct market failure aims to:
   (a) Eliminate all externalities and market distortions
   (b) Replace the market mechanism with central planning
   (c) Reduce competition and increase market power for firms
   (d) Improve market efficiency and promote economic welfare

1.4 Public Goods

1. Public goods are characterized by:
   (a) Rivalry in consumption and exclusion of non-payers
   (b) Rivalry in consumption and non-exclusion of non-payers
   (c) Non-rivalry in consumption and exclusion of non-payers
   (d) Non-rivalry in consumption and non-exclusion of non-payers
2. Which of the following is a characteristic of a public good?
   (a) It is produced and provided by private companies
   (b) It can only be consumed by one person at a time
   (c) Consumers can be excluded from consuming the good
   (d) Consumption by one person does not reduce its availability to others
3. National defense is an example of a public good because:
   (a) It is provided by private firms in the market
   (b) It is non-excludable, and consumption by one person does not diminish its availability to others
   (c) It is rivalrous in consumption, and one person's consumption reduces its availability to others
   (d) It can be selectively provided to certain individuals based on their willingness to pay
4. Which of the following statements is true regarding public goods?
   (a) Private firms have a strong incentive to produce public goods due to high profits
   (b) Public goods are usually provided by the government to ensure widespread access
   (c) Public goods are always rivalrous in consumption
   (d) Public goods have well-defined property rights for exclusive use

5. One of the main challenges with public goods is the:
   (a) High cost of production and provision
   (b) Difficulty in excluding non-payers from consuming the good
   (c) Lack of consumer demand for such goods
   (d) Rivalry in consumption, leading to scarcity
6. Free-rider problem refers to the situation where:
   (a) Consumers demand more goods than producers can supply
   (b) Firms in the market charge excessively high prices for their products
   (c) People benefit from a public good without contributing to its provision
   (d) Government intervention causes market inefficiencies
7. Which of the following is NOT an example of a public good?
   (a) Street lighting in a city
   (b) National defense and military protection
   (c) A private toll road with restricted access
   (d) Air pollution control to benefit the entire community
8. The concept of public goods is relevant to:
   (a) Only developed countries with strong governments
   (b) Both developed and developing countries
   (c) Only developing countries with limited resources
   (d) Only countries with a large population

1.5 Incomplete Information

1. In economics, incomplete information refers to:
   (a) Situations where consumers have perfect knowledge about the goods and services they purchase
   (b) Situations where producers have perfect knowledge about the costs of production
   (c) Situations where there is uncertainty or asymmetry of information between buyers and sellers
   (d) Situations where government regulations provide complete information to all market participants

2. Asymmetric information occurs when:
   (a) Buyers and sellers have equal knowledge about the quality of goods and services
   (b) One party in a transaction has more information than the other
   (c) Government agencies provide information to all market participants
   (d) Market participants have perfect knowledge about market prices
3. Moral hazard refers to:
   (a) The risk that one party in a transaction will take advantage of the other's lack of information
   (b) The risk that market prices will change due to new information becoming available
   (c) The risk that a party will deliberately take actions that increase the probability of a negative outcome
   (d) The risk that one party will change the terms of a contract after it is agreed upon
4. Adverse selection occurs when:
   (a) Buyers and sellers have equal knowledge about the quality of goods and services
   (b) One party in a transaction has more information about the product's quality than the other
   (c) The government provides complete information to all market participants
   (d) Market participants have perfect knowledge about market prices
5. In the context of insurance markets, adverse selection refers to:
   (a) The tendency for high-risk individuals to seek insurance coverage more than low-risk individuals
   (b) The tendency for insurance companies to offer low premiums to attract more customers
   (c) The presence of government regulations that ensure complete information for insurance buyers
   (d) The equal access to insurance products for all individuals, regardless of their risk profile

6. Which of the following is an example of adverse selection in the used car market?
   (a) A seller providing complete information about a car's history to potential buyers
   (b) A buyer knowing more about a car's hidden defects than the seller
   (c) A government agency regulating the prices of used cars
   (d) All used cars being sold at the same price regardless of their condition
7. How can market participants mitigate the problem of incomplete information?
   (a) By increasing government regulations and oversight
   (b) By sharing more information with each other
   (c) By avoiding any form of insurance contracts
   (d) By refusing to engage in any transactions
8. The problem of adverse selection is most commonly observed in markets for:
   (a) Luxury goods and services
   (b) Essential commodities and basic necessities
   (c) Used cars and insurance products
   (d) Government-subsidized products

1.6 Government Intervention to Minimize Market Power

1. Market power refers to:
   (a) The ability of the government to control market prices
   (b) The dominance of a single firm or a group of firms in a market
   (c) The efficiency of markets in allocating resources
   (d) The absence of government regulations in the market
2. Why is market power a concern for policymakers?
   (a) Market power leads to perfect competition and efficient markets
   (b) Market power can lead to higher prices and reduced consumer choice
   (c) Market power promotes innovation and technological advancements
   (d) Market power ensures equitable distribution of wealth in society

3. Government intervention to minimize market power is aimed at:
   (a) Promoting monopolistic practices for economic growth
   (b) Encouraging firms to merge and create larger entities
   (c) Increasing barriers to entry for new firms in the market
   (d) Preventing anti-competitive behavior and promoting competition
4. Which of the following is an example of government intervention to minimize market power?
   (a) Implementing price controls to regulate market prices
   (b) Providing subsidies to dominant firms in the market
   (c) Granting exclusive licenses to companies to operate in a specific industry
   (d) Enforcing antitrust laws to prevent monopolistic practices
5. Antitrust laws are designed to:
   (a) Facilitate mergers and acquisitions between large firms
   (b) Restrict the entry of foreign companies in the domestic market
   (c) Promote fair competition and prevent monopolistic practices
   (d) Allow companies to engage in price-fixing agreements
6. A merger between two large companies in the same industry may raise concerns about:
   (a) Increased competition in the market
   (b) Lower prices and better consumer choice
   (c) Potential abuse of market power and reduced competition
   (d) A more efficient allocation of resources
7. How can the government promote competition and minimize market power?
   (a) By providing subsidies and incentives to dominant firms
   (b) By imposing price controls to limit price fluctuations
   (c) By enforcing antitrust laws and regulating mergers and acquisitions
   (d) By granting exclusive licenses to companies for specific industries
8. The primary goal of government intervention to minimize market power is to:
   (a) Ensure maximum profits for dominant firms in the market
   (b) Restrict consumer choice and options to prevent market inefficiencies
   (c) Promote competition and protect consumers from unfair practices
   (d) Stifle innovation and technological advancements in the market

1.7 Government Intervention to Correct Externalities

1. Externalities refer to:
   (a) The benefits or costs of production that spill over to affect third parties
   (b) The government's intervention in the market to control prices
   (c) The equal distribution of income and wealth in society
   (d) The fluctuations in supply and demand in the market
2. Negative externalities occur when:
   (a) The government imposes taxes to fund public goods
   (b) The costs of production are borne by producers alone
   (c) The benefits of production are enjoyed by consumers alone
   (d) The costs of production are imposed on third parties not involved in the transaction
3. Which of the following is an example of a negative externality?
   (a) A company providing scholarships to local students
   (b) The construction of a new park in the neighborhood
   (c) Pollution from a factory affecting nearby residents
   (d) Government subsidies to support renewable energy
4. To correct negative externalities, the government can use:
   (a) Subsidies to encourage more production of goods with negative externalities
   (b) Taxes to discourage the production of goods with negative externalities
   (c) Import tariffs to protect domestic industries
   (d) Price controls to regulate the prices of goods with negative externalities
5. Positive externalities occur when:
   (a) The government provides subsidies to firms to promote production
   (b) The costs of production are imposed on third parties not involved in the transaction
   (c) The benefits of production are enjoyed by producers alone
   (d) The benefits of production spill over to benefit third parties not involved in the transaction

6. Which of the following is an example of a positive externality?
   (a) A company selling a product at a higher price than its competitors
   (b) A vaccination program reducing the spread of infectious diseases in a community
   (c) A government imposing high tariffs on imported goods
   (d) A company causing pollution that affects the health of nearby residents
7. To correct positive externalities, the government can use:
   (a) Subsidies to discourage the production of goods with positive externalities
   (b) Taxes to reduce consumption of goods with positive externalities
   (c) Regulations to limit the benefits of production to certain individuals
   (d) Subsidies to encourage the production of goods with positive externalities
8. The main goal of government intervention to correct externalities is to:
   (a) Completely eliminate all externalities from the market
   (b) Reduce the efficiency of market transactions
   (c) Internalize external costs or benefits to achieve a more optimal outcome
   (d) Limit the role of government in economic activities

1.8 Government Intervention in the Case of Merit Goods

1. Merit goods are characterized by:
   (a) Being produced and provided by private companies only
   (b) High prices and limited accessibility for all consumers
   (c) Having positive externalities and being under-consumed in the market
   (d) Being rivalrous in consumption and subject to market failures
2. Which of the following is an example of a merit good?
   (a) Luxury cars with high price tags
   (b) Fast food items with excessive sugar and fat content
   (c) Public education and healthcare services
   (d) Designer clothing and accessories

3. Merit goods are typically:
   (a) Overprovided in the market due to high consumer demand
   (b) Subject to competitive market forces and price fluctuations
   (c) Underprovided in the market due to positive externalities
   (d) Provided by private companies with no government involvement
4. To encourage the consumption of merit goods, the government can:
   (a) Impose taxes to reduce consumption and limit negative externalities
   (b) Provide subsidies to consumers to lower the prices of these goods
   (c) Deregulate the market to allow for greater competition
   (d) Implement price controls to keep the prices stable
5. The primary goal of government intervention in the case of merit goods is to:
   (a) Limit consumer choice and promote government-controlled markets
   (b) Increase the prices of these goods to generate more government revenue
   (c) Ensure that consumers have access to these goods despite their positive externalities
   (d) Eliminate the production of merit goods to reduce market inefficiencies
6. One of the challenges of government intervention in providing merit goods is:
   (a) Overconsumption and excessive demand for these goods
   (b) The difficulty in identifying which goods have positive externalities
   (c) The lack of interest from private companies to produce merit goods
   (d) The need to impose high taxes on consumers to fund the provision of these goods
7. In the case of merit goods, the government's role is to:
   (a) Completely replace the private sector in providing these goods
   (b) Let the market forces determine their prices and availability
   (c) Encourage private companies to overproduce these goods for profit
   (d) Correct market failures by ensuring adequate provision of these goods

8. Which of the following is a potential consequence of inadequate provision of merit goods in society?
   (a) Increased consumption of harmful goods with negative externalities
   (b) Lower government expenditures and reduced budget deficits
   (c) Higher prices of merit goods due to excessive demand
   (d) A more efficient allocation of resources in the market

1.9 Government Intervention in the Case of Demerit Goods

1. Demerit goods are characterized by:
   (a) Having positive externalities and being under-consumed in the market
   (b) High prices and limited accessibility for all consumers
   (c) Having negative externalities and being over-consumed in the market
   (d) Being rivalrous in consumption and subject to market failures
2. Which of the following is an example of a demerit good?
   (a) Organic fruits and vegetables
   (b) Cigarettes and tobacco products
   (c) Public education and healthcare services
   (d) Renewable energy sources
3. Demerit goods are typically:
   (a) Overprovided in the market due to high consumer demand
   (b) Subject to competitive market forces and price fluctuations
   (c) Underprovided in the market due to negative externalities
   (d) Provided by private companies with no government involvement
4. To discourage the consumption of demerit goods, the government can:
   (a) Impose taxes to reduce consumption and internalize negative externalities
   (b) Provide subsidies to consumers to lower the prices of these goods
   (c) Deregulate the market to allow for greater competition
   (d) Implement price controls to keep the prices stable

5. The primary goal of government intervention in the case of demerit goods is to:
   (a) Limit consumer choice and promote government-controlled markets
   (b) Increase the prices of these goods to generate more government revenue
   (c) Reduce the consumption of these goods due to their negative externalities
   (d) Encourage the production of demerit goods for profit
6. One of the challenges of government intervention in discouraging demerit goods is:
   (a) Overconsumption and excessive demand for these goods
   (b) The difficulty in identifying which goods have negative externalities
   (c) The lack of interest from private companies to produce demerit goods
   (d) The need to provide subsidies to consumers to increase consumption
7. In the case of demerit goods, the government's role is to:
   (a) Completely replace the private sector in providing these goods
   (b) Let the market forces determine their prices and availability
   (c) Encourage private companies to overproduce these goods for profit
   (d) Correct market failures by discouraging the consumption of these goods
8. Which of the following is a potential consequence of excessive consumption of demerit goods in society?
   (a) Reduced government expenditures and increased budget surplus
   (b) Higher healthcare costs and negative health outcomes
   (c) Lower prices of demerit goods due to excessive demand
   (d) Improved allocation of resources in the market

1.10 Government Intervention in the Case of Public Goods

1. Public goods are characterized by:
   (a) Rivalry in consumption and exclusion of non-payers
   (b) Rivalry in consumption and non-exclusion of non-payers
   (c) Non-rivalry in consumption and exclusion of non-payers
   (d) Non-rivalry in consumption and non-exclusion of non-payers

2. Which of the following is an example of a public good?
   (a) A private toll road with restricted access
   (b) National defense and military protection
   (c) A company providing exclusive memberships
   (d) Pollution from a factory affecting nearby residents
3. Public goods are typically:
   (a) Overprovided in the market due to high consumer demand
   (b) Subject to competitive market forces and price fluctuations
   (c) Underprovided in the market due to free-rider problem
   (d) Provided by private companies with no government involvement
4. The free-rider problem refers to:
   (a) Consumers demanding more goods than producers can supply
   (b) Firms in the market charging excessively high prices for their products
   (c) People benefiting from a public good without contributing to its provision
   (d) Government intervention causing market inefficiencies
5. To ensure the provision of public goods, the government can:
   (a) Impose taxes to fund the production of public goods
   (b) Provide subsidies to private firms to produce public goods
   (c) Deregulate the market to allow for greater competition
   (d) Implement price controls to regulate the prices of public goods
6. Which of the following is NOT a characteristic of public goods?
   (a) Non-rivalry in consumption
   (b) Non-exclusion of non-payers
   (c) Positive externalities associated with consumption
   (d) Under-consumption in the market
7. The primary goal of government intervention in the case of public goods is to:
   (a) Limit consumer choice and control the production of public goods
   (b) Increase prices of public goods to generate more government revenue
   (c) Ensure the provision of public goods despite free-rider problem
   (d) Encourage private companies to produce public goods for profit

8. Which of the following is a potential consequence of under-provision of public goods in society?
   (a) Excessive government spending and budget deficit
   (b) Lower taxes and reduced government expenditure
   (c) Lack of access to essential services and infrastructure
   (d) Inefficient allocation of resources in the market

1.11 Price Intervention: Non-Market Pricing

1. Non-market pricing refers to:
   (a) The pricing mechanism determined by supply and demand forces in a market
   (b) The setting of prices by the government or other authorities outside of the market forces
   (c) The practice of firms colluding to fix prices in a competitive market
   (d) The use of price controls to regulate market prices
2. Which of the following is an example of non-market pricing?
   (a) A company setting its product price based on market demand and production costs
   (b) The government capping the price of essential goods to control inflation
   (c) A competitive market where prices are determined solely by supply and demand
   (d) A company engaging in predatory pricing to drive competitors out of the market
3. Price controls are government interventions that:
   (a) Allow firms to set prices freely to maximize profits
   (b) Restrict the entry of new firms in the market to maintain price stability
   (c) Fix maximum or minimum prices for certain goods and services
   (d) Prohibit firms from engaging in price discrimination
4. Which of the following is an example of a price ceiling?
   (a) The government sets a minimum price for agricultural products to support farmers
   (b) A city government caps the rent that landlords can charge for residential properties

   (c) A company raises its product price to increase profit margins
   (d) The government allows free-market forces to determine the price of luxury goods
5. Price floors are designed to:
   (a) Prevent price discrimination in the market
   (b) Stabilize prices during periods of high inflation
   (c) Encourage competition among firms to lower prices
   (d) Set a minimum price for certain goods to support producers
6. The primary purpose of implementing non-market pricing measures like price controls is to:
   (a) Allow firms to maximize profits by freely setting prices
   (b) Achieve an equitable distribution of income and wealth in society
   (c) Increase government revenue by taxing consumer purchases
   (d) Eliminate all market inefficiencies and imperfections
7. One of the potential drawbacks of price controls is:
   (a) The increased likelihood of price gouging by firms
   (b) The potential for excessive competition and price wars
   (c) The distortion of market signals and reduced incentives for producers
   (d) The elimination of all price fluctuations in the market
8. Non-market pricing measures are often implemented when:
   (a) The market is experiencing perfect competition and efficient price determination
   (b) There is a need to correct externalities and market failures
   (c) The government seeks to maximize profits for firms
   (d) Consumers demand lower prices for goods and services

1.12 Government Intervention for Correcting Information Failure

1. Information failure refers to:
   (a) The inability of the government to regulate markets effectively
   (b) The situation where the government has access to all relevant information
   (c) The lack of information or asymmetric information in the market
   (d) The government's interference in market pricing mechanisms

2. Asymmetric information occurs when:
   (a) The government provides complete information to all market participants
   (b) Market participants have equal knowledge about market prices
   (c) One party in a transaction has more information than the other
   (d) Buyers and sellers have equal knowledge about the quality of goods and services
3. Government intervention to correct information failure can involve:
   (a) Imposing price controls to regulate market prices
   (b) Providing subsidies to consumers to increase demand for goods
   (c) Encouraging firms to engage in price discrimination
   (d) Implementing regulations to ensure accurate and transparent information
4. Which of the following is an example of government intervention to correct information failure?
   (a) The government setting a maximum price for a particular good
   (b) The implementation of consumer protection laws to prevent deceptive advertising
   (c) The government providing subsidies to a specific industry
   (d) The enforcement of monopolistic practices by the government
5. The main goal of government intervention to correct information failure is to:
   (a) Control market prices to ensure affordability for consumers
   (b) Limit consumer choice and promote government-controlled markets
   (c) Improve market transparency and protect consumers from fraud
   (d) Increase government revenue by imposing higher taxes on businesses
6. How can government intervention help correct information failure in financial markets?
   (a) By increasing taxes on financial transactions
   (b) By imposing price controls on financial assets
   (c) By requiring companies to disclose accurate financial information
   (d) By limiting consumer access to financial products and services

7. One of the challenges of government intervention to correct information failure is:
   (a) The lack of willingness from firms to provide accurate information
   (b) The potential for excessive competition and price wars
   (c) The difficulty in identifying goods with positive externalities
   (d) The need to eliminate all market inefficiencies
8. Correcting information failure is essential to:
   (a) Ensure market prices are always at their equilibrium level
   (b) Encourage firms to engage in price discrimination
   (c) Achieve a more efficient allocation of resources in the market
   (d) Allow market forces to completely determine prices and quantities

1.13 Government Intervention for Equitable Distribution

1. Equitable distribution refers to:
   (a) The equal distribution of income and wealth among all individuals in society
   (b) The distribution of resources based on merit and individual effort
   (c) The concentration of wealth and income in the hands of a few individuals
   (d) The government's interference in market pricing mechanisms
2. Government intervention for equitable distribution can involve:
   (a) Implementing price controls to regulate market prices
   (b) Providing subsidies to high-income individuals to support their lifestyles
   (c) Imposing progressive taxation to redistribute wealth from the rich to the poor
   (d) Encouraging firms to engage in price discrimination
3. Which of the following is an example of government intervention for equitable distribution?
   (a) The government imposing a flat tax rate on all income levels
   (b) The implementation of consumer protection laws to ensure fair prices for goods
   (c) The government providing subsidies to wealthy individuals for luxury goods
   (d) The enforcement of monopolistic practices by the government

4. The main goal of government intervention for equitable distribution is to:
   (a) Control market prices to ensure affordability for consumers
   (b) Limit consumer choice and promote government-controlled markets
   (c) Achieve a more equal distribution of income and wealth in society
   (d) Increase government revenue by imposing higher taxes on businesses
5. How can progressive taxation help achieve a more equitable distribution of income?
   (a) By taxing low-income individuals at a higher rate than high-income individuals
   (b) By taxing high-income individuals at a higher rate than low-income individuals
   (c) By imposing a flat tax rate on all income levels
   (d) By eliminating taxes on all sources of income
6. One of the challenges of government intervention for equitable distribution is:
   (a) The potential for excessive competition and price wars
   (b) The lack of willingness from individuals to pay taxes for redistribution
   (c) The difficulty in identifying goods with positive externalities
   (d) The need to eliminate all market inefficiencies
7. In the context of equitable distribution, what is a means-tested benefit?
   (a) A benefit that is provided to all individuals regardless of their income level
   (b) A benefit that is provided based on specific criteria, such as income or assets
   (c) A benefit that is only available to high-income individuals
   (d) A benefit that is provided without any eligibility requirements
8. Correcting information failure is essential to:
   (a) Ensure market prices are always at their equilibrium level
   (b) Encourage firms to engage in price discrimination
   (c) Achieve a more efficient allocation of resources in the market
   (d) Allow market forces to completely determine prices and quantities

Answer

1.1 Introduction

1. (b) The market is unable to allocate resources efficiently
2. (d) Externalities and the absence of property rights
3. (a) The benefits or costs of production that spill over to affect third parties
4. (b) Vaccination programs reducing the spread of infectious diseases
5. (d) Imposing taxes or regulations to address externalities
6. (d) Non-rivalry in consumption and non-exclusion of non-payers
7. (c) People benefiting from a public good without contributing to its provision
8. (c) Improve market efficiency and promote economic welfare

   Explanation:

   Government intervention to correct market failure is intended to improve market efficiency and address the inefficiencies caused by externalities, public goods, and other market imperfections. It is not about completely replacing the market mechanism but rather about enhancing its functioning for the overall benefit of society.

1.2 The Concept of Market Failure

1. (c) The market fails to allocate resources efficiently
2. (c) Externalities and market imperfections
3. (b) The benefits or costs of production that spill over to affect third parties
4. (c) Pollution from a factory affecting nearby residents
5. (d) Non-rivalry in consumption and non-exclusion of non-payers
6. (c) People benefiting from a public good without contributing to its provision
7. (c) Overconsumption of natural resources leading to environmental degradation

8. (d) Improve market efficiency and promote economic welfare
Explanation:
Government intervention to correct market failure is intended to improve market efficiency and address the inefficiencies caused by externalities, public goods, and other market imperfections. The goal is to promote overall economic welfare and enhance the functioning of the market.

1.3 Why do Markets Fail?

1. (c) The market fails to allocate resources efficiently
2. (a) Lack of consumer demand for goods and services
3. (b) The benefits or costs of production that spill over to affect third parties
4. (c) Pollution from a factory affecting nearby residents
5. (d) Non-rivalry in consumption and non-exclusion of non-payers
6. (c) People benefiting from a public good without contributing to its provision
7. (c) Externalities and market imperfections
8. (d) Improve market efficiency and promote economic welfare
Explanation:
Government intervention to correct market failure is intended to improve market efficiency and address the inefficiencies caused by externalities, public goods, and other market imperfections. The goal is to promote overall economic welfare and enhance the functioning of the market.

1.4 Public Goods

1. (d) Non-rivalry in consumption and non-exclusion of non-payers
2. (d) Consumption by one person does not reduce its availability to others
3. (b) It is non-excludable, and consumption by one person does not diminish its availability to others
4. (b) Public goods are usually provided by the government to ensure widespread access
5. (b) Difficulty in excluding non-payers from consuming the good

6. (c) People benefit from a public good without contributing to its provision
7. (c) A private toll road with restricted access
8. (b) Both developed and developing countries
Explanation:
Public goods are relevant to both developed and developing countries, as they are goods or services that benefit society as a whole and have the characteristic of non-excludability, making them difficult to provide through private markets alone. Governments often play a role in providing public goods to ensure their widespread availability and consumption.

1.5 Incomplete Information

1. (c) Situations where there is uncertainty or asymmetry of information between buyers and sellers
2. (b) One party in a transaction has more information than the other
3. (c) The risk that a party will deliberately take actions that increase the probability of a negative outcome
4. (b) One party in a transaction has more information about the product's quality than the other
5. (a) The tendency for high-risk individuals to seek insurance coverage more than low-risk individuals
6. (b) A buyer knowing more about a car's hidden defects than the seller
7. (b) By sharing more information with each other
8. (c) Used cars and insurance products
Explanation:
Adverse selection is frequently observed in markets for used cars and insurance products, where the buyer's lack of information about the quality or risk can lead to potential issues and challenges.

1.6 Government Intervention to Minimize Market Power

1. (b) The dominance of a single firm or a group of firms in a market
2. (b) Market power can lead to higher prices and reduced consumer choice

3. (d) Preventing anti-competitive behavior and promoting competition
4. (d) Enforcing antitrust laws to prevent monopolistic practices
5. (c) Promote fair competition and prevent monopolistic practices
6. (c) Potential abuse of market power and reduced competition
7. (c) By enforcing antitrust laws and regulating mergers and acquisitions
8. (c) Promote competition and protect consumers from unfair practices

1.7 Government Intervention to Correct Externalities

1. (a) The benefits or costs of production that spill over to affect third parties
2. (d) The costs of production are imposed on third parties not involved in the transaction
3. (c) Pollution from a factory affecting nearby residents
4. (b) Taxes to discourage the production of goods with negative externalities
5. (d) The benefits of production spill over to benefit third parties not involved in the transaction
6. (b) A vaccination program reducing the spread of infectious diseases in a community
7. (d) Subsidies to encourage the production of goods with positive externalities
8 (c) Internalize external costs or benefits to achieve a more optimal outcome

1.8 Government Intervention in the Case of Merit Goods

1. (c) Having positive externalities and being under-consumed in the market
2. (c) Public education and healthcare services
3. (c) Underprovided in the market due to positive externalities
4. (b) Provide subsidies to consumers to lower the prices of these goods
5. (c) Ensure that consumers have access to these goods despite their positive externalities
6. (b) The difficulty in identifying which goods have positive externalities

7. (d) Correct market failures by ensuring adequate provision of these goods
8. (a) Increased consumption of harmful goods with negative externalities

1.9 Government Intervention in the Case of Demerit Goods

1. (c) Having negative externalities and being over-consumed in the market
2. (b) Cigarettes and tobacco products
3. (c) Underprovided in the market due to negative externalities
4. (a) Impose taxes to reduce consumption and internalize negative externalities
5. (c) Reduce the consumption of these goods due to their negative externalities
6. (b) The difficulty in identifying which goods have negative externalities
7. (d) Correct market failures by discouraging the consumption of these goods
8. (b) Higher healthcare costs and negative health outcomes

1.10 Government Intervention in the Case of Public Goods

1. (d) Non-rivalry in consumption and non-exclusion of non-payers
2. (b) National defense and military protection
3. (c) Underprovided in the market due to free-rider problem
4. (c) People benefiting from a public good without contributing to its provision
5. (a) Impose taxes to fund the production of public goods
6. (c) Positive externalities associated with consumption
7. (c) Ensure the provision of public goods despite free-rider problem
8. (c) Lack of access to essential services and infrastructure

1.11 Price Intervention: Non-Market Pricing

1. (b) The setting of prices by the government or other authorities outside of the market forces
2. (b) The government capping the price of essential goods to control inflation

3. (c) Fix maximum or minimum prices for certain goods and services
4. (b) A city government caps the rent that landlords can charge for residential properties
5. (d) Set a minimum price for certain goods to support producers
6. (b) Achieve an equitable distribution of income and wealth in society
7. (c) The distortion of market signals and reduced incentives for producers
8. (b) There is a need to correct externalities and market failures

1.12 Government Intervention for Correcting Information Failure

1. (c) The lack of information or asymmetric information in the market
2. (c) One party in a transaction has more information than the other
3. (d) Implementing regulations to ensure accurate and transparent information
4. (b) The implementation of consumer protection laws to prevent deceptive advertising
5. (c) Improve market transparency and protect consumers from fraud
6. (c) By requiring companies to disclose accurate financial information
7. (a) The lack of willingness from firms to provide accurate information
8. (c) Achieve a more efficient allocation of resources in the market

1.13 Government Intervention for Equitable Distribution

1. (a) The equal distribution of income and wealth among all individuals in society
2. (c) Imposing progressive taxation to redistribute wealth from the rich to the poor
3. (a) The government imposing a flat tax rate on all income levels
4. (c) Achieve a more equal distribution of income and wealth in society
5. (b) By taxing high-income individuals at a higher rate than low-income individuals
6. (b) The lack of willingness from individuals to pay taxes for redistribution
7. (b) A benefit that is provided based on specific criteria, such as income or assets
8. (c) Achieve a more efficient allocation of resources in the market

7 PUBLIC FINANCE

Unit:3 The Process of Budget Making: Sources of Revenue, Expenditure Management and Management of Public Debt

Multiple Choice Questions

1.1 Introduction

1. What is the primary purpose of the government budget?
   (a) To maximize government revenue through taxes.
   (b) To allocate resources efficiently in the economy.
   (c) To manage public debt and reduce fiscal deficits.
   (d) To outline the government's financial plans and policies for the fiscal year.

   Answer:
   (d) To outline the government's financial plans and policies for the fiscal year.

   Explanation:
   The primary purpose of the government budget is to outline the government's financial plans, policies, and priorities for the upcoming fiscal year, including sources of revenue, expenditure management, and debt management.

2. Which of the following is considered a source of government revenue?
   (a) Issuing bonds and borrowing from international lenders.
   (b) Providing subsidies to low-income individuals.
   (c) Investing in infrastructure development.
   (d) Collecting taxes from individuals and businesses.

   Answer:
   (d) Collecting taxes from individuals and businesses.

Explanation:
Collecting taxes from individuals and businesses is a significant source of government revenue.

3. What is revenue expenditure in the government budget?
   (a) Investment in long-term assets like infrastructure.
   (b) Day-to-day expenses like salaries and subsidies.
   (c) Transferring funds to other levels of government.
   (d) Borrowing money from foreign countries.

Answer:
(b) Day-to-day expenses like salaries and subsidies.

Explanation:
Revenue expenditure in the government budget refers to day-to-day expenses incurred by the government, such as salaries of government employees, subsidies, and other operational costs.

4. How can the government manage public debt effectively?
   (a) By reducing taxes to increase disposable income.
   (b) By increasing government spending on social programs.
   (c) By ensuring that debt remains sustainable with manageable interest payments.
   (d) By borrowing more to fund large infrastructure projects.

Answer:
(c) By ensuring that debt remains sustainable with manageable interest payments.

Explanation:
Effective management of public debt involves ensuring that the debt remains sustainable, with manageable interest payments and repayment obligations, to avoid fiscal crises.

5. Why is the government budget subject to public debate and scrutiny?
   (a) To determine the profitability of government projects.
   (b) To assess the performance of government employees.
   (c) To evaluate the effectiveness of government policies.
   (d) To promote competition among different government agencies.

Answer:
(c) To evaluate the effectiveness of government policies.

Explanation:
The government budget is subject to public debate and scrutiny to evaluate the effectiveness of government policies and ensure that public funds are used efficiently to meet the needs of citizens.

6. Which of the following is NOT a source of government revenue?
   (a) Income tax
   (b) Sales tax
   (c) Government grants to businesses
   (d) Corporate tax

Answer:
(c) Government grants to businesses

Explanation:
Government grants to businesses are not a source of government revenue but rather an expenditure item in the budget.

7. What is the difference between capital expenditure and revenue expenditure?
   (a) Capital expenditure relates to expenses on public infrastructure, while revenue expenditure relates to interest payments on public debt.
   (b) Capital expenditure includes investments in long-term assets, while revenue expenditure includes day-to-day expenses like salaries and subsidies.
   (c) Capital expenditure is funded through taxes, while revenue expenditure is funded through borrowing.
   (d) Capital expenditure is decided by the central bank, while revenue expenditure is decided by the finance ministry.

Answer:
(b) Capital expenditure includes investments in long-term assets, while revenue expenditure includes day-to-day expenses like salaries and subsidies.

Explanation:
Capital expenditure involves investments in long-term assets like infrastructure, while revenue expenditure includes day-to-day expenses required for the normal functioning of the government.

8. Why is effective management of public debt important for the government?
   (a) To maximize government profits.
   (b) To reduce government spending.
   (c) To ensure sustainable fiscal policy and debt repayment.
   (d) To encourage private investment in the economy.

   Answer:

   (c) To ensure sustainable fiscal policy and debt repayment.

   Explanation:

   Effective management of public debt is important for the government to ensure that its fiscal policy remains sustainable, and it can meet its debt repayment obligations without facing financial crises.

9. What is the ultimate goal of the budget-making process?
   (a) To maximize government control over the economy.
   (b) To minimize government interference in the market.
   (c) To achieve economic growth and development.
   (d) To promote fairness and social justice in resource distribution.

   Answer:

   (d) To promote fairness and social justice in resource distribution.

   Explanation:

   The ultimate goal of the budget-making process is to promote fairness and social justice by allocating resources in a way that benefits the entire society and addresses the needs of various sections of the population.

1.2 The Process of Budget Making

1. What is the first step in the process of budget making?
   (a) Setting financial goals and objectives.
   (b) Estimating government revenue for the fiscal year.
   (c) Allocating funds to various ministries and departments.
   (d) Presenting the budget to the public.

   Answer:

   (a) Setting financial goals and objectives.

   Explanation:

   The first step in the process of budget making involves setting financial goals and objectives that the government aims to achieve in the upcoming fiscal year.

2. Which government agency is responsible for preparing the budget in most countries?
   (a) The central bank.
   (b) The finance ministry or treasury department.
   (c) The department of taxation.
   (d) The ministry of economic planning.

   Answer:

   (b) The finance ministry or treasury department.

   Explanation:

   In most countries, the finance ministry or treasury department is responsible for preparing the budget, coordinating with various government departments and agencies.

3. The fiscal year for most governments typically runs from:
   (a) January 1st to December 31st.
   (b) April 1st to March 31st.
   (c) July 1st to June 30th.
   (d) October 1st to September 30th.

   Answer: (b) April 1st to March 31st.

   Explanation:

   The fiscal year for most governments typically runs from April 1st to March 31st of the following year.

4. During the budget making process, the estimation of government revenue includes:
   (a) Only tax revenue and non-tax revenue.
   (b) Tax revenue, non-tax revenue, and borrowing.
   (c) Tax revenue, non-tax revenue, borrowing, and grants.
   (d) Only borrowing and grants.

   Answer:

   (c) Tax revenue, non-tax revenue, borrowing, and grants.

Explanation:
During the budget making process, the estimation of government revenue includes various sources such as tax revenue, non-tax revenue (dividends, interest, etc.), borrowing (if necessary), and grants from international organizations or other countries.

5. After the budget is prepared by the finance ministry, it is presented to:
(a) The president or prime minister.
(b) The central bank governor.
(c) The parliament or legislature.
(d) The ministry of economic planning.

Answer:
(c) The parliament or legislature.

Explanation:
After the budget is prepared by the finance ministry, it is presented to the parliament or legislature for approval and discussion before it becomes law.

6. The fiscal year in many countries typically runs from:
(a) January 1st to December 31^{st}.
(b) April 1st to March 31^{st}.
(c) July 1st to June 30^{th}.
(d) October 1st to September 30^{th}.

Answer:
(b) April 1st to March 31st.

Explanation:
The fiscal year in many countries, including India, typically runs from April 1st to March 31st.

7. Which government official is responsible for presenting the budget to the parliament or legislature?
(a) The Prime Minister
(b) The Finance Minister
(c) The President
(d) The Governor of the Central Bank

Answer:
(b) The Finance Minister

Explanation:
The Finance Minister is responsible for presenting the budget to the parliament or legislature on behalf of the government.

8. The "Budget Speech" usually includes:
(a) A detailed breakdown of individual taxpayers' contributions.
(b) Economic statistics of the previous fiscal year.
(c) A list of government employees and their salaries.
(d) Policy recommendations from opposition parties.

Answer:
(b) Economic statistics of the previous fiscal year.

Explanation:
The "Budget Speech" typically includes economic statistics and performance indicators of the previous fiscal year, as well as the government's economic and fiscal policy goals for the upcoming year.

9. After the budget is presented, it is usually sent to:
(a) The President for approval.
(b) The Supreme Court for review.
(c) The Central Bank for implementation.
(d) The Parliament or Legislature for approval and debate.

Answer:
(d) The Parliament or Legislature for approval and debate.

Explanation:
After the budget is presented, it is usually sent to the Parliament or Legislature for approval and debate. The budget undergoes scrutiny and discussion before it is officially approved.

1.3 Sources of Revenue

1. Which of the following is a direct source of government revenue?
(a) Sales tax
(b) Corporate tax
(c) Excise duty
(d) Value Added Tax (VAT)

Answer:
(b) Corporate tax

Explanation:
Corporate tax is a direct tax levied on the income of corporations and businesses, and it is a significant source of government revenue.

2. What is the primary source of revenue for the government in many countries?
(a) Personal income tax
(b) Goods and Services Tax (GST)
(c) Customs duties
(d) Corporate tax

Answer:
(a) Personal income tax

Explanation:
Personal income tax, which is levied on the income of individuals, is often the primary source of revenue for the government in many countries.

3. Revenue from non-tax sources may include:
(a) Income tax from individuals.
(b) Sales tax on goods.
(c) Dividends from state-owned enterprises.
(d) Corporate tax from private companies.

Answer:
(c) Dividends from state-owned enterprises.

Explanation:
Revenue from non-tax sources includes income generated from various non-tax activities, such as dividends from state-owned enterprises and interest income from loans given by the government.

4. Which of the following is an indirect source of government revenue?
(a) Property tax
(b) Goods and Services Tax (GST)
(c) Personal income tax
(d) Corporate tax

Answer:
(b) Goods and Services Tax (GST)

Explanation:
Goods and Services Tax (GST) is an indirect tax levied on the sale of goods and services, and it is an important source of government revenue.

5. Revenue from external sources may include:
(a) Income tax from individuals and corporations.
(b) Sales tax on goods and services.
(c) Foreign aid and grants from other countries.
(d) Dividends from state-owned enterprises.

Answer:
(c) Foreign aid and grants from other countries.

Explanation:
Revenue from external sources includes income received from foreign aid and grants provided by other countries to support specific projects or development initiatives.

6. Which of the following is a direct tax?
(a) Goods and Services Tax (GST)
(b) Corporate Tax
(c) Excise Duty
(d) Customs Duty

Answer:
(b) Corporate Tax

Explanation:
Direct taxes are taxes that are directly levied on individuals and entities. Corporate tax is a type of direct tax that is imposed on the income of corporations or companies.

7. Which of the following is an indirect tax?
(a) Income Tax
(b) Wealth Tax
(c) Sales Tax
(d) Property Tax

Answer:
(c) Sales Tax

Explanation:
Indirect taxes are taxes that are imposed on goods and services, and the burden of these taxes is passed on to the consumers. Sales tax is an example of an indirect tax.

8. Which of the following sources of revenue is considered non-tax revenue?
(a) Income Tax
(b) Customs Duty
(c) Dividends from state-owned enterprises
(d) Goods and Services Tax (GST)

Answer:
(c) Dividends from state-owned enterprises

Explanation:
Non-tax revenue refers to the revenue earned by the government from sources other than taxes. Dividends received from state-owned enterprises are considered non-tax revenue.

9. Which of the following taxes is levied on the value added at each stage of production or distribution?
(a) Income Tax
(b) Goods and Services Tax (GST)
(c) Excise Duty
(d) Property Tax

Answer:
(b) Goods and Services Tax (GST)

Explanation:
Goods and Services Tax (GST) is a value-added tax that is levied on the value added at each stage of production or distribution of goods and services.

10. Which of the following is an example of an external source of revenue for the government?
(a) Income Tax
(b) Corporate Tax
(c) Foreign Aid
(d) Sales Tax

Answer:
(c) Foreign Aid

Explanation:
Foreign aid refers to financial assistance provided to a country by other countries or international organizations. It is an example of an external source of revenue for the government.

1.4 Public Expenditure Management

1. What is the main objective of public expenditure management?
(a) To increase government revenue through taxation.
(b) To maximize government spending on welfare programs.
(c) To ensure efficient allocation of resources for public goods and services.
(d) To reduce government involvement in the economy.

Answer:
(c) To ensure efficient allocation of resources for public goods and services.

Explanation:
The main objective of public expenditure management is to ensure that government resources are allocated efficiently to provide public goods and services that benefit society.

2. Which of the following is an example of capital expenditure?
(a) Payment of salaries to government employees.
(b) Investment in building new schools and hospitals.
(c) Subsidies provided to low-income families.
(d) Interest payments on public debt.

Answer:
(b) Investment in building new schools and hospitals.

Explanation:
Capital expenditure refers to investments in long-term assets like infrastructure, such as building new schools and hospitals.

3. What is the difference between revenue expenditure and capital expenditure?
(a) Revenue expenditure relates to investments in long-term assets, while capital expenditure includes day-to-day expenses.

(b) Revenue expenditure includes day-to-day expenses, while capital expenditure relates to interest payments on public debt.
(c) Revenue expenditure is funded through borrowing, while capital expenditure is funded through taxes.
(d) Revenue expenditure is incurred on regular operations, while capital expenditure is incurred on long-term assets.

Answer:

(d) Revenue expenditure is incurred on regular operations, while capital expenditure is incurred on long-term assets.

Explanation:

Revenue expenditure includes day-to-day expenses required for the normal functioning of the government, while capital expenditure involves investments in long-term assets.

4. Which of the following is an example of transfer payments?
(a) Investment in infrastructure development.
(b) Payment of salaries to government employees.
(c) Subsidies provided to farmers.
(d) Interest payments on public debt.

Answer:

(c) Subsidies provided to farmers.

Explanation: Transfer payments refer to payments made by the government to individuals or other levels of government without any corresponding goods or services being received in return. Subsidies provided to farmers are an example of transfer payments.

5. Why is effective public expenditure management important for the government?
(a) To reduce government revenue through taxation.
(b) To increase government control over the economy.
(c) To ensure that public funds are used efficiently and effectively.
(d) To minimize government spending on welfare programs.

Answer:

(c) To ensure that public funds are used efficiently and effectively.

Explanation:

Effective public expenditure management is important to ensure that public funds are used efficiently and effectively to achieve the government's policy objectives and provide essential services to the public.

6. What is public expenditure management?
(a) 'The process of managing private sector spending in the economy
(b) The process of allocating and controlling government spending
(c) The process of managing public debt and borrowing
(d) The process of managing foreign aid and grants

Answer:

(b) The process of allocating and controlling government spending

Explanation:

Public expenditure management refers to the process of planning, allocating, and controlling government spending to achieve various economic and social objectives.

7. Which of the following is not a primary objective of public expenditure management?
(a) Promoting economic growth and development
(b) Ensuring price stability in the economy
(c) Reducing income inequality and poverty
(d) Maximizing government revenue through taxation

Answer:

(d) Maximizing government revenue through taxation

Explanation:

While maximizing government revenue is an important aspect of public finance, it is not the primary objective of public expenditure management. The primary focus is on how the government allocates and controls its spending.

8. Fiscal policy is closely related to public expenditure management because:
(a) Fiscal policy determines the level of government spending
(b) Public expenditure management is a part of fiscal policy

(c) Both involve controlling the money supply in the economy
(d) Fiscal policy focuses on regulating private sector spending only

Answer:
(a) Fiscal policy determines the level of government spending

Explanation:
Fiscal policy refers to the use of government spending and taxation to influence the economy. Public expenditure management is an integral part of fiscal policy, as it involves deciding how much the government spends on various programs and projects.

9. What is the role of budgeting in public expenditure management?
(a) Budgeting helps the government increase taxes for revenue generation
(b) Budgeting ensures that government spending aligns with its policy priorities
(c) Budgeting allows the government to control private sector investments
(d) Budgeting helps the government manage international trade relations

Answer:
(b) Budgeting ensures that government spending aligns with its policy priorities

Explanation:
Budgeting is a crucial component of public expenditure management as it helps the government allocate funds to various sectors and programs based on its policy priorities and objectives.

10. One of the challenges in public expenditure management is:
(a) The inability of the government to borrow from international financial institutions
(b) The difficulty in increasing government spending to stimulate economic growth
(c) The lack of transparency and accountability in budget execution
(d) The lack of demand for public goods and services in the economy

Answer:
(c) The lack of transparency and accountability in budget execution

Explanation:
Transparency and accountability in budget execution are essential for ensuring that public funds are used efficiently and effectively. Lack of transparency can lead to mismanagement and corruption.

11. What is the role of the legislature in public expenditure management?
(a) The legislature sets monetary policy to control government spending
(b) The legislature approves the national budget and oversees government spending
(c) The legislature controls the prices of public goods and services
(d) The legislature regulates international trade and tariffs

Answer:
(b) The legislature approves the national budget and oversees government spending

Explanation:
The legislature plays a critical role in public expenditure management by approving the national budget and monitoring government spending to ensure that it aligns with the approved budget.

12. In public expenditure management, "virement" refers to:
(a) The process of raising government revenue through taxes
(b) The process of reallocating funds between different budget items
(c) The process of managing foreign aid and grants
(d) The process of controlling inflation through monetary policy

Answer:
(b) The process of reallocating funds between different budget items

Explanation:
Virement in public expenditure management refers to the authority granted to government agencies to reallocate funds from one budget item to another within the approved budget, usually without seeking legislative approval.

13. What is the purpose of conducting performance evaluations in public expenditure management?
(a) To increase government spending on all sectors equally
(b) To determine the effectiveness and efficiency of government programs

(c) To limit public spending to only essential goods and services
(d) To ensure that all public expenditure is focused on defense and security

Answer:
(b) To determine the effectiveness and efficiency of government programs

Explanation:
Performance evaluations in public expenditure management help assess the impact and efficiency of government programs and ensure that resources are allocated to programs that deliver the best results. It enables the government to make informed decisions on budget allocations.

1.5 Public Debt Management

Budget concepts
Type of budgets
Sure! Here are some multiple-choice questions (MCQs) related to budget concepts and types of budgets along with their answers and explanations:

1. What is a budget?
   (a) A financial statement showing the revenue and expenses of a company
   (b) The total income of an individual or household
   (c) A plan that outlines expected income and expenses over a specific period
   (d) The total assets and liabilities of a government

   Answer:
   (c) A plan that outlines expected income and expenses over a specific period

   Explanation:
   A budget is a financial plan that outlines expected income and expenses for a specific period, usually a year. It helps individuals, households, businesses, and governments to manage their finances effectively.

2. Which of the following budgets is used by businesses to plan and control day-to-day operations?
   (a) Operating budget
   (b) Cash budget
   (c) Capital budget
   (d) Flexible budget

   Answer:
   (a) Operating budget

   Explanation:
   An operating budget is used by businesses to plan and control day-to-day operations, including revenue and expenses related to regular business activities.

3. A cash budget is essential for managing:
   (a) Long-term investments and capital projects
   (b) Short-term cash flow and liquidity
   (c) Marketing and advertising expenses
   (d) Employee salaries and benefits

   Answer:
   (b) Short-term cash flow and liquidity

   Explanation:
   A cash budget is used to manage short-term cash flow and liquidity, helping organizations ensure they have enough cash on hand to meet their financial obligations.

4. Which type of budget is most suitable for capital-intensive projects like building infrastructure?
   (a) Operating budget (b) Cash budget
   (c) Capital budget (d) Flexible budget

   Answer:
   (c) Capital budget

   Explanation:
   A capital budget is used to plan and control long-term investments and capital projects, such as building infrastructure, purchasing major equipment, or expanding facilities.

5. A flexible budget is useful for:
   (a) Controlling day-to-day expenses in a business
   (b) Allocating funds for specific capital projects
   (c) Adapting to changes in sales or production levels
   (d) Forecasting long-term revenue and expenses

   Answer:
   (c) Adapting to changes in sales or production levels

   Explanation:
   A flexible budget allows for adjustments in revenue and expenses based on changes in sales or production levels, providing a more accurate financial plan in dynamic business environments.
6. What is a master budget?
   (a) A budget prepared by individuals for personal financial planning
   (b) The total budget of a government for all its departments and agencies
   (c) The comprehensive budget that includes all individual budgets of a company
   (d) A budget prepared by businesses for short-term cash management

   Answer:
   (c) The comprehensive budget that includes all individual budgets of a company

   Explanation:
   A master budget is a comprehensive budget that includes all individual budgets of a company, such as the operating budget, capital budget, cash budget, and others. It represents the overall financial plan for the organization.
7. Zero-based budgeting requires:
   (a) Using the previous year's budget as a starting point for the new budget
   (b) Justifying every budgeted expense as if starting from scratch
   (c) Increasing the budget by a fixed percentage every year
   (d) Allocating funds based on the popularity of different programs

   Answer:
   (b) Justifying every budgeted expense as if starting from scratch

   Explanation:
   Zero-based budgeting requires justifying every budgeted expense as if starting from scratch, without considering the previous year's budget. This approach helps identify and prioritize essential expenses.
8. Incremental budgeting involves:
   (a) Reducing the budget by a fixed percentage every year
   (b) Increasing the budget by a fixed percentage every year
   (c) Allocating funds based on the popularity of different programs
   (d) Using the previous year's budget as a starting point for the new budget

   Answer:
   (d) Using the previous year's budget as a starting point for the new budget

   Explanation:
   Incremental budgeting involves using the previous year's budget as a starting point for the new budget and then making adjustments or incremental changes based on new priorities or requirements.

Capital Receipts

9. Capital receipts refer to:
   (a) Money received from selling goods and services
   (b) Revenue earned from taxes and fines
   (c) Funds raised through long-term borrowing or the sale of assets
   (d) Money received from grants and subsidies

   Answer:
   (c) Funds raised through long-term borrowing or the sale of assets

   Explanation:
   Capital receipts represent funds raised by the government or an organization through long-term borrowing (e.g., issuing bonds) or the sale of assets (e.g., selling property or stocks).
10. Which of the following is an example of a capital receipt for a government?
   (a) Income tax collected from individuals
   (b) Revenue generated from selling government services

(c) Proceeds from selling government-owned land
(d) Grants received from other countries

Answer:

(c) Proceeds from selling government-owned land

Explanation:

Proceeds from selling government-owned land are considered a capital receipt because they represent funds obtained through the sale of a capital asset.

11. Non-debt capital receipts include:
(a) Borrowings and loans from financial institutions
(b) Revenue generated from taxes and fines
(c) Grants received from other countries
(d) Interest received on government loans

Answer:

(c) Grants received from other countries

Explanation:

Non-debt capital receipts consist of grants and aids received from other countries or international organizations, which do not create a debt obligation for the receiving country.

12. Why are capital receipts essential for a government's financial planning?
(a) They help the government generate revenue from taxes
(b) They enable the government to finance day-to-day expenses
(c) They provide funds for development projects and infrastructure
(d) They ensure the government's financial stability during economic downturns

Answer:

(c) They provide funds for development projects and infrastructure

Explanation:

Capital receipts provide funds that are crucial for financing long-term development projects, building infrastructure, and making capital investments.

13. Which of the following represents a debt capital receipt for a government?
(a) Revenue earned from government services
(b) Proceeds from the sale of government assets

(c) Borrowing from the central bank
(d) Grants received from international organizations

Answer:

(c) Borrowing from the central bank

Explanation:

Borrowing from the central bank or financial institutions creates a debt obligation for the government, making it a debt capital receipt.

14. How are capital receipts different from revenue receipts?
(a) Capital receipts are used to finance day-to-day expenses, while revenue receipts are used for long-term projects.
(b) Capital receipts represent funds raised through long-term borrowing or asset sales, while revenue receipts represent funds from regular income sources like taxes and fines.
(c) Capital receipts are non-tax revenue, while revenue receipts are tax revenue.
(d) Capital receipts are received from foreign countries, while revenue receipts are domestic receipts.

Answer:

(b) Capital receipts represent funds raised through long-term borrowing or asset sales, while revenue receipts represent funds from regular income sources like taxes and fines.

Explanation:

Capital receipts are funds raised through long-term borrowing or the sale of assets, while revenue receipts represent funds from regular income sources like taxes, fines, and fees.

15. Government bonds and securities issued to the public represent:
(a) Capital expenditure (b) Capital receipts
(c) Revenue expenditure (d) Revenue receipts

Answer:

(b) Capital receipts

Explanation:

Government bonds and securities issued to the public are capital receipts as they represent funds raised through long-term borrowing.

16. How do capital receipts impact the fiscal deficit of a government?
 (a) Capital receipts decrease the fiscal deficit
 (b) Capital receipts have no impact on the fiscal deficit
 (c) Capital receipts increase the fiscal deficit
 (d) Capital receipts eliminate the fiscal deficit

 Answer:
 (a) Capital receipts decrease the fiscal deficit

 Explanation:
 Capital receipts, especially non-debt capital receipts, can help reduce the fiscal deficit by providing additional funds to the government without increasing debt burden.

Revenue Receipts

17. Revenue receipts refer to:
 (a) Funds raised through long-term borrowing or the sale of assets
 (b) Money received from selling goods and services
 (c) Revenue earned from taxes, fines, and other regular income sources
 (d) Grants and aids received from other countries

 Answer:
 (c) Revenue earned from taxes, fines, and other regular income sources

 Explanation:
 Revenue receipts represent funds generated by a government or organization from regular income sources, such as taxes, fines, fees, and other non-borrowed or non-capital sources.

18. Which of the following is an example of a revenue receipt for a government?
 (a) Proceeds from selling government-owned land
 (b) Borrowings from financial institutions
 (c) Income tax collected from individuals and businesses
 (d) Grants received from international organizations

 Answer:
 (c) Income tax collected from individuals and businesses

 Explanation:
 Income tax collected from individuals and businesses is considered a revenue receipt for the government as it is a regular source of income for funding government operations.

19. Non-tax revenue receipts include:
 (a) Income tax collected from individuals and businesses
 (b) Borrowings from financial institutions
 (c) Grants received from other countries
 (d) Revenue generated from government services and fines

 Answer:
 (d) Revenue generated from government services and fines

 Explanation: Non-tax revenue receipts consist of funds generated from government services, fines, fees, and other non-tax sources of income.

20. Why are revenue receipts essential for a government's financial planning?
 (a) They provide funds for development projects and infrastructure
 (b) They enable the government to finance long-term borrowing
 (c) They ensure the government's financial stability during economic downturns
 (d) They help the government generate revenue from asset sales

 Answer:
 (a) They provide funds for development projects and infrastructure

 Explanation:
 Revenue receipts are crucial for funding day-to-day government operations and financing various development projects, public services, and infrastructure.

21. Which of the following represents a non-debt revenue receipt for a government?
 (a) Proceeds from the sale of government assets
 (b) Borrowing from the central bank
 (c) Grants received from international organizations
 (d) Revenue earned from government services

 Answer:
 (d) Revenue earned from government services

Explanation:
Revenue earned from government services is a non-debt revenue receipt as it represents regular income from providing services to the public.

22. How are revenue receipts different from capital receipts?
   (a) Revenue receipts are funds raised through long-term borrowing, while capital receipts represent regular income sources.
   (b) Revenue receipts represent funds raised through long-term borrowing or asset sales, while capital receipts represent funds from regular income sources like taxes and fines.
   (c) Revenue receipts are used to finance day-to-day expenses, while capital receipts are used for long-term projects.
   (d) Revenue receipts are non-tax revenue, while capital receipts are tax revenue.

   Answer:
   (c) Revenue receipts are used to finance day-to-day expenses, while capital receipts are used for long-term projects.

   Explanation:
   Revenue receipts are used to finance day-to-day expenses and regular government operations, while capital receipts are used for long-term investments, capital projects, or asset acquisition.

23. Government revenue earned from import duties and taxes on goods and services represents:
   (a) Revenue expenditure
   (b) Revenue receipts
   (c) Capital expenditure
   (d) Capital receipts

   Answer:
   (b) Revenue receipts

   Explanation:
   Government revenue earned from import duties and taxes on goods and services represents revenue receipts as it is a regular source of income for the government.

24. How do revenue receipts impact the fiscal deficit of a government?
   (a) Revenue receipts decrease the fiscal deficit
   (b) Revenue receipts have no impact on the fiscal deficit
   (c) Revenue receipts increase the fiscal deficit
   (d) Revenue receipts eliminate the fiscal deficit

   Answer:
   (c) Revenue receipts increase the fiscal deficit

   Explanation:
   Revenue receipts, when insufficient to cover government expenditures, can contribute to a fiscal deficit. The fiscal deficit occurs when the government spends more than it earns in revenue receipts.

Revenue Expenditure

25. Revenue expenditure refers to:
   (a) Funds spent on long-term investments and capital projects
   (b) Money spent on acquiring assets and properties
   (c) Expenditure incurred on day-to-day government operations and services
   (d) Expenditure on repaying long-term loans and debts

   Answer:
   (c) Expenditure incurred on day-to-day government operations and services

   Explanation:
   Revenue expenditure includes all regular and recurring expenses incurred by the government on day-to-day operations, such as salaries, wages, maintenance, supplies, and services.

26. Which of the following is an example of revenue expenditure for a government?
   (a) Purchase of land for a new government office building
   (b) Payment of interest on a government loan
   (c) Construction of a new highway infrastructure
   (d) Investment in a state-owned enterprise

   Answer:
   (b) Payment of interest on a government loan

Explanation:
The payment of interest on a government loan is an example of revenue expenditure, as it represents a regular and recurring expense related to servicing the government's debt.

27. Revenue expenditure can be classified into:
(a) Capital and non-capital expenditure
(b) Debt and equity expenditure
(c) Foreign and domestic expenditure
(d) Social and defense expenditure
Answer: (a) Capital and non-capital expenditure
Explanation:
Revenue expenditure can be classified into capital expenditure, which relates to expenses on acquiring assets or investments, and non-capital expenditure, which pertains to regular day-to-day expenses.

28. Why is revenue expenditure important for a government's financial planning?
(a) It provides funds for long-term investments and development projects
(b) It helps the government repay long-term loans and debts
(c) It ensures efficient delivery of public services and day-to-day operations
(d) It enables the government to increase tax revenue
Answer:
(c) It ensures efficient delivery of public services and day-to-day operations
Explanation:
Revenue expenditure is essential for the efficient delivery of public services and the smooth functioning of day-to-day government operations, ensuring that essential services are adequately funded.

29. Which of the following represents a non-capital revenue expenditure for a government?
(a) Investment in building a new government office
(b) Purchase of vehicles for government officials

(c) Payment of salaries to government employees
(d) Investment in a state-owned enterprise
Answer:
(c) Payment of salaries to government employees
Explanation:
The payment of salaries to government employees is a non-capital revenue expenditure as it represents a regular and recurring expense for government operations.

30. How are revenue expenditure and capital expenditure different?
(a) Revenue expenditure is incurred on day-to-day operations, while capital expenditure is incurred on long-term investments and projects.
(b) Revenue expenditure is funded through long-term borrowing, while capital expenditure is funded through regular income sources.
(c) Revenue expenditure is related to asset acquisition, while capital expenditure is related to regular expenses.
(d) Revenue expenditure is non-tax revenue, while capital expenditure is tax revenue.
Answer:
(a) Revenue expenditure is incurred on day-to-day operations, while capital expenditure is incurred on long-term investments and projects.
Explanation:
Revenue expenditure is incurred on regular day-to-day operations and services, while capital expenditure is incurred on long-term investments, capital projects, and asset acquisition.

31. Government spending on social welfare programs and public education represents:
(a) Capital expenditure
(b) Capital receipts
(c) Revenue expenditure
(d) Revenue receipts
Answer:
(c) Revenue expenditure

Explanation:
Government spending on social welfare programs and public education is revenue expenditure as it represents regular expenses incurred on providing essential public services.

32. How does revenue expenditure impact the fiscal deficit of a government?
    (a) Revenue expenditure decreases the fiscal deficit
    (b) Revenue expenditure has no impact on the fiscal deficit
    (c) Revenue expenditure increases the fiscal deficit
    (d) Revenue expenditure eliminates the fiscal deficit

    Answer:
    (c) Revenue expenditure increases the fiscal deficit

    Explanation:
    Revenue expenditure, when higher than revenue receipts, can contribute to a fiscal deficit. The fiscal deficit occurs when the government spends more than it earns in revenue receipts.

Capital Expenditure

33. Capital expenditure refers to:
    (a) Money spent on day-to-day government operations and services
    (b) Expenditure incurred on long-term investments and capital projects
    (c) Funds received from the sale of government assets
    (d) Expenditure on repaying long-term loans and debts

    Answer:
    (b) Expenditure incurred on long-term investments and capital projects

    Explanation:
    Capital expenditure represents funds spent on long-term investments, such as acquiring assets, infrastructure development, and capital projects.

34. Which of the following is an example of capital expenditure for a government?
    (a) Payment of salaries to government employees
    (b) Construction of a new government office building

    (c) Purchase of office supplies and equipment
    (d) Investment in a state-owned enterprise

    Answer:
    (b) Construction of a new government office building

    Explanation:
    The construction of a new government office building is an example of capital expenditure as it involves a long-term investment in acquiring an asset (the building).

35. Capital expenditure can be classified into:
    (a) Capital and non-capital expenditure
    (b) Debt and equity expenditure
    (c) Foreign and domestic expenditure
    (d) Social and defense expenditure

    Answer:
    (a) Capital and non-capital expenditure

    Explanation:
    Capital expenditure can be classified into capital expenditure, which relates to long-term investments and capital projects, and non-capital expenditure, which pertains to regular day-to-day expenses.

36. Why is capital expenditure important for a government's financial planning?
    (a) It provides funds for long-term investments and development projects
    (b) It helps the government repay long-term loans and debts
    (c) It ensures efficient delivery of public services and day-to-day operations
    (d) It enables the government to increase tax revenue

    Answer:
    (a) It provides funds for long-term investments and development projects

    Explanation:
    Capital expenditure is crucial for financing long-term investments, development projects, and infrastructure, which are essential for the economic growth and development of a country.

37. Which of the following represents a non-capital expenditure for a government?
    (a) Investment in building a new government office
    (b) Purchase of vehicles for government officials
    (c) Payment of salaries to government employees
    (d) Investment in a state-owned enterprise

Answer:

(c) Payment of salaries to government employees

Explanation:

The payment of salaries to government employees is a non-capital expenditure as it represents a regular and recurring expense for government operations.

38. How are capital expenditure and revenue expenditure different?
    (a) Capital expenditure is incurred on long-term investments and projects, while revenue expenditure is incurred on day-to-day operations.
    (b) Capital expenditure is funded through long-term borrowing, while revenue expenditure is funded through regular income sources.
    (c) Capital expenditure is related to asset acquisition, while revenue expenditure is related to regular expenses.
    (d) Capital expenditure is non-tax revenue, while revenue expenditure is tax revenue.

Answer:

(a) Capital expenditure is incurred on long-term investments and projects, while revenue expenditure is incurred on day-to-day operations.

Explanation:

Capital expenditure is incurred on long-term investments, capital projects, and asset acquisition, while revenue expenditure is incurred on regular day-to-day operations and services.

39. Government spending on defense and military equipment represents:
    (a) Capital expenditure (b) Capital receipts
    (c) Revenue expenditure (d) Revenue receipts

Answer:

(a) Capital expenditure

Explanation:

Government spending on defense and military equipment is capital expenditure as it involves long-term investments in acquiring assets (e.g., military equipment and infrastructure).

40. How does capital expenditure impact the fiscal deficit of a government?
    (a) Capital expenditure decreases the fiscal deficit
    (b) Capital expenditure has no impact on the fiscal deficit
    (c) Capital expenditure increases the fiscal deficit
    (d) Capital expenditure eliminates the fiscal deficit

Answer:

(c) Capital expenditure increases the fiscal deficit

Explanation:

Capital expenditure, when higher than capital receipts and revenue receipts, can contribute to a fiscal deficit. The fiscal deficit occurs when the government spends more than it earns in revenue and capital receipts.

Budgetary Deficit or Overall Deficit

41. What is budgetary deficit?
    (a) The difference between total revenue and total expenditure of the government
    (b) The difference between capital receipts and capital expenditure of the government
    (c) The difference between revenue receipts and revenue expenditure of the government
    (d) The difference between government savings and investments

Answer:

(c) The difference between revenue receipts and revenue expenditure of the government

Explanation:

Budgetary deficit refers to the difference between total revenue receipts and total revenue expenditure of the government in a fiscal year.

42. Budgetary deficit occurs when:
    (a) Total revenue is greater than total expenditure
    (b) Capital receipts are greater than capital expenditure
    (c) Total revenue is less than total expenditure
    (d) Capital receipts are less than capital expenditure

    Answer:
    (c) Total revenue is less than total expenditure

    Explanation:
    Budgetary deficit occurs when total revenue (both revenue receipts and capital receipts) is less than total expenditure (both revenue expenditure and capital expenditure).

43. Which of the following is a measure of the overall deficit of a country?
    (a) Fiscal deficit
    (b) Budgetary deficit
    (c) Current account deficit
    (d) Trade deficit

    Answer:
    (c) Current account deficit

    Explanation:
    The current account deficit represents the difference between a country's total imports of goods, services, and transfers and its total exports of goods, services, and transfers.

44. Budgetary deficit is also known as:
    (a) Revenue deficit
    (b) Trade deficit
    (c) Fiscal deficit
    (d) Capital deficit

    Answer:
    (a) Revenue deficit

    Explanation:
    Budgetary deficit is also referred to as revenue deficit, which is the difference between revenue receipts and revenue expenditure of the government.

45. Fiscal deficit includes:
    (a) Only revenue deficit
    (b) Only capital deficit
    (c) Both revenue deficit and capital deficit
    (d) Neither revenue deficit nor capital deficit

    Answer:
    (c) Both revenue deficit and capital deficit

    Explanation:
    Fiscal deficit includes both revenue deficit (the difference between revenue receipts and revenue expenditure) and capital deficit (the difference between capital receipts and capital expenditure).

46. How does a budgetary deficit impact the overall financial health of a government?
    (a) A budgetary deficit indicates financial stability and fiscal responsibility
    (b) A budgetary deficit leads to an increase in government savings
    (c) A budgetary deficit indicates that the government is spending more than its revenue
    (d) A budgetary deficit has no impact on the overall financial health of a government

    Answer:
    (c) A budgetary deficit indicates that the government is spending more than its revenue

    Explanation:
    A budgetary deficit indicates that the government's total spending exceeds its total revenue, which may lead to borrowing or accumulating debt to cover the shortfall.

47. The formula to calculate budgetary deficit is:
    (a) Budgetary Deficit = Total Revenue - Total Expenditure
    (b) Budgetary Deficit = Revenue Receipts - Revenue Expenditure
    (c) Budgetary Deficit = Capital Receipts - Capital Expenditure
    (d) Budgetary Deficit = Fiscal Receipts - Fiscal Expenditure

    Answer:
    (b) Budgetary Deficit = Revenue Receipts - Revenue Expenditure

Explanation:

Budgetary deficit is calculated as the difference between revenue receipts and revenue expenditure of the government.

48. If a government has a budgetary surplus, it means:
    (a) Total revenue is less than total expenditure
    (b) Total revenue is equal to total expenditure
    (c) Total revenue is greater than total expenditure
    (d) Total revenue is negative

    Answer:

    (c) Total revenue is greater than total expenditure

    Explanation:

    A budgetary surplus occurs when the government's total revenue (both revenue receipts and capital receipts) is greater than its total expenditure (both revenue expenditure and capital expenditure).

Revenue Deficit

49. What is revenue deficit?
    (a) The difference between total revenue and total expenditure of the government
    (b) The difference between capital receipts and capital expenditure of the government
    (c) The difference between revenue receipts and revenue expenditure of the government
    (d) The difference between government savings and investments

    Answer:

    (c) The difference between revenue receipts and revenue expenditure of the government

    Explanation:

    Revenue deficit refers to the difference between total revenue receipts and total revenue expenditure of the government in a fiscal year.

50. Revenue deficit occurs when:
    (a) Total revenue is greater than total expenditure
    (b) Capital receipts are greater than capital expenditure

    (c) Total revenue is less than total expenditure
    (d) Capital receipts are less than capital expenditure

    Answer:

    (c) Total revenue is less than total expenditure

    Explanation:

    Revenue deficit occurs when total revenue (both revenue receipts and capital receipts) is less than total revenue expenditure.

51. The revenue deficit implies that the government's regular income (revenue) is insufficient to meet its:
    (a) Long-term investments
    (b) Short-term loans
    (c) Day-to-day expenses
    (d) Foreign debt obligations

    Answer:

    (c) Day-to-day expenses

    Explanation:

    The revenue deficit indicates that the government's regular income (revenue) is insufficient to cover its day-to-day expenses and regular operational costs.

52. How is revenue deficit different from fiscal deficit?
    (a) Revenue deficit considers only revenue receipts and expenditure, while fiscal deficit considers both revenue and capital receipts and expenditure.
    (b) Revenue deficit is calculated annually, while fiscal deficit is calculated monthly.
    (c) Revenue deficit is the same as fiscal deficit.
    (d) Revenue deficit is a type of fiscal deficit.

    Answer:

    (a) Revenue deficit considers only revenue receipts and expenditure, while fiscal deficit considers both revenue and capital receipts and expenditure.

    Explanation:

    Revenue deficit focuses on the difference between revenue receipts and revenue expenditure, whereas fiscal deficit considers the difference between both revenue and capital receipts and total expenditure.

53. How does revenue deficit impact a government's borrowing?
    (a) A revenue deficit reduces the need for government borrowing.
    (b) A revenue deficit may lead to increased government borrowing to finance expenses.
    (c) A revenue deficit has no impact on government borrowing.
    (d) A revenue deficit eliminates the need for government borrowing.

    Answer:

    (b) A revenue deficit may lead to increased government borrowing to finance expenses.

    Explanation:

    A revenue deficit may necessitate increased borrowing by the government to cover the shortfall between revenue receipts and revenue expenditure.
54. The formula to calculate revenue deficit is:
    (a) Revenue Deficit = Total Revenue - Total Expenditure
    (b) Revenue Deficit = Revenue Receipts - Revenue Expenditure
    (c) Revenue Deficit = Capital Receipts - Capital Expenditure
    (d) Revenue Deficit = Fiscal Receipts - Fiscal Expenditure

    Answer:

    (b) Revenue Deficit = Revenue Receipts - Revenue Expenditure

    Explanation:

    Revenue deficit is calculated as the difference between revenue receipts and revenue expenditure of the government.
55. If a government has a revenue surplus, it means:
    (a) Total revenue is less than total expenditure
    (b) Total revenue is equal to total expenditure
    (c) Total revenue is greater than total expenditure
    (d) Total revenue is negative

    Answer:

    (c) Total revenue is greater than total expenditure

    Explanation:

    A revenue surplus occurs when the government's total revenue (both revenue receipts and capital receipts) is greater than its total revenue expenditure.

56. The revenue deficit primarily arises due to:
    (a) Capital investments in infrastructure projects
    (b) Repayment of long-term loans and debts
    (c) Day-to-day operational expenses and subsidies
    (d) Foreign aid and grants received

    Answer:

    (c) Day-to-day operational expenses and subsidies

    Explanation:

    The revenue deficit mainly arises due to the government's day-to-day operational expenses and subsidies that exceed its regular revenue receipts.

Fiscal Deficit

57. What is fiscal deficit?
    (a) The difference between total revenue and total expenditure of the government
    (b) The difference between capital receipts and capital expenditure of the government
    (c) The difference between revenue receipts and revenue expenditure of the government
    (d) The difference between government savings and investments

    Answer:

    (a) The difference between total revenue and total expenditure of the government

    Explanation:

    Fiscal deficit refers to the difference between the total revenue (both revenue receipts and capital receipts) and total expenditure (both revenue expenditure and capital expenditure) of the government in a fiscal year.
58. Fiscal deficit occurs when:
    (a) Total revenue is greater than total expenditure
    (b) Capital receipts are greater than capital expenditure

(c) Total revenue is less than total expenditure
(d) Capital receipts are less than capital expenditure

Answer:

(c) Total revenue is less than total expenditure

Explanation:

Fiscal deficit occurs when the total revenue (both revenue receipts and capital receipts) is less than the total expenditure (both revenue expenditure and capital expenditure) of the government.

59. The fiscal deficit implies that the government is spending more than its:
(a) Long-term investments (b) Short-term loans
(c) Day-to-day expenses (d) Foreign debt obligations

Answer:

(c) Day-to-day expenses

Explanation:

The fiscal deficit indicates that the government's total expenditure (including day-to-day expenses) exceeds its total revenue.

60. How is fiscal deficit different from revenue deficit?
(a) Fiscal deficit considers only revenue receipts and expenditure, while revenue deficit considers both revenue and capital receipts and expenditure.
(b) Fiscal deficit is calculated annually, while revenue deficit is calculated monthly.
(c) Fiscal deficit is the same as revenue deficit.
(d) Fiscal deficit is a type of revenue deficit.

Answer:

(a) Fiscal deficit considers only revenue receipts and expenditure, while revenue deficit considers both revenue and capital receipts and expenditure.

Explanation:

Fiscal deficit focuses on the difference between total revenue (both revenue receipts and capital receipts) and total expenditure (both revenue expenditure and capital expenditure), whereas revenue deficit considers the difference only between revenue receipts and revenue expenditure.

61. How does fiscal deficit impact a government's borrowing?
(a) A fiscal deficit reduces the need for government borrowing.
(b) A fiscal deficit may lead to increased government borrowing to finance expenses.
(c) A fiscal deficit has no impact on government borrowing.
(d) A fiscal deficit eliminates the need for government borrowing.

Answer:

(b) A fiscal deficit may lead to increased government borrowing to finance expenses.

Explanation:

A fiscal deficit may necessitate increased borrowing by the government to cover the shortfall between total revenue and total expenditure.

62. The formula to calculate fiscal deficit is:
(a) Fiscal Deficit = Total Revenue - Total Expenditure
(b) Fiscal Deficit = Revenue Receipts - Revenue Expenditure
(c) Fiscal Deficit = Capital Receipts - Capital Expenditure
(d) Fiscal Deficit = Revenue Receipts + Capital Receipts - Revenue Expenditure - Capital Expenditure

Answer:

(a) Fiscal Deficit = Total Revenue - Total Expenditure

Explanation:

Fiscal deficit is calculated as the difference between total revenue (both revenue receipts and capital receipts) and total expenditure (both revenue expenditure and capital expenditure) of the government.

63. If a government has a fiscal surplus, it means:
(a) Total revenue is less than total expenditure
(b) Total revenue is equal to total expenditure
(c) Total revenue is greater than total expenditure
(d) Total revenue is negative

Answer:

(c) Total revenue is greater than total expenditure

Explanation:

A fiscal surplus occurs when the government's total revenue (both revenue receipts and capital receipts) is greater than its total expenditure (both revenue expenditure and capital expenditure).

64. The fiscal deficit primarily arises due to:
    (a) Capital investments in infrastructure projects
    (b) Repayment of long-term loans and debts
    (c) Day-to-day operational expenses and subsidies
    (d) Foreign aid and grants received

Answer:

(c) Day-to-day operational expenses and subsidies

Explanation:

The fiscal deficit mainly arises due to the government's day-to-day operational expenses and subsidies that exceed its total revenue.

Primary Deficit

65. What is the primary deficit?
    (a) The difference between total revenue and total expenditure of the government
    (b) The difference between capital receipts and capital expenditure of the government
    (c) The difference between revenue receipts and revenue expenditure of the government
    (d) The difference between total revenue and total expenditure excluding interest payments on debt

Answer:

(d) The difference between total revenue and total expenditure excluding interest payments on debt

Explanation:

The primary deficit refers to the difference between total revenue and total expenditure of the government excluding interest payments on debt. It indicates the extent to which the government relies on borrowings to finance its expenses, excluding the interest burden.

66. The primary deficit takes into account which of the following items?
    (a) Capital receipts and capital expenditure
    (b) Revenue receipts and revenue expenditure

    (c) Total revenue and total expenditure
    (d) Interest payments on debt and government savings

Answer:

(b) Revenue receipts and revenue expenditure

Explanation:

The primary deficit considers revenue receipts (both regular and capital receipts) and revenue expenditure (both regular and capital expenditure) while excluding interest payments on debt.

67. How is the primary deficit different from the fiscal deficit?
    (a) The primary deficit considers total revenue and total expenditure, while the fiscal deficit considers only revenue receipts and revenue expenditure.
    (b) The primary deficit considers both revenue and capital receipts and expenditure, while the fiscal deficit considers only revenue receipts and revenue expenditure.
    (c) The primary deficit is the same as the fiscal deficit.
    (d) The primary deficit is a type of fiscal deficit.

Answer:

(b) The primary deficit considers both revenue and capital receipts and expenditure, while the fiscal deficit considers only revenue receipts and revenue expenditure.

Explanation:

The primary deficit includes both revenue and capital receipts and expenditure but excludes interest payments on debt, whereas the fiscal deficit considers both revenue and capital receipts and expenditure, including interest payments on debt.

68. Which of the following is true regarding the primary deficit?
    (a) A primary deficit can only occur when total revenue is less than total expenditure.
    (b) A primary deficit occurs when total revenue is greater than total expenditure.
    (c) A primary deficit is unrelated to the government's borrowing.
    (d) A primary deficit is always equal to the fiscal deficit.

Answer:

(a) A primary deficit can only occur when total revenue is less than total expenditure.

Explanation:
A primary deficit occurs when total revenue (both revenue receipts and capital receipts) is less than total expenditure (both revenue expenditure and capital expenditure), excluding interest payments on debt.

69. The formula to calculate the primary deficit is:
(a) Primary Deficit = Total Revenue - Total Expenditure
(b) Primary Deficit = Revenue Receipts - Revenue Expenditure
(c) Primary Deficit = Capital Receipts - Capital Expenditure
(d) Primary Deficit = Fiscal Deficit - Interest Payments on Debt

Answer:
(d) Primary Deficit = Fiscal Deficit - Interest Payments on Debt

Explanation:
The primary deficit is calculated as the difference between the fiscal deficit and interest payments on debt. Mathematically, Primary Deficit = Fiscal Deficit - Interest Payments on Debt.

70. What does a primary deficit imply about a government's finances?
(a) The government is managing its expenses efficiently without reliance on borrowings.
(b) The government is spending more than its total revenue, including interest payments on debt.
(c) The government is generating enough revenue to cover all its expenses, including interest payments on debt.
(d) The government is not engaged in any borrowing activities.

Answer:
(b) The government is spending more than its total revenue, including interest payments on debt.

Explanation:
A primary deficit indicates that the government is spending more than its total revenue, including interest payments on debt. It highlights the extent to which the government is reliant on borrowings to finance its expenses.

71. If a government has a primary surplus, it means:
(a) Total revenue is less than total expenditure
(b) Total revenue is equal to total expenditure

(c) Total revenue is greater than total expenditure, including interest payments on debt
(d) Total revenue is negative

Answer:
(c) Total revenue is greater than total expenditure, including interest payments on debt

Explanation:
A primary surplus occurs when the government's total revenue (both revenue receipts and capital receipts) is greater than its total expenditure (both revenue expenditure and capital expenditure), including interest payments on debt.

72. The primary deficit is considered a more appropriate measure of a government's fiscal health because it focuses on:
(a) Long-term investments and capital projects
(b) Day-to-day operational expenses and subsidies
(c) Interest payments on debt
(d) Both revenue and capital receipts and expenditure

Answer:
(b) Day-to-day operational expenses and subsidies

Explanation:
The primary deficit is considered a more appropriate measure of a government's fiscal health because it focuses on the government's day-to-day operational expenses and subsidies, excluding the impact of interest payments on debt.

Finance Bill

73. What is the Finance Bill?
(a) A bill introduced in the parliament to allocate funds for various government projects
(b) A bill introduced by the Ministry of Finance to propose new tax laws and make amendments to existing ones
(c) A bill introduced to regulate the financial sector and banking activities

(d) A bill introduced to control government expenditure and reduce fiscal deficit

Answer:

(b) A bill introduced by the Ministry of Finance to propose new tax laws and make amendments to existing ones

Explanation:

The Finance Bill is a bill presented by the Ministry of Finance in the parliament that includes proposals related to new taxes, amendments to existing tax laws, and other financial matters.

74. The Finance Bill is presented every year during the presentation of:
(a) The Economic Survey
(b) The Union Budget
(c) The Annual Financial Statement
(d) The Fiscal Policy Statement

Answer:

(b) The Union Budget

Explanation:

The Finance Bill is presented in the parliament every year as part of the Union Budget, which contains the government's revenue and expenditure plans for the upcoming financial year.

75. Which of the following is NOT included in the Finance Bill?
(a) Proposals related to direct and indirect taxes
(b) Amendments to the rates of existing taxes
(c) Allocation of funds for various government projects and schemes
(d) Measures to promote economic growth and development

Answer:

(c) Allocation of funds for various government projects and schemes

Explanation:

The Finance Bill focuses on tax proposals, amendments to existing tax laws, and related financial matters. The allocation of funds for government projects and schemes is part of the Annual Financial Statement presented along with the Finance Bill.

76. The Finance Bill becomes an Act after it is:
(a) Approved by the President of the country
(b) Passed by the Lok Sabha and Rajya Sabha and receives the President's assent
(c) Approved by the Ministry of Finance
(d) Passed by the State Assemblies and receives the Governor's approval

Answer:

(b) Passed by the Lok Sabha and Rajya Sabha and receives the President's assent

Explanation:

The Finance Bill becomes an Act after it is passed by both houses of parliament (Lok Sabha and Rajya Sabh(a) and receives the assent of the President of India.

77. The provisions of the Finance Bill come into effect from:
(a) The date of its presentation in the parliament
(b) The beginning of the next financial year
(c) The date of approval by the Lok Sabha
(d) The date of approval by the Rajya Sabha

Answer:

(b) The beginning of the next financial year

Explanation:

The provisions of the Finance Bill generally come into effect from the beginning of the next financial year, i.e., from April 1 of the following year after its presentation in the parliament.

78. Who introduces the Finance Bill in the parliament?
(a) The Prime Minister of the country
(b) The Finance Minister of the country
(c) The President of the country
(d) The Chief Justice of the Supreme Court

Answer:

(b) The Finance Minister of the country

Explanation:
The Finance Bill is introduced in the parliament by the Finance Minister of the country.

79. The Finance Bill is primarily concerned with which aspect of governance?
   (a) Defense and security matters
   (b) Social welfare and education programs
   (c) Economic and financial matters
   (d) Environmental protection and conservation

   Answer:
   (c) Economic and financial matters

   Explanation:
   The Finance Bill is primarily concerned with economic and financial matters, particularly related to taxes, fiscal policies, and financial regulations.

80. The Finance Bill is discussed and debated in which house of parliament?
   (a) The Lok Sabha
   (b) The Rajya Sabha
   (c) Both the Lok Sabha and Rajya Sabha
   (d) The State Assemblies

   Answer:
   (c) Both the Lok Sabha and Rajya Sabha

   Explanation:
   The Finance Bill is discussed and debated in both houses of parliament, i.e., the Lok Sabha and Rajya Sabha, before it is passed and becomes an Act.

Outcome budget

81. What is the Outcome Budget?
   (a) A budget prepared by the Ministry of Finance to allocate funds for various government projects
   (b) A budget presented in the parliament that includes proposals related to new taxes and financial matters
   (c) A budget that focuses on the outcomes and results achieved by various government schemes and programs

   (d) A budget that outlines the government's revenue and expenditure plans for the upcoming financial year

   Answer:
   (c) A budget that focuses on the outcomes and results achieved by various government schemes and programs

   Explanation:
   The Outcome Budget is a budget document that focuses on presenting the outcomes and results achieved by various government schemes and programs, rather than just the allocation of funds.

82. The Outcome Budget is presented every year by:
   (a) The Ministry of Finance
   (b) The Planning Commission
   (c) The Ministry of Statistics and Program Implementation
   (d) The Prime Minister of India

   Answer:
   (c) The Ministry of Statistics and Program Implementation

   Explanation:
   The Outcome Budget is presented every year by the Ministry of Statistics and Program Implementation (MOSPI) in India.

83. The Outcome Budget assesses the performance of government schemes based on:
   (a) The total budget allocated to each scheme
   (b) The number of government employees involved in the implementation of each scheme
   (c) The outcomes and outputs achieved by each scheme
   (d) The popularity of each scheme among the public

   Answer:
   (c) The outcomes and outputs achieved by each scheme

   Explanation:
   The Outcome Budget assesses the performance of government schemes based on the actual outcomes and outputs achieved by each scheme, rather than just the budget allocation or number of employees involved.

84. The primary focus of the Outcome Budget is to:
   (a) Evaluate the financial health of the government
   (b) Monitor the implementation progress of various government schemes
   (c) Ensure compliance with fiscal responsibility and budget management rules
   (d) Assess the impact and effectiveness of government policies and programs

   Answer:
   (d) Assess the impact and effectiveness of government policies and programs

   Explanation:
   The primary focus of the Outcome Budget is to assess the impact and effectiveness of government policies and programs in achieving their intended outcomes and objectives.

85. The Outcome Budget is aimed at promoting:
   (a) Fiscal discipline and reducing government expenditure
   (b) Transparency and accountability in government spending
   (c) Short-term goals and objectives of the government
   (d) Public-private partnerships for effective governance

   Answer:
   (b) Transparency and accountability in government spending

   Explanation:
   The Outcome Budget promotes transparency and accountability in government spending by providing a detailed assessment of the outcomes and results achieved by various government schemes.

86. How does the Outcome Budget differ from the Regular Budget?
   (a) The Regular Budget focuses on outcomes and results, while the Outcome Budget focuses on budget allocation.
   (b) The Regular Budget includes new tax proposals, while the Outcome Budget includes fiscal deficit figures.
   (c) The Regular Budget presents the government's revenue and expenditure plans, while the Outcome Budget assesses the impact of government schemes.

   (d) The Regular Budget is presented by the Prime Minister, while the Outcome Budget is presented by the Finance Minister.

   Answer:
   (c) The Regular Budget presents the government's revenue and expenditure plans, while the Outcome Budget assesses the impact of government schemes.

   Explanation:
   The Regular Budget primarily focuses on presenting the government's revenue and expenditure plans for the upcoming financial year, whereas the Outcome Budget assesses the impact and effectiveness of various government schemes and programs.

87. The Outcome Budget helps in identifying:
   (a) The number of government employees in each department
   (b) Areas of duplication in government schemes
   (c) The popularity of government schemes among the public
   (d) The total funds allocated to each government department

   Answer:
   (b) Areas of duplication in government schemes

   Explanation:
   The Outcome Budget helps in identifying areas of duplication in government schemes and programs and provides insights to streamline resources and improve the effectiveness of schemes.

88. The Outcome Budget is presented along with which other budget document?
   (a) The Regular Budget
   (b) The Performance Budget
   (c) The Zero-based Budget
   (d) The Supplementary Budget

   Answer:
   (b) The Performance Budget

   Explanation:
   The Outcome Budget is presented along with the Performance Budget, which focuses on presenting the performance and achievements of various government schemes and programs.

Guillotine

89. What is the Guillotine in the context of the parliamentary budget process?
    (a) A device used for capital punishment in some countries
    (b) A method to close debates and allocate time for discussions during the budget session
    (c) A parliamentary committee responsible for reviewing the budget proposals
    (d) A tool used by the finance minister to present the budget in the parliament

    Answer:
    (b) A method to close debates and allocate time for discussions during the budget session

    Explanation:
    In the context of the parliamentary budget process, the Guillotine is a method used to close debates and allocate time for discussions on various budget proposals and bills during the budget session. It helps ensure that all the essential budgetary discussions are completed within the scheduled time.

90. When is the Guillotine typically used in the parliament?
    (a) During discussions on non-financial bills
    (b) To extend the budget session beyond its scheduled time
    (c) To end discussions on budget proposals and related bills
    (d) To allow unlimited time for debates on budget matters

    Answer:
    (c) To end discussions on budget proposals and related bills

    Explanation:
    The Guillotine is typically used in the parliament to end discussions on budget proposals, votes on demands for grants, and other financial bills within the scheduled time. It ensures that all essential budgetary matters are considered and passed before the conclusion of the budget session.

91. How does the Guillotine help in the efficient passage of the budget?
    (a) It allows for unlimited time for debates on each budget proposal.
    (b) It ensures that all non-financial bills are discussed thoroughly.

    (c) It allows the finance minister to present the budget efficiently.
    (d) It sets a deadline for discussions, thereby streamlining the process.

    Answer:
    (d) It sets a deadline for discussions, thereby streamlining the process.

    Explanation:
    The Guillotine sets a deadline for discussions on budget proposals and financial bills, which helps streamline the process and ensures that the budget is passed within the scheduled time. It prevents unnecessary delays and keeps the discussions focused on essential budgetary matters.

92. Who decides the allocation of time for discussions using the Guillotine?
    (a) The Speaker of the Lok Sabha
    (b) The Prime Minister
    (c) The Finance Minister
    (d) The President of India

    Answer:
    (a) The Speaker of the Lok Sabha

    Explanation:
    The allocation of time for discussions and the application of the Guillotine during the budget session are typically decided by the Speaker of the Lok Sabha (in the lower house of the parliament).

93. What happens when the Guillotine is applied during the budget session?
    (a) All budget proposals are automatically approved without any discussions.
    (b) Remaining discussions on budget proposals are cut short, and votes are taken collectively.
    (c) The budget session is extended to allow for more time for discussions.
    (d) The finance minister presents the budget to the President for approval.

    Answer:
    (b) Remaining discussions on budget proposals are cut short, and votes are taken collectively.

Explanation:
When the Guillotine is applied, the remaining discussions on budget proposals are cut short, and votes on demands for grants and other financial matters are taken collectively to ensure the efficient passage of the budget within the scheduled time.

94. Which house of parliament uses the Guillotine during the budget session?
(a) Lok Sabha
(b) Rajya Sabha
(c) Both Lok Sabha and Rajya Sabha
(d) State Legislative Assemblies

Answer:
(c) Both Lok Sabha and Rajya Sabha

Explanation:
The Guillotine can be applied in both houses of parliament, i.e., Lok Sabha (the lower house) and Rajya Sabha (the upper house), during the budget session to facilitate the efficient passage of the budget and related bills.

95. How does the Guillotine impact the participation of members in budget discussions?
(a) It encourages active participation and thorough discussions on each proposal.
(b) It limits the participation of members and curtails the time for discussions.
(c) It allows members to extend the budget session for more detailed debates.
(d) It has no impact on the participation of members in budget discussions.

Answer:
(b) It limits the participation of members and curtails the time for discussions.

Explanation:
The Guillotine limits the time for discussions and curtails the participation of members in budget discussions to ensure that all essential matters are completed within the scheduled time. It may lead to less time for detailed debates on each proposal.

Cut Motions

96. What are Cut Motions in the context of parliamentary procedures?
(a) Motions to cut short the duration of parliamentary sessions
(b) Motions to reduce the salaries of government officials
(c) Motions to reduce the amount of a demand for grant presented in the budget
(d) Motions to cut off funding for a specific government project

Answer:
(c) Motions to reduce the amount of a demand for grant presented in the budget

Explanation:
Cut Motions are motions moved by Members of Parliament (MPs) to reduce the amount of a demand for grant presented in the budget. They allow MPs to express their disapproval of a particular policy or expenditure proposed by the government.

97. When are Cut Motions moved in the parliament?
(a) During discussions on non-financial bills
(b) Before the presentation of the budget
(c) During discussions on financial matters and demands for grants
(d) After the passage of the budget

Answer:
(c) During discussions on financial matters and demands for grants

Explanation:
Cut Motions are moved during discussions on financial matters, including demands for grants, when the budget is being considered in the parliament.

98. What is the purpose of a Cut Motion?
(a) To propose a reduction in the total budget allocation
(b) To criticize the functioning of the opposition parties
(c) To express disapproval of a specific policy or expenditure
(d) To delay the passage of the budget

Answer:
(c) To express disapproval of a specific policy or expenditure

Explanation:
The primary purpose of a Cut Motion is to express disapproval of a specific policy or expenditure proposed by the government. It allows MPs to put forth their objections to the allocation of funds for a particular purpose.

99. Which of the following statements is true about Cut Motions?
(a) Cut Motions are moved after the budget is passed.
(b) Cut Motions can only be moved by the ruling party MPs.
(c) Cut Motions are meant to propose an increase in budget allocations.
(d) Cut Motions can be moved by any MP to seek a reduction in budget allocations.

Answer:
(d) Cut Motions can be moved by any MP to seek a reduction in budget allocations.

Explanation:
Cut Motions can be moved by any MP, irrespective of their party affiliation, to seek a reduction in budget allocations for specific demands for grants.

100. How many types of Cut Motions are typically allowed in the parliament?
(a) One type
(b) Two types
(c) Three types
(d) Four types

Answer:
(c) Three types

Explanation:
There are typically three types of Cut Motions allowed in the parliament: (1) Policy Cut, (2) Economy Cut, and (3) Token Cut.

101. Which type of Cut Motion aims at reducing the amount of a demand for grant to Re. 1?
(a) Policy Cut (b) Economy Cut
(c) Token Cut (d) Fiscal Cut

Answer:
(c) Token Cut

Explanation:
A Token Cut aims at reducing the amount of a demand for grant to Re. 1, symbolically indicating the MP's disapproval of the entire amount.

102. What is the consequence if a Cut Motion is accepted by the Speaker of the house?
(a) The demand for grant is withdrawn from the budget.
(b) The budget is rejected and needs to be presented again.
(c) The amount of the demand for grant is reduced as proposed in the motion.
(d) The budget is passed without any changes.

Answer:
(c) The amount of the demand for grant is reduced as proposed in the motion.

Explanation:
If a Cut Motion is accepted by the Speaker of the house, the amount of the demand for grant is reduced as proposed in the motion. The government is then required to adjust its budget accordingly.

103. What is the purpose of allowing Cut Motions in the parliament?
(a) To delay the passage of the budget and stall government activities
(b) To give MPs an opportunity to express their grievances and concerns
(c) To increase the power of the opposition parties
(d) To provide additional time for parliamentary debates

Answer:
(b) To give MPs an opportunity to express their grievances and concerns

Explanation:
The purpose of allowing Cut Motions in the parliament is to give MPs an opportunity to express their grievances and concerns about specific policies or expenditures proposed in the budget. It allows for a healthy and constructive debate on budgetary matters.

Consolidated Fund of India

104. What is the Consolidated Fund of India?
   (a) A fund managed by the Reserve Bank of India for foreign exchange transactions
   (b) A fund maintained by the government to finance development projects
   (c) A fund that holds all revenues received and loans raised by the government
   (d) A fund created to support the defense and security expenses of the country

   Answer:
   (c) A fund that holds all revenues received and loans raised by the government

   Explanation:
   The Consolidated Fund of India is a fund that holds all revenues received by the government of India from taxes, non-tax sources, and loans raised by the government.

105. Which article of the Indian Constitution deals with the Consolidated Fund of India?
   (a) Article 110
   (b) Article 280
   (c) Article 266
   (d) Article 360

   Answer:
   (c) Article 266

   Explanation:
   Article 266 of the Indian Constitution deals with the Consolidated Fund of India.

106. All government revenues and receipts are credited to which fund?
   (a) Public Account (b) Contingency Fund
   (c) Consolidated Fund of India (d) Development Fund

   Answer:
   (c) Consolidated Fund of India

   Explanation:
   All government revenues, including taxes and non-tax revenues, and receipts from loans raised are credited to the Consolidated Fund of India.

107. The expenditure charged on the Consolidated Fund of India includes:
   (a) Expenditure on foreign aid and grants
   (b) Expenditure on salaries and allowances of the President and Governors
   (c) Expenditure on defense and security
   (d) Expenditure on welfare and social programs

   Answer: (b) Expenditure on salaries and allowances of the President and Governors

   Explanation:
   The expenditure charged on the Consolidated Fund of India includes expenditure on salaries and allowances of the President and Governors of states.

108. How is the money from the Consolidated Fund of India withdrawn?
   (a) By the President's order
   (b) By the Governor's order
   (c) By the Finance Minister's order
   (d) Only through parliamentary approval

   Answer:
   (d) Only through parliamentary approval

   Explanation:
   Money from the Consolidated Fund of India can be withdrawn only through parliamentary approval by passing the appropriation bills.

109. Which fund is audited by the Comptroller and Auditor General (CAG) of India?
   (a) Public Account
   (b) Contingency Fund
   (c) Consolidated Fund of India
   (d) Development Fund

   Answer:
   (c) Consolidated Fund of India

Explanation:

The Consolidated Fund of India is audited by the Comptroller and Auditor General (CAG) of India to ensure proper utilization of funds.

110. If there is a need for additional funds during an emergency, from which fund can the government draw money?
   (a) Public Account
   (b) Contingency Fund
   (c) Consolidated Fund of India
   (d) Development Fund

Answer:

(b) Contingency Fund

Explanation:

In case of an urgent and unforeseen need for funds, the government can draw money from the Contingency Fund of India. This fund is created to meet urgent and unforeseen expenses.

111. Which of the following statements about the Consolidated Fund of India is correct?
   (a) The President has complete control over the withdrawals from this fund.
   (b) All government revenues are credited to this fund, but no expenditure is charged on it.
   (c) The fund is maintained by the Reserve Bank of India.
   (d) The fund is utilized for all government expenditure, except the expenditure charged on the Contingency Fund.

Answer:

(d) The fund is utilized for all government expenditure, except the expenditure charged on the Contingency Fund.

Explanation:

The Consolidated Fund of India is utilized for all government expenditure, except for the expenditure that is charged on the Contingency Fund of India and the Public Account.

Contingency Fund of India

112. What is the Contingency Fund of India?
   (a) A fund managed by the Reserve Bank of India for foreign exchange transactions
   (b) A fund maintained by the government to finance development projects
   (c) A fund that holds all revenues received and loans raised by the government
   (d) A fund created to meet urgent and unforeseen expenditure of the government

Answer:

(d) A fund created to meet urgent and unforeseen expenditure of the government

Explanation:

The Contingency Fund of India is a fund created to meet urgent and unforeseen expenditure of the government, pending authorization from the parliament.

113. Which article of the Indian Constitution deals with the Contingency Fund of India?
   (a) Article 110 (b) Article 266
   (c) Article 360 (d) Article 280

Answer:

(c) Article 267

Explanation:

Article 267 of the Indian Constitution deals with the Contingency Fund of India.

114. How is the Contingency Fund of India financed?
   (a) By the President from personal funds
   (b) By voluntary contributions from the public
   (c) By budgetary allocations from the Consolidated Fund of India
   (d) By external borrowings from international agencies

Answer:

(c) By budgetary allocations from the Consolidated Fund of India

Explanation:
The Contingency Fund of India is financed by budgetary allocations made by the parliament from the Consolidated Fund of India.

115. What is the maximum amount that can be kept in the Contingency Fund of India?
(a) ₹ 10,000 crore
(b) ₹ 30,000 crore
(c) ₹ 50,000 crore
(d) There is no specified maximum limit.

Answer:
(d) There is no specified maximum limit.

Explanation:
There is no specified maximum limit for the Contingency Fund of India. The amount that can be kept in the fund is determined by the government as per the requirement.

116. Who has the authority to make withdrawals from the Contingency Fund of India?
(a) The President of India
(b) The Prime Minister of India
(c) The Finance Minister of India
(d) The Reserve-Bank of India

Answer:
(a) The President of India

Explanation:
The President of India has the authority to make withdrawals from the Contingency Fund of India for urgent and unforeseen expenses.

117. How are withdrawals from the Contingency Fund of India made?
(a) By the President's order
(b) By the Prime Minister's order
(c) By the Finance Minister's order
(d) By the Reserve Bank of India's approval

Answer: (a) By the President's order

Explanation:
Withdrawals from the Contingency Fund of India are made by the order of the President of India.

118. What happens if the amount in the Contingency Fund of India is insufficient to meet the expenditure?
(a) The government can draw additional funds from the Consolidated Fund of India.
(b) The government can borrow from international financial institutions.
(c) The expenditure remains pending until the parliament approves additional funds.
(d) The President can use personal funds to cover the shortfall.

Answer:
(a) The government can draw additional funds from the Consolidated Fund of India.

Explanation:
If the amount in the Contingency Fund of India is insufficient to meet the expenditure, the government can draw additional funds from the Consolidated Fund of India after obtaining the necessary authorization from the parliament.

119. The Contingency Fund of India is audited by:
(a) The President of India
(b) The Comptroller and Auditor General (CAG) of India
(c) The Finance Minister of India
(d) The Reserve Bank of India

Answer:
(b) The Comptroller and Auditor General (CAG) of India

Explanation:
The Contingency Fund of India is audited by the Comptroller and Auditor General (CAG) of India to ensure proper utilization of funds.

Public Account

120. What is the Public Account of India?
(a) A fund managed by the Reserve Bank of India for foreign exchange transactions
(b) A fund maintained by the government to finance development projects

(c) A fund that holds all revenues received and loans raised by the government
(d) A fund that accounts for money received by the government other than those classified under the Consolidated Fund of India

Answer:
(d) A fund that accounts for money received by the government other than those classified under the Consolidated Fund of India

Explanation:
The Public Account of India is a fund that accounts for money received by the government other than those classified under the Consolidated Fund of India. It includes receipts of the government that do not belong to the government as a whole and are kept in the Public Account for specific purposes.

121. Which article of the Indian Constitution deals with the Public Account of India?
(a) Article 266
(b) Article 110
(c) Article 360
(d) Article 280

Answer:
(a) Article 266

Explanation:
Article 266 of the Indian Constitution deals with the Public Account of India.

122. Which of the following receipts is credited to the Public Account of India?
(a) Revenue from income tax
(b) Revenue from customs duty
(c) Proceeds from disinvestment of public sector enterprises
(d) Proceeds from loans raised by the government

Answer:
(c) Proceeds from disinvestment of public sector enterprises

Explanation:
The proceeds from disinvestment of public sector enterprises are credited to the Public Account of India, as these receipts do not form part of the government's current revenue.

123. How are withdrawals from the Public Account of India made?
(a) By the President's order
(b) By the Prime Minister's order
(c) By the Finance Minister's order
(d) Only through parliamentary approval

Answer:
(a) By the President's order

Explanation:
Withdrawals from the Public Account of India are made by the order of the President of India for specified purposes.

124. Which of the following is NOT a part of the Public Account of India?
(a) Provident Fund
(b) Small Savings Funds
(c) Investment in public sector companies
(d) National Investment Fund

Answer:
(c) Investment in public sector companies

Explanation:
The investment in public sector companies is not a part of the Public Account of India. Public sector companies are separate entities, and their investments are treated differently.

125. The Public Account of India is administered by:
(a) The President of India
(b) The Reserve Bank of India
(c) The Finance Minister of India
(d) The Comptroller and Auditor General (CAG) of India

Answer:
(c) The Finance Minister of India

Explanation:
The Public Account of India is administered by the Finance Minister of India.

126. What is the primary purpose of the Public Account of India?
(a) To finance government development projects
(b) To hold revenues for the welfare of government employees

(c) To account for receipts and disbursements of public money
(d) To provide funds for emergency situations

Answer:

(c) To account for receipts and disbursements of public money

Explanation:

The primary purpose of the Public Account of India is to account for receipts and disbursements of public money that does not belong to the government as a whole.

127. The surplus amount in the Public Account of India is usually utilized for:
(a) Financing the defense and security expenses of the country
(b) Meeting the fiscal deficit of the government
(c) Financing various welfare and social programs
(d) Repayment of loans raised by the government

Answer:

(c) Financing various welfare and social programs

Explanation:

The surplus amount in the Public Account of India is typically utilized for financing various welfare and social programs and other specified purposes, as approved by the government.

Additional Question Bank

1.1 Introduction

1. What is the process of budget making?
(a) Planning, execution, evaluation
(b) Revenue generation, expenditure management, debt management
(c) Budget proposal, legislative approval, implementation
(d) Financial forecasting, revenue estimation, expenditure estimation

2. Which of the following is a source of revenue for the government?
(a) Expenditure on public services
(b) Public debt
(c) Taxes
(d) Budget deficit

3. Which aspect of budgeting involves controlling and optimizing government spending?
(a) Expenditure management
(b) Debt management
(c) Revenue generation
(d) Budget forecasting

4. What does the management of public debt refer to?
(a) Generating revenue through borrowing
(b) Allocating funds for public projects
(c) Controlling government expenses
(d) Managing loans and liabilities of the government

5. Which of the following is a part of the budget process that involves estimating the expected income and expenses for the upcoming period?
(a) Budget approval
(b) Budget implementation
(c) Budget forecasting
(d) Budget evaluation

1.2 The Process of Budget Making

1. Which stage of the budget-making process involves analyzing the past performance, current economic conditions, and future projections?
(a) Budget execution
(b) Budget evaluation
(c) Budget formulation
(d) Budget authorization

2. What is the primary purpose of the budget-making process?
(a) Increasing government debt
(b) Controlling inflation
(c) Allocating resources effectively
(d) Reducing taxes

3. During which stage of the budget process is public input and feedback typically considered?
(a) Budget authorization (b) Budget execution
(c) Budget formulation (d) Budget evaluation

4. Which government entity is responsible for approving and authorizing the final budget?
   (a) Central bank
   (b) Parliament/Congress
   (c) Ministry of Finance
   (d) International Monetary Fund (IMF)
5. Which aspect of the budget-making process involves implementing the budgetary plans and disbursing funds?
   (a) Budget execution
   (b) Budget forecasting
   (c) Budget evaluation
   (d) Budget authorization

1.3 Sources of Revenue

1. Which of the following is an example of a direct source of government revenue?
   (a) Corporate income tax (b) Inflation tax
   (c) Sales tax (d) Property tax
2. What type of revenue is generated from government-owned assets or businesses?
   (a) Indirect taxes (b) Grants
   (c) User fees (d) Non-tax revenue
3. Which tax is typically levied on the value of goods and services at each stage of production and distribution?
   (a) Income tax
   (b) Excise tax
   (c) Value Added Tax (VAT)
   (d) Property tax
4. What is the main source of revenue for the government in a country with a predominantly agricultural economy?
   (a) Corporate income tax
   (b) Personal income tax
   (c) Export duties
   (d) Sales tax

5. Which revenue source involves funds provided by foreign governments or international organizations to support specific projects or programs?
   (a) Corporate tax
   (b) Grants
   (c) Excise tax
   (d) Tariffs

1.4 Public Expenditure Management

1. What is the primary goal of public expenditure management?
   (a) Maximizing government revenue
   (b) Minimizing budget deficit
   (c) Efficient allocation of resources
   (d) Reducing inflation
2. Which aspect of public expenditure management involves setting clear objectives and priorities for government spending?
   (a) Budget forecasting (b) Budget execution
   (c) Budget formulation (d) Budget evaluation
3. What does the term "Virement" mean in public expenditure management?
   (a) The transfer of funds from one budget head to another
   (b) The allocation of funds for a specific project
   (c) The evaluation of budget performance
   (d) The approval of the final budget by the parliament
4. Which mechanism is used in public expenditure management to control spending when actual revenues are lower than expected?
   (a) Debt management (b) Budget deficit
   (c) Austerity measures (d) Inflation targeting
5. What is the purpose of conducting mid-year budget reviews in public expenditure management?
   (a) To evaluate the performance of government agencies
   (b) To identify potential cost-saving measures
   (c) To assess the impact of inflation on the budget
   (d) To adjust the budget based on changing economic conditions

1.5 Public Debt Management

1. What is public debt?
   (a) The total debt owed by individuals to the government
   (b) The total debt owed by the government to individuals and foreign entities
   (c) The debt owed by corporations to the government
   (d) The debt owed by the government to the central bank
2. Which of the following is a common instrument used by governments to borrow money from the public?
   (a) Corporate bonds
   (b) Treasury bills
   (c) Stocks
   (d) Mortgage-backed securities
3. How does a government use bond issuance as a debt management strategy?
   (a) To increase inflation
   (b) To raise funds for specific public projects
   (c) To reduce interest rates
   (d) To decrease the money supply
4. What is the role of a debt-to-GDP ratio in public debt management?
   (a) It determines the interest rate on government bonds.
   (b) It indicates the total amount of government revenue generated from debt.
   (c) It assesses the government's ability to repay its debt relative to its economic output.
   (d) It determines the maturity period of government debt instruments.
5. How does a government utilize debt restructuring as a debt management measure?
   (a) To reduce the national debt to zero
   (b) To extend the repayment period of existing debt
   (c) To borrow from international organizations
   (d) To increase interest rates on outstanding debt

Answer

1.1 Introduction

1. (c) Budget proposal, legislative approval, implementation
2. (c) Taxes
3. (a) Expenditure management
4. (d) Managing loans and liabilities of the government
5. (c) Budget forecasting

1.2 The Process of Budget Making

1. (c) Budget formulation
2. (c) Allocating resources effectively
3. (c) Budget formulation
4. (b) Parliament/Congress
5. (a) Budget execution

1.3 Sources of Revenue

1. (a) Corporate income tax
2. (d) Non-tax revenue
3. (c) Value Added Tax (VAT)
4. (c) Export duties
5. (b) Grants

1.4 Public Expenditure Management

1. (c) Efficient allocation of resources
2. (c) Efficient allocation of resources
3. (c) Budget formulation
4. (a) The transfer of funds from one budget head to another
5. (c) Austerity measures
6. (d) To adjust the budget based on changing economic conditions

1.5 Public Debt Management

1. (b) The total debt owed by the government to individuals and foreign entities
2. (b) Treasury bills
3. (b) To raise funds for specific public projects
4. (c) It assesses the government's ability to repay its debt relative to its economic output.
5. (b) To extend the repayment period of existing debt

7 PUBLIC FINANCE

Unit:4 Fiscal Policy

Multiple Choice Questions

1.1 Introduction

1. What is Fiscal Policy?
   (a) A policy that regulates the flow of foreign exchange in the economy
   (b) A policy that controls the circulation of currency notes and coins
   (c) A policy that deals with government's taxation and spending decisions to influence the economy
   (d) A policy that regulates the interest rates in the financial market

   Answer:
   (c) A policy that deals with government's taxation and spending decisions to influence the economy

   Explanation:
   Fiscal Policy refers to the use of government's taxation and spending decisions to influence the economy's overall level of economic activity.

2. The main objectives of Fiscal Policy include:
   (a) Controlling inflation and reducing the fiscal deficit
   (b) Regulating the foreign exchange rate and promoting exports
   (c) Maintaining price stability and ensuring balanced economic growth
   (d) Controlling the money supply and stabilizing the financial market

   Answer:
   (c) Maintaining price stability and ensuring balanced economic growth

   Explanation:
   The main objectives of Fiscal Policy include maintaining price stability, controlling inflation, and ensuring balanced economic growth by managing government spending and taxation.

3. Fiscal Policy can be classified into two types:
   (a) Monetary Policy and Exchange Rate Policy
   (b) Expansionary Fiscal Policy and Contractionary Fiscal Policy
   (c) Microeconomic Policy and Macroeconomic Policy
   (d) Trade Policy and Investment Policy

   Answer:

   (b) Expansionary Fiscal Policy and Contractionary Fiscal Policy

   Explanation:

   Fiscal Policy can be classified into two types: Expansionary Fiscal Policy, which involves increasing government spending and reducing taxes to stimulate economic growth, and Contractionary Fiscal Policy, which involves reducing government spending and increasing taxes to control inflation and cool down the economy.

4. When does the government use an Expansionary Fiscal Policy?
   (a) During periods of high inflation and overheating in the economy
   (b) During periods of recession and high unemployment
   (c) During periods of trade deficits and depreciation of the currency
   (d) During periods of budget surplus and surplus revenue

   Answer:

   (b) During periods of recession and high unemployment

   Explanation:

   The government uses an Expansionary Fiscal Policy during periods of recession and high unemployment to stimulate economic growth and increase aggregate demand.

5. What is the primary tool used by the government in implementing Fiscal Policy?
   (a) Printing of currency notes and coins
   (b) Setting interest rates in the banking sector
   (c) Regulation of foreign trade and exports
   (d) Government spending and taxation decisions

   Answer:

   (d) Government spending and taxation decisions

   Explanation:

   Government spending and taxation decisions are the primary tools used by the government in implementing Fiscal Policy to influence the level of economic activity.

6. How does Contractionary Fiscal Policy aim to control inflation?
   (a) By reducing the money supply in the economy
   (b) By increasing government spending on infrastructure projects
   (c) By reducing interest rates to boost investment and consumption
   (d) By reducing government spending and increasing taxes

   Answer:

   (d) By reducing government spending and increasing taxes

   Explanation:

   Contractionary Fiscal Policy aims to control inflation by reducing government spending and increasing taxes, which reduces aggregate demand and helps cool down the economy.

7. Fiscal Policy operates through its impact on:
   (a) Monetary policy and exchange rates
   (b) Interest rates and credit availability
   (c) Government administration and bureaucracy
   (d) Fiscal deficits and trade imbalances

   Answer:

   (b) Interest rates and credit availability

   Explanation:

   Fiscal Policy operates through its impact on interest rates and credit availability in the economy, which, in turn, affects consumption and investment decisions.

8. What are the limitations of Fiscal Policy?
   (a) Limited government control over taxation and public spending
   (b) The inability to influence the money supply and interest rates
   (c) Time lags in the implementation of fiscal measures and their impact
   (d) The lack of coordination between fiscal and monetary policies

   Answer:

   (c) Time lags in the implementation of fiscal measures and their impact

Explanation:
One of the limitations of Fiscal Policy is the existence of time lags in the implementation of fiscal measures and their impact on the economy. Fiscal measures may take time to have their desired effect, leading to challenges in timing the policy response appropriately.

1.2 Objectives of Fiscal Policy

1. What are the primary objectives of Fiscal Policy?
   (a) Regulating the money supply and controlling inflation
   (b) Promoting exports and reducing trade deficits
   (c) Managing government spending and reducing the fiscal deficit
   (d) Maintaining price stability and ensuring balanced economic growth
   Answer:
   (d) Maintaining price stability and ensuring balanced economic growth
   Explanation:
   The primary objectives of Fiscal Policy are to maintain price stability, control inflation, and ensure balanced economic growth by managing government spending and taxation.
2. How does Fiscal Policy contribute to economic stability?
   (a) By directly controlling interest rates and money supply
   (b) By influencing the level of aggregate demand and economic activity
   (c) By regulating foreign exchange rates and trade balances
   (d) By promoting savings and investments in the economy
   Answer:
   (b) By influencing the level of aggregate demand and economic activity
   Explanation:
   Fiscal Policy contributes to economic stability by influencing the level of aggregate demand and economic activity through government spending and taxation decisions.
3. During periods of recession and high unemployment, Fiscal Policy aims to:
   (a) Increase government spending and reduce taxes
   (b) Reduce government spending and increase taxes

   (c) Control inflation and cool down the economy
   (d) Reduce interest rates and boost private investment
   Answer:
   (a) Increase government spending and reduce taxes
   Explanation:
   During periods of recession and high unemployment, Fiscal Policy aims to stimulate economic growth and increase aggregate demand by increasing government spending and reducing taxes. This is known as an Expansionary Fiscal Policy.
4. How does Fiscal Policy help in controlling inflation?
   (a) By directly controlling interest rates and money supply
   (b) By reducing government spending and increasing taxes
   (c) By promoting exports and reducing trade deficits
   (d) By encouraging private investment through tax incentives
   Answer:
   (b) By reducing government spending and increasing taxes
   Explanation:
   Fiscal Policy helps in controlling inflation by reducing aggregate demand in the economy. This is achieved through a Contractionary Fiscal Policy, which involves reducing government spending and increasing taxes.
5. What is the relationship between Fiscal Policy and economic growth?
   (a) Fiscal Policy has no impact on economic growth.
   (b) Expansionary Fiscal Policy leads to economic growth.
   (c) Contractionary Fiscal Policy leads to economic growth.
   (d) Fiscal Policy only affects the distribution of income.
   Answer:
   (b) Expansionary Fiscal Policy leads to economic growth.
   Explanation:
   Expansionary Fiscal Policy, which involves increasing government spending and reducing taxes, leads to an increase in aggregate demand and stimulates economic growth.
6. Fiscal Policy can be used to address which of the following economic challenges?
   (a) Political instability and corruption
   (b) Technological advancements and automation

(c) Income inequality and poverty
(d) Exchange rate fluctuations and balance of payments

Answer:

(c) Income inequality and poverty

Explanation:

Fiscal Policy can be used to address income inequality and poverty by implementing progressive taxation and directing government spending towards social welfare programs.

7. How does Fiscal Policy influence private sector investment?
(a) By directly controlling interest rates in the financial market
(b) By providing subsidies and incentives to private companies
(c) By regulating foreign direct investment (FDI) and trade policies
(d) By altering the overall level of economic activity and confidence in the economy

Answer:

(d) By altering the overall level of economic activity and confidence in the economy

Explanation:

Fiscal Policy influences private sector investment by altering the overall level of economic activity and creating a favorable business environment, which affects business confidence and investment decisions.

8. What is the major challenge in implementing Fiscal Policy effectively?
(a) Coordinating fiscal measures with monetary policy
(b) Limitations in government control over taxation and public spending
(c) Uncertainties in the global economic environment
(d) Lack of skilled labor and technological advancements

Answer:

(a) Coordinating fiscal measures with monetary policy

Explanation:

A major challenge in implementing Fiscal Policy effectively is coordinating fiscal measures with monetary policy to ensure that both policies work coherently and support the overall economic objectives.

1.3 Types of Fiscal Policy

1. What are the two main types of Fiscal Policy?
(a) Monetary Fiscal Policy and Exchange Rate Fiscal Policy
(b) Expansionary Fiscal Policy and Contractionary Fiscal Policy
(c) Micro Fiscal Policy and Macro Fiscal Policy
(d) Trade Fiscal Policy and Investment Fiscal Policy

Answer:

(b) Expansionary Fiscal Policy and Contractionary Fiscal Policy

Explanation:

The two main types of Fiscal Policy are Expansionary Fiscal Policy and Contractionary Fiscal Policy. The former aims to stimulate economic growth, while the latter aims to control inflation.

2. What is the objective of an Expansionary Fiscal Policy?
(a) To control inflation and reduce aggregate demand
(b) To reduce government spending and increase taxes
(c) To stimulate economic growth and increase aggregate demand
(d) To promote exports and reduce trade deficits

Answer:

(c) To stimulate economic growth and increase aggregate demand

Explanation:

The objective of an Expansionary Fiscal Policy is to stimulate economic growth and increase aggregate demand in the economy by increasing government spending and reducing taxes.

3. How does Contractionary Fiscal Policy impact the economy?
(a) It leads to higher economic growth and reduced unemployment.
(b) It stimulates private investment and increases consumer spending.
(c) It reduces aggregate demand and controls inflation.
(d) It promotes exports and improves the balance of payments.

Answer:

(c) It reduces aggregate demand and controls inflation.

Explanation:

Contractionary Fiscal Policy reduces aggregate demand in the economy by reducing government spending and increasing taxes. It is used to control inflation and prevent the economy from overheating.

4. During an economic recession, which type of Fiscal Policy would be most appropriate?
   (a) Expansionary Fiscal Policy (b) Contractionary Fiscal Policy
   (c) Monetary Fiscal Policy (d) Exchange Rate Fiscal Policy

   Answer:
   (a) Expansionary Fiscal Policy

   Explanation:
   During an economic recession, when there is low economic growth and high unemployment, an Expansionary Fiscal Policy is most appropriate to stimulate economic activity and increase aggregate demand.

5. How does the government implement an Expansionary Fiscal Policy?
   (a) By reducing government spending and increasing taxes
   (b) By reducing interest rates and controlling the money supply
   (c) By increasing government spending and reducing taxes
   (d) By regulating foreign exchange rates and trade balances

   Answer:
   (c) By increasing government spending and reducing taxes

   Explanation:
   To implement an Expansionary Fiscal Policy, the government increases government spending on infrastructure projects and social welfare programs, and it reduces taxes to boost disposable income and consumer spending.

6. What is the goal of a Contractionary Fiscal Policy?
   (a) To promote exports and improve the balance of trade
   (b) To increase government spending and stimulate economic growth
   (c) To reduce government revenue and increase budget deficit
   (d) To control inflation and reduce aggregate demand

   Answer:
   (d) To control inflation and reduce aggregate demand

   Explanation:
   The goal of a Contractionary Fiscal Policy is to control inflation and reduce aggregate demand in the economy by reducing government spending and increasing taxes.

7. What are the main instruments used in implementing Fiscal Policy?
   (a) Regulation of foreign exchange rates and monetary policies
   (b) Control over the money supply and interest rates
   (c) Government spending and taxation decisions
   (d) Trade policies and export incentives

   Answer:
   (c) Government spending and taxation decisions

   Explanation:
   The main instruments used in implementing Fiscal Policy are government spending and taxation decisions, which directly influence aggregate demand and economic activity.

8. In a period of high inflation and excessive economic growth, which type of Fiscal Policy is appropriate?
   (a) Expansionary Fiscal Policy
   (b) Contractionary Fiscal Policy
   (c) Monetary Fiscal Policy
   (d) Exchange Rate Fiscal Policy

   Answer:
   (b) Contractionary Fiscal Policy

   Explanation:
   In a period of high inflation and excessive economic growth, a Contractionary Fiscal Policy is appropriate to control inflation and reduce aggregate demand in the economy.

1.4 The Instruments of Fiscal Policy

1. Which of the following is an instrument of Fiscal Policy used to stimulate economic growth and increase aggregate demand?
   (a) Monetary Policy
   (b) Contractionary Fiscal Policy
   (c) Exchange Rate Policy
   (d) Expansionary Fiscal Policy

   Answer:
   (d) Expansionary Fiscal Policy

Explanation:
Expansionary Fiscal Policy is an instrument of Fiscal Policy used to stimulate economic growth and increase aggregate demand by increasing government spending and reducing taxes.

2. How does the government use taxation as an instrument of Fiscal Policy?
   (a) By imposing tariffs on imports to promote domestic industries
   (b) By controlling the money supply and interest rates
   (c) By regulating the exchange rate to boost exports
   (d) By adjusting tax rates to influence disposable income and consumption

   Answer:
   (d) By adjusting tax rates to influence disposable income and consumption

   Explanation:
   The government uses taxation as an instrument of Fiscal Policy by adjusting tax rates to influence disposable income and consumption, which in turn affects aggregate demand.

3. During periods of high inflation, which instrument of Fiscal Policy is most likely to be used?
   (a) Monetary Policy
   (b) Expansionary Fiscal Policy
   (c) Exchange Rate Policy
   (d) Contractionary Fiscal Policy

   Answer:
   (d) Contractionary Fiscal Policy

   Explanation:
   During periods of high inflation, the government is likely to use Contractionary Fiscal Policy to control inflation by reducing government spending and increasing taxes.

4. What is the primary objective of using government spending as an instrument of Fiscal Policy?
   (a) To regulate the money supply and control interest rates
   (b) To increase tax revenue and reduce budget deficit

   (c) To stimulate economic growth and create demand for goods and services
   (d) To promote exports and improve the balance of trade

   Answer:
   (c) To stimulate economic growth and create demand for goods and services

   Explanation:
   The primary objective of using government spending as an instrument of Fiscal Policy is to stimulate economic growth and create demand for goods and services, thereby increasing aggregate demand.

5. How does the government use public investment as an instrument of Fiscal Policy?
   (a) By investing in foreign markets to promote international trade
   (b) By providing subsidies to private companies for investments
   (c) By investing in infrastructure projects to boost economic activity
   (d) By controlling the foreign exchange rate and capital flows

   Answer:
   (c) By investing in infrastructure projects to boost economic activity

   Explanation:
   The government uses public investment as an instrument of Fiscal Policy by investing in infrastructure projects, such as roads, bridges, and public utilities, to boost economic activity and create jobs.

6. Which of the following is an automatic stabilizer used in Fiscal Policy?
   (a) Public debt management
   (b) Progressive taxation
   (c) Exchange rate intervention
   (d) Controlling inflation expectations

   Answer:
   (b) Progressive taxation

   Explanation:
   Progressive taxation is an automatic stabilizer used in Fiscal Policy, as it helps stabilize the economy by reducing income inequality during economic downturns.

7. How does Fiscal Policy complement monetary policy?
   (a) By controlling foreign exchange rates and capital flows
   (b) By regulating the money supply and interest rates
   (c) By promoting exports and reducing trade deficits
   (d) By influencing government spending and taxation decisions

   Answer:
   (d) By influencing government spending and taxation decisions

   Explanation:
   Fiscal Policy complements monetary policy by influencing government spending and taxation decisions to achieve the desired economic objectives, such as stimulating economic growth or controlling inflation.

8. When the government increases public expenditure on education and healthcare, it is using Fiscal Policy as an instrument to:
   (a) Regulate the money supply and control inflation
   (b) Promote international trade and exports
   (c) Enhance human capital and promote long-term economic growth
   (d) Stabilize the financial market and control exchange rates

   Answer:
   (c) Enhance human capital and promote long-term economic growth

   Explanation:
   When the government increases public expenditure on education and healthcare, it is using Fiscal Policy as an instrument to enhance human capital and promote long-term economic growth by investing in the development of its workforce.

1.4.1 Government Expenditure as an Instrument of Fiscal Policy

1. How does the government use government expenditure as an instrument of Fiscal Policy?
   (a) By regulating foreign exchange rates and trade balances
   (b) By controlling the money supply and interest rates
   (c) By adjusting tax rates to influence consumption
   (d) By increasing or decreasing spending on goods and services

   Answer:
   (d) By increasing or decreasing spending on goods and services

   Explanation:
   The government uses government expenditure as an instrument of Fiscal Policy by increasing or decreasing its spending on goods and services to influence aggregate demand and stimulate economic growth or control inflation.

2. During a period of economic recession, what is the likely approach of the government regarding government expenditure?
   (a) Increase government expenditure to stimulate economic growth
   (b) Maintain government expenditure at the current level
   (c) Reduce government expenditure to control inflation
   (d) Shift government expenditure towards defense and security

   Answer:
   (a) Increase government expenditure to stimulate economic growth

   Explanation:
   During a period of economic recession, the government is likely to increase government expenditure on infrastructure projects and social welfare programs to stimulate economic growth and increase aggregate demand.

3. How does an increase in government expenditure impact the economy?
   (a) It reduces aggregate demand and leads to deflation.
   (b) It stimulates economic growth and increases employment.
   (c) It increases trade deficits and depreciation of the currency.
   (d) It leads to a budget surplus and reduces public debt.

   Answer:
   (b) It stimulates economic growth and increases employment.

   Explanation:
   An increase in government expenditure stimulates economic growth by increasing demand for goods and services, which leads to increased production and employment in the economy.

4. During a period of high inflation, what is the likely approach of the government regarding government expenditure?
   (a) Increase government expenditure to boost economic growth
   (b) Maintain government expenditure at the current level

(c) Reduce government expenditure to control inflation
(d) Shift government expenditure towards social welfare programs

Answer:

(c) Reduce government expenditure to control inflation

Explanation:

During a period of high inflation, the government is likely to reduce government expenditure to control inflation and reduce aggregate demand in the economy.

5. Which sector of the economy is typically targeted by the government for increased expenditure during an economic recession?
(a) Defense and security sector
(b) Financial and banking sector
(c) Export-oriented industries
(d) Infrastructure and social welfare sector

Answer:

(d) Infrastructure and social welfare sector

Explanation:

During an economic recession, the government typically targets increased expenditure on infrastructure and social welfare programs to stimulate economic growth and create jobs.

6. How does government expenditure influence private investment?
(a) By directly controlling interest rates in the financial market
(b) By providing subsidies and incentives to private companies
(c) By regulating foreign direct investment (FDI) and trade policies
(d) By creating a conducive business environment and increasing demand for goods and services

Answer:

(d) By creating a conducive business environment and increasing demand for goods and services

Explanation:

Government expenditure influences private investment by creating a conducive business environment through infrastructure development and increasing demand for goods and services, which can boost private sector confidence and investment.

7. Which of the following is a key consideration for the government while determining the allocation of government expenditure?
(a) Increasing trade deficits and promoting exports
(b) Balancing the budget and reducing fiscal deficits
(c) Regulating foreign exchange rates and capital flows
(d) Addressing the needs of various sectors and promoting economic development

Answer:

(d) Addressing the needs of various sectors and promoting economic development

Explanation:

A key consideration for the government while determining the allocation of government expenditure is to address the needs of various sectors in the economy and promote overall economic development.

8. What is the impact of an increase in government expenditure on fiscal deficit?
(a) It reduces the fiscal deficit due to increased tax revenue.
(b) It has no impact on the fiscal deficit as long as tax rates remain constant.
(c) It increases the fiscal deficit, especially if tax revenue does not increase proportionately.
(d) It stabilizes the fiscal deficit by controlling public debt.

Answer:

(c) It increases the fiscal deficit, especially if tax revenue does not increase proportionately.

Explanation:

An increase in government expenditure can lead to an increase in the fiscal deficit, especially if tax revenue does not increase proportionately to cover the additional spending.

1.4.2 Taxes as an Instrument of Fiscal Policy

1. How does the government use taxes as an instrument of Fiscal Policy?
(a) By adjusting government expenditure to influence aggregate demand
(b) By controlling the money supply and interest rates

(c) By increasing or decreasing tax rates to influence disposable income and consumption
(d) By regulating foreign exchange rates and trade balances

Answer:

(c) By increasing or decreasing tax rates to influence disposable income and consumption

Explanation:

The government uses taxes as an instrument of Fiscal Policy by adjusting tax rates to influence disposable income and consumption, which in turn affects aggregate demand.

2. During a period of high inflation, what is the likely approach of the government regarding taxes?
(a) Increase tax rates to reduce disposable income and control inflation
(b) Reduce tax rates to stimulate consumer spending and boost economic growth
(c) Maintain tax rates at the current level and focus on other policy measures
(d) Shift the tax burden towards corporate taxes and away from individual taxes

Answer:

(a) Increase tax rates to reduce disposable income and control inflation

Explanation:

During a period of high inflation, the government is likely to increase tax rates to reduce disposable income, decrease consumer spending, and control inflation.

3. How does a decrease in tax rates impact the economy?
(a) It reduces government revenue and increases budget deficit.
(b) It stimulates economic growth and increases private investment.
(c) It increases trade deficits and depreciation of the currency.
(d) It leads to a surplus in the balance of trade and reduces public debt.

Answer:

(b) It stimulates economic growth and increases private investment.

Explanation:

A decrease in tax rates stimulates economic growth by increasing disposable income and consumer spending, which can lead to increased private investment and overall economic activity.

4. During a period of economic recession, what is the likely approach of the government regarding taxes?
(a) Increase tax rates to boost government revenue and reduce fiscal deficit
(b) Reduce tax rates to stimulate consumer spending and increase aggregate demand
(c) Maintain tax rates at the current level and focus on other policy measures
(d) Shift the tax burden towards individual taxes and away from corporate taxes

Answer:

(b) Reduce tax rates to stimulate consumer spending and increase aggregate demand

Explanation:

During a period of economic recession, the government is likely to reduce tax rates to increase disposable income, boost consumer spending, and stimulate aggregate demand.

5. Which type of tax policy is more suitable during periods of economic expansion and growth?
(a) Progressive tax policy with higher tax rates for higher income groups
(b) Regressive tax policy with higher tax rates for lower income groups
(c) Proportional tax policy with a flat tax rate for all income groups
(d) Neutral tax policy with no changes in tax rates during economic cycles

Answer:

(a) Progressive tax policy with higher tax rates for higher income groups

Explanation:

During periods of economic expansion and growth, a progressive tax policy with higher tax rates for higher income groups is more suitable as it helps in reducing income inequality and generates higher revenue during economic prosperity.

6. How does the government use tax incentives as a tool of Fiscal Policy?
   (a) By reducing tax rates for essential goods and services
   (b) By providing subsidies to corporations for capital investments
   (c) By offering tax deductions and exemptions to encourage specific behaviors
   (d) By imposing higher taxes on luxury goods and services

   Answer:
   (c) By offering tax deductions and exemptions to encourage specific behaviors

   Explanation:
   The government uses tax incentives as a tool of Fiscal Policy by offering tax deductions and exemptions to encourage specific behaviors, such as investment in certain industries or saving for retirement.
7. What is the impact of an increase in taxes on consumer spending?
   (a) It leads to an increase in consumer spending due to higher disposable income.
   (b) It leads to a decrease in consumer spending due to reduced disposable income.
   (c) It has no impact on consumer spending as long as interest rates remain constant.
   (d) It leads to a shift in consumer spending towards non-taxable goods and services.

   Answer:
   (b) It leads to a decrease in consumer spending due to reduced disposable income.

   Explanation:
   An increase in taxes reduces disposable income, which in turn leads to a decrease in consumer spending as people have less money available for spending on goods and services.
8. How does the government use tax policy to address income inequality?
   (a) By providing tax deductions only to high-income groups
   (b) By reducing tax rates for all income groups equally
   (c) By imposing higher taxes on low-income individuals
   (d) By implementing progressive tax rates with higher rates for higher income groups

   Answer:
   (d) By implementing progressive tax rates with higher rates for higher income groups

   Explanation:
   The government uses tax policy to address income inequality by implementing progressive tax rates, where higher-income individuals are subject to higher tax rates, thereby reducing income disparity.

1.4.3 Public Debt as an Instrument of Fiscal Policy

1. How does the government use public debt as an instrument of Fiscal Policy?
   (a) By borrowing money from foreign governments to finance infrastructure projects
   (b) By repaying loans and reducing the fiscal deficit
   (c) By issuing government bonds to finance expenditures and stimulate economic growth
   (d) By using credit rating agencies to assess the government's financial position

   Answer:
   (c) By issuing government bonds to finance expenditures and stimulate economic growth

   Explanation:
   The government uses public debt as an instrument of Fiscal Policy by issuing government bonds to finance expenditures, such as infrastructure projects and social welfare programs, which can stimulate economic growth.
2. What is the impact of increased public debt on the economy?
   (a) It leads to lower interest rates and increased private investment.
   (b) It reduces government expenditure and increases budget surplus.
   (c) It may lead to higher interest rates and crowd out private investment.
   (d) It has no impact on the economy as public debt is just an accounting entry.

   Answer:
   (c) It may lead to higher interest rates and crowd out private investment.

Explanation:
Increased public debt may lead to higher interest rates, as the government competes with private borrowers for funds, which can crowd out private investment and affect overall economic growth.

3. During an economic recession, how does the government use public debt as an instrument of Fiscal Policy?
   (a) By reducing public debt through fiscal consolidation measures
   (b) By borrowing from international organizations to stimulate economic growth
   (c) By issuing government bonds to finance stimulus packages and increase government spending
   (d) By using credit rating agencies to assess the impact of public debt on the economy

   Answer:
   (c) By issuing government bonds to finance stimulus packages and increase government spending

   Explanation:
   During an economic recession, the government may use public debt as an instrument of Fiscal Policy by issuing government bonds to finance stimulus packages and increase government spending, which can help stimulate economic growth.

4. What is the primary purpose of issuing government bonds?
   (a) To control foreign exchange rates and stabilize the currency
   (b) To provide subsidies to private companies for capital investments
   (c) To finance government expenditures and infrastructure projects
   (d) To reduce the fiscal deficit and increase budget surplus

   Answer:
   (c) To finance government expenditures and infrastructure projects

   Explanation:
   The primary purpose of issuing government bonds is to finance government expenditures, including infrastructure projects and other spending initiatives.

5. How does public debt affect future generations?
   (a) It has no impact on future generations as it is repaid through fiscal consolidation measures.
   (b) It reduces the burden on future generations as they benefit from increased government spending.
   (c) It may lead to higher taxes and debt servicing costs for future generations.
   (d) It stimulates economic growth and ensures a better future for the next generation.

   Answer:
   (c) It may lead to higher taxes and debt servicing costs for future generations.

   Explanation:
   Public debt may lead to higher taxes and debt servicing costs for future generations as they may be required to repay the debt incurred by the government.

6. What is the role of credit rating agencies in relation to public debt?
   (a) To invest in government bonds and assess their credit risk
   (b) To determine the value of government bonds in the financial market
   (c) To provide credit ratings for government bonds based on their risk and creditworthiness
   (d) To regulate the issuance of government bonds in the international market

   Answer:
   (c) To provide credit ratings for government bonds based on their risk and creditworthiness

   Explanation:
   Credit rating agencies assess the risk and creditworthiness of government bonds and provide credit ratings that help investors evaluate the safety of investing in these bonds.

7. What is the impact of a higher credit rating on government bonds?
   (a) It leads to lower interest rates on government bonds and reduces the cost of borrowing for the government.

(b) It leads to higher interest rates on government bonds and increases the cost of borrowing for the government.
(c) It has no impact on interest rates as government bonds are risk-free.
(d) It encourages foreign governments to borrow from the issuing country.

Answer:
(a) It leads to lower interest rates on government bonds and reduces the cost of borrowing for the government.

Explanation:
A higher credit rating on government bonds indicates lower credit risk, which leads to lower interest rates on these bonds, reducing the cost of borrowing for the government.

8. How does public debt impact a country's fiscal sustainability?
(a) Public debt has no impact on fiscal sustainability as it is a common financial practice.
(b) Public debt enhances fiscal sustainability by increasing government revenue.
(c) Public debt may lead to fiscal instability if not managed properly.
(d) Public debt ensures fiscal sustainability by reducing the budget deficit.

Answer:
(c) Public debt may lead to fiscal instability if not managed properly.

Explanation:
Public debt may lead to fiscal instability if it is not managed properly, as excessive debt levels can increase debt servicing costs and hinder the government's ability to meet its financial obligations. Proper management is essential for fiscal sustainability.

1.4.4 Budget as an Instrument of Fiscal Policy

1. How is the budget used as an instrument of Fiscal Policy?
(a) By controlling the money supply and interest rates
(b) By regulating foreign exchange rates and trade balances
(c) By adjusting government spending and taxation to achieve economic objectives
(d) By issuing government bonds to finance infrastructure projects

Answer:
(c) By adjusting government spending and taxation to achieve economic objectives

Explanation:
The budget is used as an instrument of Fiscal Policy by adjusting government spending and taxation to achieve various economic objectives, such as stimulating economic growth or controlling inflation.

2. What is the relationship between the budget deficit and Fiscal Policy?
(a) A budget deficit indicates that Fiscal Policy is expansionary.
(b) A budget deficit indicates that Fiscal Policy is contractionary.
(c) A budget deficit has no relation to Fiscal Policy.
(d) A budget deficit indicates that monetary policy is expansionary.

Answer:
(a) A budget deficit indicates that Fiscal Policy is expansionary.

Explanation:
A budget deficit indicates that the government is spending more than it is collecting in revenue, which is typically associated with an expansionary Fiscal Policy aimed at stimulating economic growth.

3. During an economic recession, what approach is the government likely to take with the budget?
(a) Increase government spending and reduce taxes to boost economic growth
(b) Reduce government spending and increase taxes to control inflation
(c) Maintain the current budget and wait for the economy to recover naturally
(d) Shift the budget focus towards defense and security spending

Answer:
(a) Increase government spending and reduce taxes to boost economic growth

Explanation:
During an economic recession, the government is likely to use an expansionary Fiscal Policy by increasing government spending and reducing taxes to stimulate economic growth.

4. How can a budget surplus be used as an instrument of Fiscal Policy?
   (a) By investing the surplus in foreign markets to generate higher returns
   (b) By increasing government spending on social welfare programs
   (c) By using the surplus to repay public debt and reduce interest payments
   (d) By reducing tax rates to stimulate consumer spending

   Answer:

   (c) By using the surplus to repay public debt and reduce interest payments

   Explanation:

   A budget surplus can be used as an instrument of Fiscal Policy by using the surplus to repay public debt, which reduces interest payments and contributes to fiscal sustainability.

5. How does an expansionary budget impact economic growth?
   (a) It reduces economic growth due to increased government intervention.
   (b) It stimulates economic growth by increasing government spending and boosting aggregate demand.
   (c) It has no impact on economic growth as budgets are balanced.
   (d) It stimulates economic growth by reducing government spending and increasing tax revenue.

   Answer:

   (b) It stimulates economic growth by increasing government spending and boosting aggregate demand.

   Explanation:

   An expansionary budget stimulates economic growth by increasing government spending on various projects and programs, which in turn boosts aggregate demand and economic activity.

6. How can a budget deficit be managed effectively?
   (a) By increasing government spending to stimulate economic growth
   (b) By reducing tax rates to encourage private investment

   (c) By implementing austerity measures and reducing unnecessary expenses
   (d) By printing more money to cover the deficit

   Answer:

   (c) By implementing austerity measures and reducing unnecessary expenses

   Explanation:

   A budget deficit can be managed effectively by implementing austerity measures, cutting unnecessary expenses, and focusing on essential government spending to bring the budget back to balance.

7. During an inflationary period, what approach is the government likely to take with the budget?
   (a) Increase government spending and reduce taxes to stimulate economic growth
   (b) Reduce government spending and increase taxes to control inflation
   (c) Maintain the current budget and wait for inflation to stabilize naturally
   (d) Shift the budget focus towards defense and security spending

   Answer:

   (b) Reduce government spending and increase taxes to control inflation

   Explanation:

   During an inflationary period, the government is likely to use a contractionary Fiscal Policy by reducing government spending and increasing taxes to control inflation and reduce aggregate demand.

8. What is the significance of a well-balanced budget for Fiscal Policy?
   (a) A well-balanced budget indicates that Fiscal Policy is expansionary.
   (b) A well-balanced budget indicates that Fiscal Policy is contractionary.
   (c) A well-balanced budget ensures fiscal sustainability and financial stability.
   (d) A well-balanced budget leads to higher interest rates and debt servicing costs.

   Answer:

   (c) A well-balanced budget ensures fiscal sustainability and financial stability.

Explanation:
A well-balanced budget, where government revenue equals government spending, ensures fiscal sustainability and financial stability, indicating that the government is managing its finances effectively.

1.4.5 Fiscal Policy for Long-run Economic Growth

1. What is the primary objective of Fiscal Policy for long-run economic growth?
   (a) To control inflation and stabilize the economy
   (b) To achieve short-term economic stability
   (c) To stimulate economic growth and increase aggregate demand
   (d) To promote sustainable and steady economic growth over time
   Answer:
   (d) To promote sustainable and steady economic growth over time
   Explanation:
   The primary objective of Fiscal Policy for long-run economic growth is to promote sustainable and steady economic growth over time, ensuring the economy's stability and prosperity in the future.
2. How can the government use Fiscal Policy to promote long-run economic growth?
   (a) By increasing government spending during economic downturns
   (b) By implementing contractionary policies to control inflation
   (c) By reducing taxes to stimulate consumer spending
   (d) By investing in infrastructure and human capital development
   Answer:
   (d) By investing in infrastructure and human capital development
   Explanation:
   The government can use Fiscal Policy to promote long-run economic growth by investing in infrastructure projects and human capital development, which enhances the economy's productivity and potential growth.
3. Which sector does the government typically prioritize for long-run economic growth?
   (a) Defense and security sector
   (b) Financial and banking sector

   (c) Export-oriented industries
   (d) Infrastructure and education sector
   Answer:
   (d) Infrastructure and education sector
   Explanation: The government typically prioritizes investment in the infrastructure and education sector to promote long-run economic growth as these areas contribute to the economy's productivity and human capital development.
4. How does investment in research and development contribute to long-run economic growth?
   (a) It increases government revenue and reduces budget deficit.
   (b) It reduces unemployment and stimulates economic growth in the short term.
   (c) It promotes technological advancements and enhances productivity.
   (d) It increases foreign direct investment and improves trade balances.
   Answer:
   (c) It promotes technological advancements and enhances productivity.
   Explanation:
   Investment in research and development promotes technological advancements, leading to increased productivity and innovation, which are essential for long-run economic growth.
5. What role does Fiscal Policy play in addressing income inequality for long-run economic growth?
   (a) Fiscal Policy has no impact on income inequality in the long run.
   (b) Fiscal Policy reduces income inequality through wealth redistribution measures.
   (c) Fiscal Policy increases income inequality by favoring higher-income groups.
   (d) Fiscal Policy addresses income inequality through short-term subsidies.
   Answer:
   (b) Fiscal Policy reduces income inequality through wealth redistribution measures.

Explanation:
Fiscal Policy can play a role in addressing income inequality for long-run economic growth by implementing wealth redistribution measures, such as progressive taxation and social welfare programs.

6. How does a stable macroeconomic environment contribute to long-run economic growth?
   (a) It leads to higher inflation and higher interest rates.
   (b) It increases uncertainty and discourages investment.
   (c) It fosters confidence and encourages private sector investment.
   (d) It leads to budget deficits and excessive government borrowing.

   Answer: (c) It fosters confidence and encourages private sector investment.

   Explanation:
   A stable macroeconomic environment fosters confidence among businesses and investors, encouraging private sector investment, which is crucial for long-run economic growth.

7. What is the significance of fiscal discipline in achieving long-run economic growth?
   (a) Fiscal discipline leads to higher public debt and increased government spending.
   (b) Fiscal discipline ensures that government spending aligns with economic priorities.
   (c) Fiscal discipline leads to higher inflation and currency depreciation.
   (d) Fiscal discipline has no impact on long-run economic growth.

   Answer:
   (b) Fiscal discipline ensures that government spending aligns with economic priorities.

   Explanation:
   Fiscal discipline is significant for achieving long-run economic growth as it ensures that government spending aligns with economic priorities, leading to more efficient allocation of resources.

8. How does investment in education contribute to long-run economic growth?
   (a) It increases government revenue through higher taxation.
   (b) It reduces government expenditure on social welfare programs.

   (c) It enhances human capital and improves labor productivity.
   (d) It increases foreign direct investment and trade balances.

   Answer:
   (c) It enhances human capital and improves labor productivity.

   Explanation:
   Investment in education enhances human capital by improving the skills and knowledge of the workforce, leading to higher labor productivity and contributing to long-run economic growth.

1.4.6 Fiscal Policy for Reduction in Inequalities of Income and Wealth

1. What is the primary objective of Fiscal Policy for reducing inequalities of income and wealth?
   (a) To promote economic growth and increase aggregate demand
   (b) To achieve short-term economic stability
   (c) To stimulate consumer spending through tax cuts
   (d) To promote a more equitable distribution of income and wealth

   Answer:
   (d) To promote a more equitable distribution of income and wealth

   Explanation:
   The primary objective of Fiscal Policy for reducing inequalities of income and wealth is to promote a more equitable distribution of resources and opportunities within the economy.

2. How can the government use Fiscal Policy to reduce income inequality?
   (a) By increasing government spending on defense and security
   (b) By implementing contractionary policies to control inflation
   (c) By reducing tax rates for higher-income groups
   (d) By implementing progressive taxation and social welfare programs

   Answer:
   (d) By implementing progressive taxation and social welfare programs

   Explanation:
   The government can use Fiscal Policy to reduce income inequality by implementing progressive taxation, where higher-income individuals pay higher tax rates, and by implementing social welfare programs to support lower-income groups.

3. What role does Fiscal Policy play in wealth redistribution?
   (a) Fiscal Policy has no impact on wealth redistribution in the long run.
   (b) Fiscal Policy reduces wealth inequality through progressive taxation and inheritance taxes.
   (c) Fiscal Policy increases wealth inequality by favoring higher-income groups.
   (d) Fiscal Policy addresses wealth redistribution through short-term subsidies.

   Answer:
   (b) Fiscal Policy reduces wealth inequality through progressive taxation and inheritance taxes.

   Explanation:
   Fiscal Policy can play a role in wealth redistribution by implementing progressive taxation and inheritance taxes, which aim to reduce wealth inequality and promote a more even distribution of wealth.

4. How can the government use social welfare programs to address inequalities?
   (a) By providing subsidies to corporations for capital investments
   (b) By reducing government spending to decrease the budget deficit
   (c) By targeting financial assistance to vulnerable and disadvantaged groups
   (d) By implementing tax cuts for high-income individuals

   Answer:
   (c) By targeting financial assistance to vulnerable and disadvantaged groups

   Explanation:
   The government can use social welfare programs to address inequalities by targeting financial assistance, such as unemployment benefits and healthcare support, to vulnerable and disadvantaged groups in society.

5. How does Fiscal Policy impact the disposable income of low-income individuals?
   (a) Fiscal Policy has no impact on disposable income.
   (b) Fiscal Policy increases disposable income through tax cuts for higher-income groups.

   (c) Fiscal Policy increases disposable income through tax cuts for lower-income groups.
   (d) Fiscal Policy decreases disposable income through higher taxation.

   Answer:
   (c) Fiscal Policy increases disposable income through tax cuts for lower-income groups.

   Explanation:
   Fiscal Policy can increase disposable income for low-income individuals by implementing tax cuts or providing tax credits targeted at lower-income groups.

6. What is the significance of public spending on education and healthcare for reducing income and wealth inequalities?
   (a) Public spending on education and healthcare increases income inequality.
   (b) Public spending on education and healthcare has no impact on income and wealth inequalities.
   (c) Public spending on education and healthcare reduces income and wealth inequalities by improving access to essential services.
   (d) Public spending on education and healthcare leads to higher budget deficits.

   Answer:
   (c) Public spending on education and healthcare reduces income and wealth inequalities by improving access to essential services.

   Explanation:
   Public spending on education and healthcare can reduce income and wealth inequalities by improving access to quality education and healthcare services for all citizens, regardless of their economic status.

7. What role can Fiscal Policy play in promoting equal opportunities for all citizens?
   (a) Fiscal Policy can allocate resources based on political considerations.
   (b) Fiscal Policy can favor certain industries and corporations.
   (c) Fiscal Policy can provide tax breaks only to higher-income individuals.

(d) Fiscal Policy can support policies that promote education and skill development for all citizens.

Answer:

(d) Fiscal Policy can support policies that promote education and skill development for all citizens.

Explanation:

Fiscal Policy can play a role in promoting equal opportunities by supporting policies that invest in education and skill development, ensuring that all citizens have access to opportunities for personal and economic growth.

8. How does an increase in the minimum wage contribute to reducing income inequality?
   (a) An increase in the minimum wage has no impact on income inequality.
   (b) An increase in the minimum wage reduces income inequality by raising the earnings of low-income workers.
   (c) An increase in the minimum wage widens income inequality by reducing profits for businesses.
   (d) An increase in the minimum wage leads to higher unemployment and income disparities.

Answer:

(b) An increase in the minimum wage reduces income inequality by raising the earnings of low-income workers.

Explanation:

An increase in the minimum wage can reduce income inequality by raising the earnings of low-income workers, thereby narrowing the income gap between high and low-income individuals.

1.4.7 Limitations of Fiscal Policy

1. What are the limitations of Fiscal Policy in managing the economy?
   (a) Fiscal Policy is not effective in influencing aggregate demand.
   (b) Fiscal Policy can only be implemented during periods of economic expansion.

   (c) Fiscal Policy can lead to inflation and currency depreciation.
   (d) Fiscal Policy is not a suitable tool for addressing income inequality.

Answer:

(a) Fiscal Policy is not effective in influencing aggregate demand.

Explanation:

One of the limitations of Fiscal Policy is that it may not always be effective in influencing aggregate demand, especially during certain economic conditions, such as liquidity traps or when consumers and businesses are not responsive to changes in taxation and government spending.

2. What happens when Fiscal Policy is implemented with a time lag?
   (a) It leads to immediate and effective results in the economy.
   (b) It increases the effectiveness of Fiscal Policy in managing inflation.
   (c) It may lead to a mismatch between the timing of the policy measures and the economic conditions.
   (d) It reduces the impact of Fiscal Policy on economic growth.

Answer:

(c) It may lead to a mismatch between the timing of the policy measures and the economic conditions.

Explanation:

When Fiscal Policy is implemented with a time lag, there may be a mismatch between the timing of the policy measures and the prevailing economic conditions, which can reduce the effectiveness of the policy in addressing economic issues.

3. What is the crowding-out effect in relation to Fiscal Policy?
   (a) It refers to an increase in private investment due to government spending.
   (b) It refers to a decrease in private investment due to government borrowing.
   (c) It refers to the increase in consumer spending due to government tax cuts.
   (d) It refers to the reduction in government expenditure to control inflation.

Answer:

(b) It refers to a decrease in private investment due to government borrowing.

Explanation:
The crowding-out effect refers to a decrease in private investment that occurs when the government borrows funds from the financial market to finance its spending, leading to higher interest rates and reduced private investment.

4. What is the fiscal imprudence limitation of Fiscal Policy?
   (a) It refers to the government's inability to implement tax cuts effectively.
   (b) It refers to the risk of a budget surplus leading to economic instability.
   (c) It refers to the risk of excessive government borrowing and budget deficits.
   (d) It refers to the government's inability to reduce public debt.

Answer:
(c) It refers to the risk of excessive government borrowing and budget deficits.

Explanation:
Fiscal imprudence refers to the risk of excessive government borrowing and budget deficits, which can lead to fiscal instability and debt sustainability issues in the long run.

5. How can international factors limit the effectiveness of Fiscal Policy?
   (a) International factors have no impact on Fiscal Policy.
   (b) International factors can lead to fluctuations in exchange rates.
   (c) International factors can influence the level of government revenue.
   (d) International factors can affect the effectiveness of export-oriented policies.

Answer:
(d) International factors can affect the effectiveness of export-oriented policies.

Explanation:
International factors, such as changes in global demand and trade conditions, can influence the effectiveness of export-oriented Fiscal Policy, which aims to promote exports and economic growth.

6. What is the Ricardian Equivalence proposition?
   (a) It suggests that changes in government spending have no impact on aggregate demand.
   (b) It suggests that tax cuts increase disposable income and boost consumer spending.
   (c) It suggests that changes in government debt have no impact on the economy.
   (d) It suggests that consumers may offset tax cuts by increasing their savings.

Answer:
(d) It suggests that consumers may offset tax cuts by increasing their savings.

Explanation:
The Ricardian Equivalence proposition suggests that consumers may anticipate future tax increases to finance government debt and, therefore, may increase their savings to offset any potential tax cuts.

7. How can political considerations limit the effectiveness of Fiscal Policy?
   (a) Political considerations may lead to excessive government spending.
   (b) Political considerations can delay the implementation of Fiscal Policy measures.
   (c) Political considerations have no impact on Fiscal Policy decisions.
   (d) Political considerations can lead to a reduction in taxation.

Answer:
(b) Political considerations can delay the implementation of Fiscal Policy measures.

Explanation:
Political considerations can influence Fiscal Policy decisions and may lead to delays in implementing necessary measures, which can hinder the timely and effective response to economic challenges.

8. What is the risk associated with using Fiscal Policy as the primary tool for stabilization?
   (a) The risk of inflation due to increased government spending.
   (b) The risk of exchange rate volatility due to changes in tax rates.

(c) The risk of excessive government borrowing and debt accumulation.
(d) The risk of reduced consumer spending due to tax cuts.

Answer:

(c) The risk of excessive government borrowing and debt accumulation.

Explanation:

The risk associated with using Fiscal Policy as the primary tool for stabilization is the possibility of excessive government borrowing and debt accumulation, which can lead to fiscal instability and debt sustainability issues in the long term.

1.4.8 Crowding Out

1. What is the crowding-out effect in the context of Fiscal Policy?
(a) It refers to an increase in private investment due to government spending.
(b) It refers to a decrease in private investment due to government borrowing.
(c) It refers to an increase in consumer spending due to government tax cuts.
(d) It refers to the reduction in government expenditure to control inflation.

Answer:

(b) It refers to a decrease in private investment due to government borrowing.

Explanation:

The crowding-out effect refers to a decrease in private investment that occurs when the government borrows funds from the financial market to finance its spending, leading to higher interest rates and reduced private investment.

2. How does crowding out occur in the economy?
(a) Crowding out occurs when the government increases its spending to boost economic growth.
(b) Crowding out occurs when the government reduces its spending to control inflation.

(c) Crowding out occurs when the government competes with the private sector for funds in the financial market.
(d) Crowding out occurs when the government increases taxes to reduce aggregate demand.

Answer:

(c) Crowding out occurs when the government competes with the private sector for funds in the financial market.

Explanation:

Crowding out occurs when the government competes with the private sector for funds in the financial market to finance its spending, leading to higher interest rates and reduced private sector borrowing and investment.

3. How does crowding out affect interest rates in the economy?
(a) Crowding out has no impact on interest rates as they are determined by the central bank.
(b) Crowding out leads to higher interest rates due to increased government borrowing.
(c) Crowding out leads to lower interest rates due to increased private sector borrowing.
(d) Crowding out has no impact on interest rates as they are determined by market forces.

Answer:

(b) Crowding out leads to higher interest rates due to increased government borrowing.

Explanation:

Crowding out leads to higher interest rates because increased government borrowing reduces the availability of funds in the financial market, leading to higher demand for loans and pushing up interest rates.

4. What is the opportunity cost of crowding out in the economy?
(a) The opportunity cost of crowding out is the potential loss of tax revenue for the government.
(b) The opportunity cost of crowding out is the potential reduction in private investment and economic growth.

(c) The opportunity cost of crowding out is the potential loss of government revenue from taxes.
(d) The opportunity cost of crowding out is the potential increase in government expenditure.

Answer:

(b) The opportunity cost of crowding out is the potential reduction in private investment and economic growth.

Explanation:

The opportunity cost of crowding out is the potential reduction in private sector borrowing and investment, which could lead to lower economic growth and development.

5. How can crowding out impact the effectiveness of Fiscal Policy?
(a) Crowding out increases the effectiveness of Fiscal Policy in stimulating economic growth.
(b) Crowding out has no impact on the effectiveness of Fiscal Policy.
(c) Crowding out reduces the effectiveness of Fiscal Policy in stimulating economic growth.
(d) Crowding out leads to a decrease in government expenditure and budget surplus.

Answer:

(c) Crowding out reduces the effectiveness of Fiscal Policy in stimulating economic growth.

Explanation:

Crowding out reduces the effectiveness of Fiscal Policy because higher interest rates and reduced private investment can offset the positive impact of increased government spending on economic growth.

6. What happens to private sector borrowing in the presence of crowding out?
(a) Private sector borrowing decreases due to lower interest rates.
(b) Private sector borrowing increases due to higher interest rates.
(c) Private sector borrowing remains unaffected by crowding out.
(d) Private sector borrowing decreases due to higher taxes.

Answer:

(b) Private sector borrowing increases due to higher interest rates.

Explanation:

In the presence of crowding out, private sector borrowing typically increases due to higher interest rates, which are a result of increased government borrowing.

7. What can the government do to mitigate the crowding-out effect?
(a) The government can increase its borrowing to outcompete the private sector.
(b) The government can reduce taxes to increase private sector spending.
(c) The government can impose price controls to limit interest rates.
(d) The government can implement austerity measures to reduce spending.

Answer:

(b) The government can reduce taxes to increase private sector spending.

Explanation:

To mitigate the crowding-out effect, the government can reduce taxes, allowing individuals and businesses to retain more income, which may increase private sector spending and investment.

8. Which of the following situations is most likely to lead to crowding out in the economy?
(a) A decrease in government borrowing and increased private sector investment.
(b) An increase in government borrowing and increased private sector investment.
(c) A decrease in government borrowing and decreased private sector investment.
(d) An increase in government borrowing and decreased private sector investment.

Answer:

(d) An increase in government borrowing and decreased private sector investment.

Explanation:
An increase in government borrowing can lead to crowding out, resulting in decreased private sector investment due to higher interest rates and reduced availability of funds in the financial market.

1.4.9 Conclusion

1. What is the main objective of Fiscal Policy?
   (a) To control inflation and stabilize prices
   (b) To achieve short-term economic stability
   (c) To promote long-term economic growth and stability
   (d) To regulate foreign trade and exchange rates

   Answer:
   (c) To promote long-term economic growth and stability

   Explanation:
   The main objective of Fiscal Policy is to promote long-term economic growth and stability by managing government spending and taxation to influence the overall economy.

2. How does Fiscal Policy differ from Monetary Policy?
   (a) Fiscal Policy focuses on regulating money supply and interest rates, while Monetary Policy manages government spending and taxation.
   (b) Fiscal Policy is implemented by the central bank, while Monetary Policy is implemented by the government.
   (c) Fiscal Policy involves managing government spending and taxation, while Monetary Policy involves regulating money supply and interest rates.
   (d) Fiscal Policy and Monetary Policy are the same and used interchangeably.

   Answer:
   (c) Fiscal Policy involves managing government spending and taxation, while Monetary Policy involves regulating money supply and interest rates.

   Explanation:
   Fiscal Policy is concerned with managing government spending and taxation to influence economic conditions, while Monetary Policy deals with regulating money supply and interest rates to achieve economic goals.

3. How can Fiscal Policy be used to address recessionary conditions in the economy?
   (a) By increasing government spending and reducing taxes to boost aggregate demand
   (b) By reducing government spending and increasing taxes to control inflation
   (c) By implementing austerity measures to reduce budget deficit
   (d) By increasing interest rates to attract foreign investments

   Answer:
   (a) By increasing government spending and reducing taxes to boost aggregate demand

   Explanation:
   During recessionary conditions, Fiscal Policy can be used to stimulate the economy by increasing government spending and reducing taxes, which boosts aggregate demand and supports economic growth.

4. What is the significance of automatic stabilizers in Fiscal Policy?
   (a) Automatic stabilizers increase government borrowing to stimulate economic growth.
   (b) Automatic stabilizers automatically adjust government spending and taxation in response to economic fluctuations.
   (c) Automatic stabilizers reduce government spending during economic downturns.
   (d) Automatic stabilizers reduce taxes to control inflation.

   Answer:
   (b) Automatic stabilizers automatically adjust government spending and taxation in response to economic fluctuations.

   Explanation:
   Automatic stabilizers are built-in features of the Fiscal Policy that automatically adjust government spending and taxation in response to changes in economic conditions, helping to stabilize the economy during fluctuations.

5. What are the limitations of Fiscal Policy in managing the economy?
   (a) Fiscal Policy is not effective in influencing aggregate demand.
   (b) Fiscal Policy can only be implemented during periods of economic expansion.
   (c) Fiscal Policy can lead to inflation and currency depreciation.
   (d) Fiscal Policy is not a suitable tool for addressing income inequality.

   Answer:
   (a) Fiscal Policy is not effective in influencing aggregate demand.

   Explanation:
   One of the limitations of Fiscal Policy is that it may not always be effective in influencing aggregate demand, especially during certain economic conditions, such as liquidity traps or when consumers and businesses are not responsive to changes in taxation and government spending.
6. How can political considerations impact the effectiveness of Fiscal Policy?
   (a) Political considerations can lead to excessive government spending.
   (b) Political considerations can delay the implementation of Fiscal Policy measures.
   (c) Political considerations have no impact on Fiscal Policy decisions.
   (d) Political considerations can lead to a reduction in taxation.

   Answer:
   (b) Political considerations can delay the implementation of Fiscal Policy measures.

   Explanation:
   Political considerations can influence Fiscal Policy decisions and may lead to delays in implementing necessary measures, which can hinder the timely and effective response to economic challenges.
7. What is the crowding-out effect in relation to Fiscal Policy?
   (a) It refers to an increase in private investment due to government spending.
   (b) It refers to a decrease in private investment due to government borrowing.

   (c) It refers to an increase in consumer spending due to government tax cuts.
   (d) It refers to the reduction in government expenditure to control inflation.

   Answer:
   (b) It refers to a decrease in private investment due to government borrowing.

   Explanation:
   The crowding-out effect refers to a decrease in private investment that occurs when the government borrows funds from the financial market to finance its spending, leading to higher interest rates and reduced private investment.
8. What is the primary objective of Fiscal Policy for long-run economic growth?
   (a) To control inflation and stabilize the economy
   (b) To achieve short-term economic stability
   (c) To stimulate economic growth and increase aggregate demand
   (d) To promote sustainable and steady economic growth over time

   Answer:
   (d) To promote sustainable and steady economic growth over time

   Explanation:
   The primary objective of Fiscal Policy for long-run economic growth is to promote sustainable and steady economic growth over time, ensuring the economy's stability and prosperity in the future.

Additional Question Bank

1.1 Introduction

1. Fiscal policy is a tool used by governments to:
   (a) Control inflation
   (b) Influence the money supply
   (c) Stabilize the economy through taxation and government spending
   (d) Regulate interest rates

2. Expansionary fiscal policy involves:
   (a) Decreasing government spending and increasing taxes
   (b) Decreasing government spending and decreasing taxes
   (c) Increasing government spending and decreasing taxes
   (d) Increasing government spending and increasing taxes
3. Contractionary fiscal policy is implemented to:
   (a) Encourage borrowing and spending
   (b) Combat recession and control inflation
   (c) Stimulate economic growth
   (d) Increase the money supply
4. When the government's total expenditures exceed its total revenues in a fiscal year, it results in:
   (a) A budget surplus (b) A budget deficit
   (c) Fiscal equilibrium (d) An inflationary gap
5. Automatic stabilizers in fiscal policy refer to:
   (a) Automatic adjustments in tax rates and government spending that counter economic fluctuations
   (b) Fixed government spending that remains constant regardless of economic conditions
   (c) The government's ability to stabilize the stock market automatically
   (d) The automatic increase in interest rates during a recession

1.2 Objectives of Fiscal Policy

1. The primary objective of fiscal policy is to:
   (a) Control inflation
   (b) Stabilize the exchange rate
   (c) Maximize government revenue
   (d) Promote economic stability and growth
2. Fiscal policy can be used to reduce unemployment by:
   (a) Decreasing government spending and increasing taxes
   (b) Decreasing government spending and decreasing taxes
   (c) Increasing government spending and decreasing taxes
   (d) Increasing government spending and increasing taxes

3. To control inflation, the government can use:
   (a) Expansionary fiscal policy
   (b) Contractionary fiscal policy
   (c) Neutral fiscal policy
   (d) Fiscal austerity measures
4. When the government aims to achieve a balanced budget, it means:
   (a) Government spending is equal to government revenue
   (b) Government spending exceeds government revenue
   (c) Government revenue exceeds government spending
   (d) Government spending is minimized to zero
5. One of the social objectives of fiscal policy is to:
   (a) Encourage foreign investment
   (b) Promote exports
   (c) Reduce income inequality
   (d) Increase interest rates

1.3 Types of Fiscal Policy

1. Which type of fiscal policy is used during periods of economic downturn or recession to stimulate economic growth?
   (a) Expansionary fiscal policy
   (b) Contractionary fiscal policy
   (c) Neutral fiscal policy
   (d) Austerity fiscal policy
2. When the government aims to decrease aggregate demand and control inflation, it adopts:
   (a) Expansionary fiscal policy
   (b) Contractionary fiscal policy
   (c) Neutral fiscal policy
   (d) Regressive fiscal policy
3. Fiscal policy that aims to keep the economy at a stable growth rate without significant fluctuations is called:
   (a) Expansionary fiscal policy
   (b) Contractionary fiscal policy
   (c) Neutral fiscal policy
   (d) Counter-cyclical fiscal policy

4. A government reducing public spending and increasing taxes to address a high budget deficit and reduce inflation is an example of:
   (a) Expansionary fiscal policy (b) Contractionary fiscal policy
   (c) Neutral fiscal policy (d) Discretionary fiscal policy
5. Automatic stabilizers are considered a part of which type of fiscal policy?
   (a) Expansionary fiscal policy (b) Contractionary fiscal policy
   (c) Automatic fiscal policy (d) Discretionary fiscal policy

1.4 The Instruments of Fiscal Policy

1. Which fiscal policy instrument involves the government's ability to control the total amount of money in circulation and the interest rates?
   (a) Government spending (b) Taxation
   (c) Public debt (d) Monetary policy
2. How does the government use fiscal policy to implement expansionary measures during a recession?
   (a) Decreasing government spending and increasing taxes
   (b) Increasing government spending and increasing taxes
   (c) Increasing government spending and decreasing taxes
   (d) Decreasing government spending and decreasing taxes
3. When the government aims to reduce inflation and control economic growth, it can use which fiscal policy instrument?
   (a) Decreasing government spending
   (b) Increasing government spending
   (c) Increasing taxes
   (d) Decreasing taxes
4. Which fiscal policy instrument can be used to finance government spending and bridge budget deficits?
   (a) Government subsidies (b) Public debt
   (c) Automatic stabilizers (d) Fiscal multipliers
5. Fiscal policy can be employed to achieve income redistribution by:
   (a) Increasing corporate taxes
   (b) Implementing progressive income taxes
   (c) Decreasing sales taxes
   (d) Providing subsidies to businesses

Answer

1.1 Introduction

1. (c) Stabilize the economy through taxation and government spending
2. (c) Increasing government spending and decreasing taxes
3. (b) Combat recession and control inflation
4. (b) A budget deficit
5. (a) Automatic adjustments in tax rates and government spending that counter economic fluctuations

1.2 Objectives of Fiscal Policy

1. (d) Promote economic stability and growth
2. (c) Increasing government spending and decreasing taxes
3. (b) Contractionary fiscal policy
4. (a) Government spending is equal to government revenue
5. (c) Reduce income inequality

1.3 Types of Fiscal Policy

1. (c) Reduce income inequality
2. (b) Contractionary fiscal policy
3. (c) Neutral fiscal policy
4. (b) Contractionary fiscal policy
5. (c) Automatic fiscal policy

1.4 The Instruments of Fiscal Policy

1. (b) Taxation
2. (c) Increasing government spending and decreasing taxes
3. (c) Increasing taxes
4. (b) Public debt
5. (b) Implementing progressive income taxes

8 MONEY MARKET

Unit:1 The Concept of Money Demand: Important Theories

Multiple Choice Questions

1.1 Introduction

1. What is the concept of money demand in economic?
   (a) It refers to the quantity of money supplied by the central bank.
   (b) It refers to the desire of individuals and businesses to hold money for transactions and speculative purposes.
   (c) It refers to the quantity of money demanded by the government for its expenditures.
   (d) It refers to the total money supply in the economy.

   Answer:
   (b) It refers to the desire of individuals and businesses to hold money for transactions and speculative purposes.

   Explanation:
   The concept of money demand in economics refers to the willingness and desire of individuals and businesses to hold money for various purposes, such as transactions and speculative motives.

2. What does the speculative motive for holding money suggest?
   (a) Individuals hold money to finance their day-to-day expenses.
   (b) Individuals hold money as a store of value to preserve wealth.
   (c) Individuals hold money to speculate on the future direction of interest rates.
   (d) Individuals hold money to invest in financial assets.

   Answer:
   (c) Individuals hold money to speculate on the future direction of interest rates.

   Explanation:
   The speculative motive for holding money suggests that individuals hold money to take advantage of potential changes in interest rates, anticipating higher returns in the future.

3. Which of the following is NOT a component of the demand for money?
   (a) Transaction motive (b) Speculative motive
   (c) Precautionary motive (d) Investment motive

   Answer:
   (d) Investment motive

   Explanation:
   The investment motive is not a component of the demand for money. The components of money demand are the transaction motive, speculative motive, and precautionary motive.

4. What is the transaction motive for holding money?
   (a) It refers to holding money to speculate on future price changes in financial assets.
   (b) It refers to holding money for future investment opportunities.
   (c) It refers to holding money to finance day-to-day transactions and purchases.
   (d) It refers to holding money to preserve wealth.

   Answer:
   (c) It refers to holding money to finance day-to-day transactions and purchases.

   Explanation:
   The transaction motive for holding money refers to holding money to facilitate day-to-day transactions and purchases of goods and services.

5. How does an increase in interest rates affect the demand for money?
   (a) An increase in interest rates decreases the demand for money.
   (b) An increase in interest rates increases the demand for money.
   (c) An increase in interest rates has no impact on the demand for money.
   (d) An increase in interest rates reduces the money supply.

   Answer:
   (a) An increase in interest rates decreases the demand for money.

Explanation:
An increase in interest rates reduces the attractiveness of holding money, as individuals may prefer to hold interest-bearing financial assets instead. Therefore, an increase in interest rates decreases the demand for money.

6. What are the factors that influence the demand for money in an economy?
   (a) The quantity of money supplied by the central bank and the level of government spending.
   (b) The level of economic growth and the rate of inflation.
   (c) The level of interest rates, the level of income, and the price level.
   (d) The quantity of money demanded by consumers and businesses.

   Answer:
   (c) The level of interest rates, the level of income, and the price level.

   Explanation:
   The demand for money is influenced by the level of interest rates (cost of holding money), the level of income (higher income may lead to higher money demand), and the price level (higher prices may increase the demand for money).

7. Which theory of money demand suggests that people hold money because they prefer liquidity over other assets?
   (a) Quantity Theory of Money
   (b) Cambridge Cash-Balance Theory
   (c) Keynesian Liquidity Preference Theory
   (d) Classical Quantity Theory of Money

   Answer:
   (c) Keynesian Liquidity Preference Theory

   Explanation:
   The Keynesian Liquidity Preference Theory suggests that people hold money because they prefer liquidity (easy access to cash) over other assets. It emphasizes the speculative motive for holding money.

8. According to the Cambridge Cash-Balance Theory, what is the relationship between the demand for money and the price level?
   (a) There is a positive relationship between the demand for money and the price level.

   (b) There is a negative relationship between the demand for money and the price level.
   (c) There is no relationship between the demand for money and the price level.
   (d) The demand for money is influenced by changes in the money supply, not the price level.

   Answer:
   (a) There is a positive relationship between the demand for money and the price level.

   Explanation:
   According to the Cambridge Cash-Balance Theory, there is a positive relationship between the demand for money and the price level. As prices rise, people need to hold more money to finance their transactions, leading to an increased demand for money.

Fiat Money

9. What is fiat money?
   (a) Money that has intrinsic value based on its physical properties.
   (b) Money that is backed by a commodity, such as gold or silver.
   (c) Money that is declared legal tender by the government and has no intrinsic value.
   (d) Money that is used for online transactions and digital payments.

   Answer:
   (c) Money that is declared legal tender by the government and has no intrinsic value.

   Explanation: Fiat money is a type of currency that is declared legal tender by the government and is used as a medium of exchange, but it has no intrinsic value and is not backed by any physical commodity.

10. What gives value to fiat money?
   (a) Its acceptance by the international community.
   (b) Its backing by a commodity, such as gold.
   (c) Its supply and demand in the foreign exchange market.

(d) The trust and confidence of the people in the government and the economy.

Answer:

(d) The trust and confidence of the people in the government and the economy.

Explanation:

The value of fiat money is derived from the trust and confidence of the people in the government and the stability of the economy. As long as people have faith in the currency's acceptance for transactions, it maintains its value.

11. Which of the following statements is true about fiat money?
(a) Fiat money has intrinsic value based on its physical properties.
(b) Fiat money is backed by a commodity, such as gold.
(c) Fiat money is not subject to inflationary pressures.
(d) Fiat money is susceptible to hyperinflation if not properly managed.

Answer:

(d) Fiat money is susceptible to hyperinflation if not properly managed.

Explanation:

While fiat money itself does not have intrinsic value, its value can be eroded by excessive money supply and mismanagement by the government or central bank, leading to hyperinflation in extreme cases.

12. What distinguishes fiat money from commodity money?
(a) Commodity money is declared legal tender by the government, while fiat money has intrinsic value.
(b) Commodity money is backed by a commodity, while fiat money has no intrinsic value.
(c) Commodity money is used for online transactions, while fiat money is physical currency.
(d) Commodity money is widely accepted internationally, while fiat money is limited to domestic use.

Answer:

(b) Commodity money is backed by a commodity, while fiat money has no intrinsic value.

Explanation:

Commodity money, such as gold or silver, has intrinsic value because it is made of a valuable commodity. On the other hand, fiat money has no intrinsic value and relies solely on the government's declaration of its legal tender status.

13. How does fiat money facilitate transactions in an economy?
(a) By providing a medium of exchange without any value.
(b) By allowing barter exchanges between goods and services.
(c) By serving as a store of value based on its intrinsic worth.
(d) By acting as a widely accepted medium of exchange with government backing.

Answer:

(d) By acting as a widely accepted medium of exchange with government backing.

Explanation:

Fiat money serves as a widely accepted medium of exchange in an economy because the government declares it as legal tender, which provides the necessary trust and confidence for people to use it for transactions.

14. Which of the following best describes the source of value for fiat money?
(a) Its physical properties and rarity.
(b) Its backing by precious metals, such as gold or silver.
(c) Its acceptance and recognition as a medium of exchange by the government.
(d) Its fixed exchange rate with foreign currencies.

Answer:

(c) Its acceptance and recognition as a medium of exchange by the government.

Explanation:

The value of fiat money comes from its acceptance and recognition as a medium of exchange by the government, which gives it legal tender status and ensures its use in transactions.

15. How does the government control the supply of fiat money in the economy?
    (a) By printing more money to stimulate economic growth.
    (b) By linking the money supply to the country's foreign exchange reserves.
    (c) By adhering to a fixed exchange rate with other countries.
    (d) By managing the money supply through monetary policy and central bank actions.

    Answer:

    (d) By managing the money supply through monetary policy and central bank actions.

    Explanation:

    The government controls the supply of fiat money through monetary policy, which involves actions taken by the central bank to influence interest rates, reserve requirements, and open market operations to manage the money supply and ensure price stability in the economy.
16. What are the advantages of using fiat money as a medium of exchange?
    (a) It has intrinsic value based on its physical properties.
    (b) It provides a stable and fixed exchange rate with foreign currencies.
    (c) It can be easily controlled and managed by the government.
    (d) It is not subject to inflationary pressures.

    Answer:

    (c) It can be easily controlled and managed by the government.

    Explanation:

    One of the advantages of using fiat money is that it can be easily controlled and managed by the government and central bank through monetary policy, allowing them to respond to economic conditions and maintain stability.

1.2 The Demand for Money

1. What does the demand for money refer to in economics?
    (a) The total amount of money in circulation in the economy.
    (b) The desire of individuals and businesses to hold money for various purposes.

    (c) The quantity of money supplied by the central bank.
    (d) The amount of money demanded by the government for its expenditures.

    Answer:

    (b) The desire of individuals and businesses to hold money for various purposes.

    Explanation:

    The demand for money in economics refers to the desire of individuals and businesses to hold money for various purposes, such as transactions, precautionary motives, and speculative motives.
2. Which of the following is NOT a motive for holding money?
    (a) Transaction motive
    (b) Precautionary motive
    (c) Speculative motive
    (d) Investment motive

    Answer:

    (d) Investment motive

    Explanation:

    The investment motive is not a motive for holding money. The three primary motives for holding money are the transaction motive, precautionary motive, and speculative motive.
3. What is the transaction motive for holding money?
    (a) It refers to holding money for future investment opportunities.
    (b) It refers to holding money to speculate on future price changes in financial assets.
    (c) It refers to holding money to finance day-to-day transactions and purchases.
    (d) It refers to holding money to preserve wealth.

    Answer:

    (c) It refers to holding money to finance day-to-day transactions and purchases.

    Explanation:

    The transaction motive for holding money refers to holding money to facilitate day-to-day transactions and purchases of goods and services.

4. How does an increase in interest rates affect the demand for money?
   (a) An increase in interest rates decreases the demand for money.
   (b) An increase in interest rates increases the demand for money.
   (c) An increase in interest rates has no impact on the demand for money.
   (d) An increase in interest rates reduces the money supply.

   Answer:
   (a) An increase in interest rates decreases the demand for money.

   Explanation:
   An increase in interest rates reduces the attractiveness of holding money, as individuals may prefer to hold interest-bearing financial assets instead. Therefore, an increase in interest rates decreases the demand for money.

5. Which theory of money demand suggests that people hold money because they prefer liquidity over other assets?
   (a) Quantity Theory of Money
   (b) Cambridge Cash-Balance Theory
   (c) Keynesian Liquidity Preference Theory
   (d) Classical Quantity Theory of Money

   Answer:
   (c) Keynesian Liquidity Preference Theory

   Explanation:
   The Keynesian Liquidity Preference Theory suggests that people hold money because they prefer liquidity (easy access to cash) over other assets. It emphasizes the speculative motive for holding money.

6. According to the Cambridge Cash-Balance Theory, what is the relationship between the demand for money and the price level?
   (a) There is a positive relationship between the demand for money and the price level.
   (b) There is a negative relationship between the demand for money and the price level.
   (c) There is no relationship between the demand for money and the price level.

   (d) The demand for money is influenced by changes in the money supply, not the price level.

   Answer:
   (a) There is a positive relationship between the demand for money and the price level.

   Explanation:
   According to the Cambridge Cash-Balance Theory, there is a positive relationship between the demand for money and the price level. As prices rise, people need to hold more money to finance their transactions, leading to an increased demand for money.

7. Which theory of money demand suggests that the demand for money depends on the interest rate and the level of income?
   (a) Quantity Theory of Money
   (b) Classical Quantity Theory of Money
   (c) Keynesian Liquidity Preference Theory
   (d) Cambridge Cash-Balance Theory

   Answer:
   (d) Cambridge Cash-Balance Theory

   Explanation:
   The Cambridge Cash-Balance Theory suggests that the demand for money depends on the interest rate and the level of income. As income increases, the demand for money increases, and as the interest rate rises, the demand for money decreases.

8. What is the speculative motive for holding money?
   (a) It refers to holding money for future investment opportunities.
   (b) It refers to holding money to speculate on future price changes in financial assets.
   (c) It refers to holding money to finance day-to-day transactions and purchases.
   (d) It refers to holding money to preserve wealth.

   Answer:
   (b) It refers to holding money to speculate on future price changes in financial assets.

Explanation:
The speculative motive for holding money refers to holding money with the expectation of taking advantage of potential changes in asset prices, especially in financial markets.

1.3 Theories of Demand for Money

1. Which theory of demand for money suggests that people hold money for transactions, precautionary, and speculative motives?
   (a) Classical Quantity Theory of Money
   (b) Keynesian Liquidity Preference Theory
   (c) Cambridge Cash-Balance Theory
   (d Quantity Theory of Money
   Answer:
   (b) Keynesian Liquidity Preference Theory
   Explanation:
   The Keynesian Liquidity Preference Theory proposes that people hold money for three motives: transactions, precautionary, and speculative motives.
2. According to the Keynesian Liquidity Preference Theory, what determines the demand for money?
   (a) The price level and the level of income in the economy.
   (b) The interest rate and the level of investment in the economy.
   (c) The rate of inflation and the government's fiscal policy.
   (d) The exchange rate and the country's foreign trade.
   Answer:
   (a) The price level and the level of income in the economy.
   Explanation:
   According to the Keynesian Liquidity Preference Theory, the demand for money is influenced by the price level and the level of income in the economy.
3. Which theory of demand for money suggests that people hold money to take advantage of potential changes in interest rates?
   (a) Cambridge Cash-Balance Theory
   (b) Quantity Theory of Money

   (c) Classical Quantity Theory of Money
   (d) Keynesian Liquidity Preference Theory
   Answer:
   (a) Cambridge Cash-Balance Theory
   Explanation:
   The Cambridge Cash-Balance Theory suggests that people hold money to take advantage of potential changes in interest rates, especially in financial markets.
4. According to the Cambridge Cash-Balance Theory, what is the relationship between the demand for money and the interest rate?
   (a) There is a positive relationship between the demand for money and the interest rate.
   (b) There is a negative relationship between the demand for money and the interest rate.
   (c) There is no relationship between the demand for money and the interest rate.
   (d) The demand for money is solely determined by changes in the money supply.
   Answer:
   (b) There is a negative relationship between the demand for money and the interest rate.
   Explanation:
   According to the Cambridge Cash-Balance Theory, there is a negative relationship between the demand for money and the interest rate. As interest rates increase, the opportunity cost of holding money rises, leading to a lower demand for money.
5. Which theory of demand for money focuses on the long-run relationship between money demand and income?
   (a) Keynesian Liquidity Preference Theory
   (b) Quantity Theory of Money
   (c) Classical Quantity Theory of Money
   (d) Cambridge Cash-Balance Theory
   Answer:
   (b) Quantity Theory of Money

Explanation:
The Quantity Theory of Money focuses on the long-run relationship between money demand and income, suggesting that the demand for money is directly proportional to the level of income in the economy.

6. What does the Quantity Theory of Money state about the demand for money in relation to income?
   (a) The demand for money is inversely proportional to the level of income.
   (b) The demand for money is directly proportional to the level of income.
   (c) The demand for money is unrelated to the level of income.
   (d) The demand for money is determined solely by the interest rate.
   Answer:
   (b) The demand for money is directly proportional to the level of income.
   Explanation:
   The Quantity Theory of Money states that the demand for money is directly proportional to the level of income in the economy.
7. According to the Classical Quantity Theory of Money, what is the primary determinant of the demand for money?
   (a) The interest rate in the economy.
   (b) The price level and the level of income.
   (c) The level of government spending and taxation.
   (d) The supply of money by the central bank.
   Answer:
   (b) The price level and the level of income.
   Explanation:
   According to the Classical Quantity Theory of Money, the primary determinants of the demand for money are the price level and the level of income in the economy.
8. What is the central proposition of the Classical Quantity Theory of Money?
   (a) An increase in the money supply leads to a proportional increase in prices.
   (b) An increase in the money supply leads to a proportional decrease in prices.

   (c) An increase in the money supply leads to a proportional increase in output and income.
   (d) An increase in the money supply has no impact on the economy.
   Answer:
   (a) An increase in the money supply leads to a proportional increase in prices.
   Explanation:
   The central proposition of the Classical Quantity Theory of Money is that an increase in the money supply, while holding other factors constant, leads to a proportional increase in the price level in the economy. This is often expressed as the equation $MV = PT$, where M is the money supply, V is the velocity of money, P is the price level, and T is the level of transactions in the economy.

1.3.1 Classical Approach: The Quantity Theory of Money (QTM)

1. According to the Classical Quantity Theory of Money (QTM), what is the primary determinant of the price level in an economy?
   (a) The level of income and output.
   (b) The quantity of money in circulation.
   (c) The interest rate set by the central bank.
   (d) The level of government spending.
   Answer:
   (b) The quantity of money in circulation.
   Explanation:
   According to the Classical Quantity Theory of Money, the primary determinant of the price level in an economy is the quantity of money in circulation. An increase in the money supply, assuming all other factors remain constant, leads to a proportional increase in prices.
2. The Classical Quantity Theory of Money (QTM) assumes which of the following?
   (a) Stable velocity of money.
   (b) Variable money demand.

(c) Inverse relationship between money supply and price level.
(d) Constant level of economic output.

Answer:

(a) Stable velocity of money.

Explanation:

The Classical Quantity Theory of Money assumes a stable velocity of money, meaning that the rate at which money circulates in the economy remains relatively constant over time. This assumption is necessary for the theory's central proposition.

3. According to the Classical Quantity Theory of Money (QTM), what happens if the money supply increases while other factors remain unchanged?
(a) Prices and output will both increase proportionally.
(b) Prices will increase proportionally, but output remains unchanged.
(c) Output will increase proportionally, but prices remain unchanged.
(d) Prices and output will both remain unchanged.

Answer:

(b) Prices will increase proportionally, but output remains unchanged.

Explanation:

According to the Classical Quantity Theory of Money, if the money supply increases while other factors, such as the level of output and velocity of money, remain unchanged, prices will increase proportionally. However, the theory does not posit any direct impact on the level of economic output.

4. How does the Classical Quantity Theory of Money (QTM) view the relationship between money supply and inflation?
(a) An increase in the money supply leads to deflation.
(b) An increase in the money supply has no impact on inflation.
(c) An increase in the money supply leads to inflation.
(d) An increase in the money supply leads to stagflation.

Answer:

(c) An increase in the money supply leads to inflation.

Explanation:

The Classical Quantity Theory of Money posits that an increase in the money supply, assuming a stable velocity of money, leads to a proportional increase in the price level, resulting in inflation.

5. What does the equation MV = PT represent in the context of the Classical Quantity Theory of Money (QTM)?
(a) The relationship between money supply and interest rates.
(b) The relationship between money supply and economic output.
(c) The relationship between money supply and the price level.
(d) The relationship between money supply and the velocity of money.

Answer:

(c) The relationship between money supply and the price level.

Explanation:

The equation MV = PT represents the relationship between the money supply (M), the velocity of money (V), the price level (P), and the level of transactions (T) in the economy according to the Classical Quantity Theory of Money.

6. How does the Classical Quantity Theory of Money (QTM) view the long-run relationship between money supply and economic growth?
(a) An increase in the money supply leads to sustainable economic growth.
(b) An increase in the money supply has no impact on economic growth.
(c) An increase in the money supply leads to temporary economic growth, followed by contraction.
(d) An increase in the money supply leads to short-run economic growth, followed by inflation.

Answer:

(b) An increase in the money supply has no impact on economic growth.

Explanation:

The Classical Quantity Theory of Money suggests that changes in the money supply do not have a long-run impact on economic growth. In the long run, changes in the money supply primarily influence the price level and not the level of economic output.

7. According to the Classical Quantity Theory of Money (QTM), what happens if the money supply increases more rapidly than the growth rate of real output?
   (a) Inflation will occur.
   (b) Deflation will occur.
   (c) There will be no impact on the economy.
   (d) The velocity of money will increase.

   Answer:
   (a) Inflation will occur.

   Explanation:
   According to the Classical Quantity Theory of Money, if the money supply increases more rapidly than the growth rate of real output (economic production), inflation will occur as there is a higher amount of money chasing the same amount of goods and services.

8. How does the Classical Quantity Theory of Money (QTM) view the role of monetary policy in managing the economy?
   (a) Monetary policy can control inflation but has no impact on output.
   (b) Monetary policy can control output but has no impact on inflation.
   (c) Monetary policy can control both inflation and output.
   (d) Monetary policy is ineffective in managing the economy.

   Answer:
   (a) Monetary policy can control inflation but has no impact on output.

   Explanation:
   According to the Classical Quantity Theory of Money, monetary policy primarily influences the price level (inflation) through changes in the money supply. However, it is generally believed that monetary policy has limited impact on the level of output or economic growth in the long run.

1.3.2 The Cambridge approach

1. What is the Cambridge Approach in the context of the demand for money?
   (a) It is a theory that focuses on the speculative motive for holding money.
   (b) It is a theory that emphasizes the transaction motive for holding money.

   (c) It is a theory that considers both the transaction and speculative motives for holding money.
   (d) It is a theory that rejects the relevance of money demand in the economy.

   Answer:
   (c) It is a theory that considers both the transaction and speculative motives for holding money.

   Explanation:
   The Cambridge Approach is a theory that combines both the transaction and speculative motives for holding money. It was developed to provide a more comprehensive understanding of the demand for money.

2. According to the Cambridge Approach, what is the key factor that influences the demand for money?
   (a) The interest rate set by the central bank.
   (b) The price level and the level of income in the economy.
   (c) The rate of inflation and the level of government spending.
   (d) The exchange rate and the country's foreign trade.

   Answer:
   (b) The price level and the level of income in the economy.

   Explanation:
   According to the Cambridge Approach, the demand for money is influenced by the price level and the level of income in the economy. As prices and income rise, the demand for money for transactions also increases.

3. How does the Cambridge Approach view the relationship between the demand for money and the interest rate?
   (a) There is a positive relationship between the demand for money and the interest rate.
   (b) There is a negative relationship between the demand for money and the interest rate.
   (c) There is no relationship between the demand for money and the interest rate.
   (d) The demand for money is solely determined by changes in the money supply.

Answer:

(b) There is a negative relationship between the demand for money and the interest rate.

Explanation:

According to the Cambridge Approach, there is a negative relationship between the demand for money and the interest rate. As interest rates increase, the opportunity cost of holding money rises, leading to a lower demand for money.

4. What does the Cambridge Equation, Md = kPY, represent?
   (a) The demand for money (Md) is equal to the price level (P) multiplied by the income level (Y).
   (b) The demand for money (Md) is equal to the money supply (M) multiplied by the velocity of money (V).
   (c) The demand for money (Md) is equal to the interest rate (r) divided by the price level (P).
   (d) The demand for money (Md) is equal to the level of government spending (G) divided by the price level (P).

Answer:

(a) The demand for money (Md) is equal to the price level (P) multiplied by the income level (Y).

Explanation:

The Cambridge Equation, Md = kPY, represents the demand for money (Md) as a function of the price level (P) multiplied by the income level (Y), where 'k' is a constant representing the proportion of income held as money.

5. What does the parameter 'k' in the Cambridge Equation Md = kPY signify?
   (a) The money supply in the economy.
   (b) The velocity of money.
   (c) The interest rate set by the central bank.
   (d) The proportion of income held as money.

Answer:

(d) The proportion of income held as money.

Explanation:

In the Cambridge Equation Md = kPY, 'k' represents the proportion of income (Y) that people choose to hold as money (Md).

6. According to the Cambridge Approach, how does an increase in income affect the demand for money?
   (a) An increase in income leads to a decrease in the demand for money.
   (b) An increase in income has no impact on the demand for money.
   (c) An increase in income leads to an increase in the demand for money.
   (d) An increase in income leads to a shift from speculative to transaction motive for holding money.

Answer:

(c) An increase in income leads to an increase in the demand for money.

Explanation:

According to the Cambridge Approach, an increase in income leads to an increase in the demand for money for transactions, as people need more money to finance their increased spending.

7. What does the speculative motive for holding money refer to in the Cambridge Approach?
   (a) Holding money to finance day-to-day transactions.
   (b) Holding money to take advantage of potential changes in interest rates.
   (c) Holding money to preserve wealth and protect against uncertainties.
   (d) Holding money to finance future investment opportunities.

Answer:

(c) Holding money to preserve wealth and protect against uncertainties.

Explanation:

In the Cambridge Approach, the speculative motive for holding money refers to holding money to preserve wealth and protect against uncertainties in financial markets.

8. How does the Cambridge Approach view the relationship between the demand for money and the price level?
   (a) There is a positive relationship between the demand for money and the price level.
   (b) There is a negative relationship between the demand for money and the price level.
   (c) There is no relationship between the demand for money and the price level.
   (d) The demand for money is solely determined by changes in the money supply.

   Answer:

   (a) There is a positive relationship between the demand for money and the price level.

   Explanation:

   According to the Cambridge Approach, there is a positive relationship between the demand for money and the price level. As prices rise, people need to hold more money for transactions, leading to an increased demand for money.

1.3.3 The Keynesian Theory of Demand for Money

1. According to the Keynesian Theory of Demand for Money, what are the primary motives for holding money?
   (a) Transaction motive and speculative motive.
   (b) Precautionary motive and speculative motive.
   (c) Transaction motive and precautionary motive.
   (d) Transaction motive, precautionary motive, and speculative motive.

   Answer:

   (d) Transaction motive, precautionary motive, and speculative motive.

   Explanation:

   According to the Keynesian Theory of Demand for Money, individuals hold money for three primary motives: the transaction motive (to carry out day-to-day transactions), the precautionary motive (to meet unexpected expenses or emergencies), and the speculative motive (to take advantage of potential changes in the value of financial assets).

2. What does the transaction motive for holding money refer to in the Keynesian Theory?
   (a) Holding money for future investment opportunities.
   (b) Holding money to speculate on future price changes in financial assets.
   (c) Holding money to preserve wealth and protect against uncertainties.
   (d) Holding money to finance day-to-day transactions and purchases.

   Answer:

   (d) Holding money to finance day-to-day transactions and purchases.

   Explanation:

   In the Keynesian Theory of Demand for Money, the transaction motive refers to holding money to finance day-to-day transactions and purchases of goods and services.

3. According to the Keynesian Theory of Demand for Money, what happens to the demand for money if there is an increase in income?
   (a) The demand for money increases.
   (b) The demand for money decreases.
   (c) The demand for money remains unchanged.
   (d) The demand for money is determined solely by changes in the money supply.

   Answer:

   (a) The demand for money increases.

   Explanation:

   According to the Keynesian Theory of Demand for Money, an increase in income leads to an increase in the demand for money. As income rises, people require more money to facilitate their increased spending.

4. How does the Keynesian Theory of Demand for Money view the relationship between the demand for money and the interest rate?
   (a) There is a positive relationship between the demand for money and the interest rate.
   (b) There is a negative relationship between the demand for money and the interest rate.
   (c) There is no relationship between the demand for money and the interest rate.

(d) The demand for money is solely determined by changes in the money supply.

Answer:

(b) There is a negative relationship between the demand for money and the interest rate.

Explanation:

In the Keynesian Theory of Demand for Money, there is a negative relationship between the demand for money and the interest rate. As the interest rate increases, the opportunity cost of holding money rises, leading to a decrease in the demand for money.

5. How does the Keynesian Theory of Demand for Money explain the preference for holding money in liquid form?
   (a) People prefer to hold money as it generates interest income.
   (b) People prefer to hold money to preserve wealth.
   (c) People prefer to hold money for speculative purposes.
   (d) People prefer to hold money to avoid the risk of illiquidity.

Answer:

(d) People prefer to hold money to avoid the risk of illiquidity.

Explanation:

The Keynesian Theory of Demand for Money explains that people prefer to hold money in liquid form to avoid the risk of illiquidity, meaning they want easy access to cash to meet unexpected expenses or emergencies.

6. What does the speculative motive for holding money refer to in the Keynesian Theory?
   (a) Holding money for future investment opportunities.
   (b) Holding money to speculate on future price changes in financial assets.
   (c) Holding money to preserve wealth and protect against uncertainties.
   (d) Holding money to finance day-to-day transactions and purchases.

Answer:

(b) Holding money to speculate on future price changes in financial assets.

Explanation:

In the Keynesian Theory of Demand for Money, the speculative motive refers to holding money with the expectation of taking advantage of potential changes in the value of financial assets, especially in financial markets.

7. How does the Keynesian Theory of Demand for Money view the role of interest rates in influencing investment decisions?
   (a) Interest rates have no impact on investment decisions.
   (b) Lower interest rates stimulate more investment.
   (c) Higher interest rates stimulate more investment.
   (d) Investment decisions are solely based on the level of income.

Answer:

(b) Lower interest rates stimulate more investment.

Explanation:

The Keynesian Theory of Demand for Money suggests that lower interest rates stimulate more investment by reducing the opportunity cost of holding money. Lower interest rates make borrowing cheaper, encouraging businesses to undertake more investment projects.

8. According to the Keynesian Theory of Demand for Money, how does an increase in liquidity preference affect the demand for money?
   (a) The demand for money increases.
   (b) The demand for money decreases.
   (c) The demand for money remains unchanged.
   (d) The demand for money is solely determined by changes in the money supply.

Answer:

(a) The demand for money increases.

Explanation:

According to the Keynesian Theory of Demand for Money, an increase in liquidity preference (the desire to hold money in liquid form) leads to an increase in the demand for money. This may happen during periods of economic uncertainty or when people become more cautious about spending.

(a) The Transactions Motive

9. What does the "Transactions Motive" for holding money refer to?
   (a) Holding money to preserve wealth and protect against uncertainties.
   (b) Holding money to take advantage of potential changes in the value of financial assets.
   (c) Holding money for speculative purposes.
   (d) Holding money to finance day-to-day transactions and purchases.

   Answer:
   (d) Holding money to finance day-to-day transactions and purchases.

   Explanation:
   The "Transactions Motive" for holding money refers to the primary reason individuals hold money, which is to facilitate day-to-day transactions and make purchases of goods and services.

10. According to the Transactions Motive, what happens to the demand for money when the frequency of transactions increases?
   (a) The demand for money decreases.
   (b) The demand for money increases.
   (c) The demand for money remains unchanged.
   (d) The demand for money is solely determined by changes in the money supply.

   Answer:
   (b) The demand for money increases.

   Explanation:
   According to the Transactions Motive, when the frequency of transactions increases, individuals require more money to carry out these transactions, leading to an increase in the demand for money.

11. How does the Transactions Motive explain the need for holding money in liquid form?
   (a) People prefer to hold money as it generates interest income.
   (b) People prefer to hold money to preserve wealth.
   (c) People prefer to hold money for speculative purposes.
   (d) People prefer to hold money to avoid the risk of illiquidity.

   Answer:
   (d) People prefer to hold money to avoid the risk of illiquidity.

   Explanation:
   The Transactions Motive explains that people prefer to hold money in liquid form to avoid the risk of illiquidity. Liquid money can be easily used for day-to-day transactions and is readily accessible.

12. Which of the following situations would lead to an increase in the demand for money due to the Transactions Motive?
   (a) A decrease in the level of economic activity.
   (b) An increase in the use of credit cards for transactions.
   (c) A decrease in the price level.
   (d) An increase in the interest rates.

   Answer:
   (b) An increase in the use of credit cards for transactions.

   Explanation:
   An increase in the use of credit cards for transactions would likely reduce the demand for physical cash (money) for day-to-day transactions. As a result, the demand for money due to the Transactions Motive would decrease.

13. How does the Transactions Motive influence the velocity of money in an economy?
   (a) It increases the velocity of money.
   (b) It decreases the velocity of money.
   (c) It has no impact on the velocity of money.
   (d) It leads to unpredictable changes in the velocity of money.

   Answer:
   (a) It increases the velocity of money.

   Explanation:
   The Transactions Motive encourages the frequent use of money for day-to-day transactions, leading to a higher velocity of money. Velocity of money refers to the rate at which money changes hands in the economy during a specific period.

14. According to the Transactions Motive, how does the level of economic activity affect the demand for money?
   (a) An increase in economic activity leads to an increase in the demand for money.

(b) An increase in economic activity leads to a decrease in the demand for money.
(c) The level of economic activity has no impact on the demand for money.
(d) The demand for money is solely determined by changes in the money supply.

Answer:
(a) An increase in economic activity leads to an increase in the demand for money.

Explanation:
According to the Transactions Motive, an increase in economic activity leads to an increase in the demand for money as more transactions take place, requiring a larger amount of money for facilitating those transactions.

15. Which of the following is an example of the Transactions Motive for holding money?
(a) Investing in stocks to earn capital gains.
(b) Keeping money in a savings account to earn interest.
(c) Holding cash to pay for groceries and daily expenses.
(d) Speculating on the future price of gold.

Answer:
(c) Holding cash to pay for groceries and daily expenses.

Explanation:
The example of holding cash to pay for groceries and daily expenses is consistent with the Transactions Motive, as it involves using money for day-to-day transactions.

16. How does the Transactions Motive relate to the demand for money during periods of economic expansion?
(a) The demand for money decreases during economic expansion.
(b) The demand for money remains constant during economic expansion.
(c) The demand for money increases during economic expansion.
(d) The demand for money is not influenced by economic expansion.

Answer:
(c) The demand for money increases during economic expansion.

Explanation:
During economic expansion, the frequency of transactions and economic activities typically increases. As a result, the Transactions Motive leads to an increase in the demand for money to facilitate these additional transactions.

(b) The Precautionary Motive

17. What does the "Precautionary Motive" for holding money refer to?
(a) Holding money to preserve wealth and protect against uncertainties.
(b) Holding money to take advantage of potential changes in the value of financial assets.
(c) Holding money for speculative purposes.
(d) Holding money to finance day-to-day transactions and purchases.

Answer:
(a) Holding money to preserve wealth and protect against uncertainties.

Explanation:
The "Precautionary Motive" for holding money refers to the desire of individuals to hold money as a precautionary measure against unforeseen expenses or emergencies. It serves as a form of financial buffer or insurance.

18. According to the Precautionary Motive, what happens to the demand for money when individuals become more risk-averse?
(a) The demand for money increases.
(b) The demand for money decreases.
(c) The demand for money remains unchanged.
(d) The demand for money is solely determined by changes in the money supply.

Answer:
(a) The demand for money increases.

Explanation:
According to the Precautionary Motive, when individuals become more risk-averse (more cautious about uncertainties), they tend to hold more money as a safety net to handle unexpected expenses. As a result, the demand for money increases.

19. How does the Precautionary Motive explain the preference for holding money in liquid form?
    (a) People prefer to hold money as it generates interest income.
    (b) People prefer to hold money to preserve wealth.
    (c) People prefer to hold money for speculative purposes.
    (d) People prefer to hold money to avoid the risk of illiquidity.

    Answer:
    (d) People prefer to hold money to avoid the risk of illiquidity.

    Explanation:
    The Precautionary Motive explains that people prefer to hold money in liquid form to avoid the risk of illiquidity. Liquid money can be easily accessed and used to meet unexpected expenses or emergencies.

20. Which of the following situations would lead to an increase in the demand for money due to the Precautionary Motive?
    (a) A decrease in the level of economic uncertainty.
    (b) An increase in the availability of credit facilities.
    (c) An increase in disposable income..
    (d) An increase in economic stability.

    Answer:
    (b) An increase in the availability of credit facilities.

    Explanation:
    An increase in the availability of credit facilities provides individuals with an alternative source of funds to handle unexpected expenses. As a result, the demand for money due to the Precautionary Motive decreases.

21. How does the Precautionary Motive influence the allocation of wealth between money and other financial assets?
    (a) It encourages a higher allocation of wealth to money.
    (b) It encourages a lower allocation of wealth to money.
    (c) It has no impact on the allocation of wealth.
    (d) It leads to unpredictable changes in wealth allocation.

    Answer:
    (a) It encourages a higher allocation of wealth to money.

    Explanation:
    The Precautionary Motive encourages individuals to hold a higher proportion of their wealth in the form of money to serve as a financial cushion in case of emergencies or unexpected expenses.

22. According to the Precautionary Motive, how does the level of economic uncertainty affect the demand for money?
    (a) An increase in economic uncertainty leads to an increase in the demand for money.
    (b) An increase in economic uncertainty leads to a decrease in the demand for money.
    (c) The level of economic uncertainty has no impact on the demand for money.
    (d) The demand for money is solely determined by changes in the money supply.

    Answer:
    (a) An increase in economic uncertainty leads to an increase in the demand for money.

    Explanation: According to the Precautionary Motive, an increase in economic uncertainty leads to an increase in the demand for money as individuals become more cautious and prefer to hold more liquid assets to handle uncertainties.

23. Which of the following is an example of the Precautionary Motive for holding money?
    (a) Investing in stocks to earn capital gains.
    (b) Keeping money in a savings account to earn interest.
    (c) Holding cash for emergency medical expenses.
    (d) Speculating on the future price of gold.

    Answer:
    (c) Holding cash for emergency medical expenses.

    Explanation:
    The example of holding cash for emergency medical expenses aligns with the Precautionary Motive, as it involves holding money to handle unforeseen expenses or emergencies.

24. How does the Precautionary Motive relate to the demand for money during periods of economic uncertainty?
    (a) The demand for money decreases during economic uncertainty.
    (b) The demand for money remains constant during economic uncertainty.
    (c) The demand for money increases during economic uncertainty.
    (d) The demand for money is not influenced by economic uncertainty.

    Answer:

    (c) The demand for money increases during economic uncertainty.

    Explanation:

    During periods of economic uncertainty, the Precautionary Motive becomes more pronounced, leading to an increase in the demand for money as individuals seek to hold more liquid assets to cope with potential financial risks and uncertainties.

(c) The Speculative Demand for Money

25. What does the "Speculative Demand for Money" refer to?
    (a) Holding money to preserve wealth and protect against uncertainties.
    (b) Holding money to take advantage of potential changes in the value of financial assets.
    (c) Holding money for day-to-day transactions and purchases.
    (d) Holding money to avoid the risk of illiquidity.

    Answer:

    (b) Holding money to take advantage of potential changes in the value of financial assets.

    Explanation:

    The "Speculative Demand for Money" refers to holding money with the expectation of taking advantage of potential changes in the value of financial assets, especially in financial markets.

26. According to the Speculative Demand for Money, what happens to the demand for money when individuals expect interest rates to rise in the future?
    (a) The demand for money increases.
    (b) The demand for money decreases.

    (c) The demand for money remains unchanged.
    (d) The demand for money is solely determined by changes in the money supply.

    Answer:

    (b) The demand for money decreases.

    Explanation:

    According to the Speculative Demand for Money, when individuals expect interest rates to rise in the future, they may choose to hold less money and invest in interest-earning assets to capitalize on higher returns. As a result, the demand for money decreases.

27. How does the Speculative Demand for Money explain the preference for holding money in liquid form?
    (a) People prefer to hold money as it generates interest income.
    (b) People prefer to hold money to preserve wealth.
    (c) People prefer to hold money for speculative purposes.
    (d) People prefer to hold money to avoid the risk of illiquidity.

    Answer:

    (c) People prefer to hold money for speculative purposes.

    Explanation:

    The Speculative Demand for Money explains that people hold money for speculative purposes, expecting to take advantage of potential changes in the value of financial assets. Liquid money can be easily converted into other assets when favorable investment opportunities arise.

28. Which of the following situations would lead to an increase in the demand for money due to the Speculative Demand for Money?
    (a) Expectations of a decrease in interest rates.
    (b) Expectations of a decrease in the value of financial assets.
    (c) Expectations of a decrease in inflation.
    (d) Expectations of an economic boom.

    Answer:

    (b) Expectations of a decrease in the value of financial assets.

    Explanation:

    When individuals expect a decrease in the value of financial assets, they may prefer to hold more money and reduce investments in those assets. This would lead to an increase in the demand for money due to the Speculative Demand for Money.

29 How does the Speculative Demand for Money influence the allocation of wealth between money and other financial assets?
(a) It encourages a higher allocation of wealth to money.
(b) It encourages a lower allocation of wealth to money.
(c) It has no impact on the allocation of wealth.
(d) It leads to unpredictable changes in wealth allocation.

Answer:

(a) It encourages a higher allocation of wealth to money.

Explanation:

The Speculative Demand for Money encourages individuals to hold a higher proportion of their wealth in the form of money as they wait for favorable investment opportunities. This results in a higher allocation of wealth to money.

30 According to the Speculative Demand for Money, how does the level of confidence in financial markets affect the demand for money?
(a) An increase in confidence leads to an increase in the demand for money.
(b) An increase in confidence leads to a decrease in the demand for money.
(c) The level of confidence has no impact on the demand for money.
(d) The demand for money is solely determined by changes in the money supply.

Answer:

(b) An increase in confidence leads to a decrease in the demand for money.

Explanation:

According to the Speculative Demand for Money, an increase in confidence in financial markets makes individuals more willing to invest and hold fewer liquid assets. As a result, the demand for money decreases.

31 Which of the following is an example of the Speculative Demand for Money?
(a) Investing in a high-interest savings account.
(b) Holding cash for emergency medical expenses.

(c) Holding money in anticipation of a stock market rally.
(d) Keeping money in a checking account for day-to-day expenses.

Answer:

(c) Holding money in anticipation of a stock market rally.

Explanation: The example of holding money in anticipation of a stock market rally aligns with the Speculative Demand for Money, as it involves holding money with the expectation of capitalizing on potential increases in the value of financial assets.

32 How does the Speculative Demand for Money relate to the demand for money during periods of economic optimism?
(a) The demand for money decreases during economic optimism.
(b) The demand for money remains constant during economic optimism.
(c) The demand for money increases during economic optimism.
(d) The demand for money is not influenced by economic optimism.

Answer:

(a) The demand for money decreases during economic optimism.

Explanation:

During periods of economic optimism, individuals are more willing to invest in financial assets, reducing the demand for holding money for speculative purposes. This leads to a decrease in the Speculative Demand for Money.

1.4 Post-Keynesian Developments in the Theory of Demand for Money

1. What are the key Post-Keynesian developments in the theory of demand for money?
(a) Quantity Theory of Money and Fisher's Equation of Exchange.
(b) Cambridge Approach and Keynesian Liquidity Preference Theory.
(c) Speculative Demand for Money and Transactions Demand for Money.
(d) Endogenous Money Theory and Horizontalist Theory.

Answer:

(d) Endogenous Money Theory and Horizontalist Theory.

Explanation:
Post-Keynesian developments in the theory of demand for money focus on two key concepts: Endogenous Money Theory, which emphasizes that money supply is determined endogenously by the central bank and commercial banks based on demand for credit, and Horizontalist Theory, which suggests that banks are not reserve constrained and can create money by lending.

2. How does the Post-Keynesian approach differ from the Keynesian Theory of Demand for Money?
   (a) Post-Keynesian approach focuses on the speculative motive, while Keynesian Theory emphasizes the transactions motive.
   (b) Post-Keynesian approach emphasizes the speculative motive, while Keynesian Theory focuses on the precautionary motive.
   (c) Post-Keynesian approach considers money supply as endogenous, while Keynesian Theory treats it as exogenous.
   (d) Post-Keynesian approach considers money supply as exogenous, while Keynesian Theory treats it as endogenous.

Answer:
(c) Post-Keynesian approach considers money supply as endogenous, while Keynesian Theory treats it as exogenous.

Explanation:
The key difference between the Post-Keynesian approach and the Keynesian Theory of Demand for Money lies in their treatment of money supply. The Post-Keynesian approach views money supply as endogenous, determined by the banking system's lending behavior, while the Keynesian Theory considers it as exogenous, controlled by the central bank.

3. According to the Post-Keynesian view, how does the demand for money relate to the interest rate?
   (a) There is a positive relationship between the demand for money and the interest rate.
   (b) There is a negative relationship between the demand for money and the interest rate.

   (c) The demand for money is not influenced by changes in the interest rate.
   (d) The demand for money is solely determined by changes in the money supply.

Answer:
(b) There is a negative relationship between the demand for money and the interest rate.

Explanation:
According to the Post-Keynesian view, there is a negative relationship between the demand for money and the interest rate. As interest rates rise, the opportunity cost of holding money increases, leading to a decrease in the demand for money.

4. How does the Post-Keynesian approach view the role of banks in the money creation process?
   (a) Banks play a passive role and cannot influence the money supply.
   (b) Banks can actively control the money supply through their lending decisions.
   (c) Banks are solely responsible for determining the quantity of money in circulation.
   (d) The money supply is determined independently of banks' actions.

Answer:
(b) Banks can actively control the money supply through their lending decisions.

Explanation:
The Post-Keynesian approach recognizes that banks play an active role in the money creation process. Through their lending decisions, banks can influence the money supply and create new money.

5. According to the Post-Keynesian perspective, what drives the demand for money in an economy?
   (a) Changes in the level of income and interest rates.
   (b) Changes in the price level and exchange rates.
   (c) Changes in the government's fiscal policy.
   (d) Changes in the money supply by the central bank.

Answer:
(a) Changes in the level of income and interest rates.

Explanation:
The Post-Keynesian perspective highlights that the demand for money is primarily driven by changes in the level of income and interest rates. As income rises or interest rates change, individuals and firms adjust their demand for money.

6. Which of the following is a major criticism of the Post-Keynesian view of the demand for money?
   (a) It neglects the importance of interest rates in determining the demand for money.
   (b) It overemphasizes the role of banks in the money creation process.
   (c) It fails to consider the impact of fiscal policy on money demand.
   (d) It lacks empirical evidence to support its claims.

   Answer:
   (d) It lacks empirical evidence to support its claims.

   Explanation:
   One major criticism of the Post-Keynesian view of the demand for money is that it has been criticized for lacking sufficient empirical evidence to support its claims and assumptions about the money creation process by banks and the endogenous nature of money supply.

1.4.1 Inventory Approach to Transaction Balances

1. What does the Inventory Approach to Transaction Balances refer to?
   (a) Holding money as a precautionary measure to cover future uncertainties.
   (b) Holding money to take advantage of potential changes in the value of financial assets.
   (c) Holding money to facilitate day-to-day transactions based on the desired frequency of purchases.
   (d) Holding money as an inventory to manage cash flows in a business.

   Answer:
   (d) Holding money as an inventory to manage cash flows in a business.

   Explanation:
   The Inventory Approach to Transaction Balances is a concept used in the context of business and firms. It refers to holding money as an

inventory or buffer to manage cash flows efficiently and cover various transactional needs, such as paying suppliers, meeting operational expenses, and managing working capital.

2. According to the Inventory Approach, how does the size of a firm's cash balance relate to the desired level of transactions?
   (a) The cash balance is unrelated to the desired level of transactions.
   (b) The cash balance is always equal to the desired level of transactions.
   (c) The cash balance is determined by the desired level of transactions.
   (d) The cash balance is inversely related to the desired level of transactions.

   Answer:
   (c) The cash balance is determined by the desired level of transactions.

   Explanation:
   According to the Inventory Approach, the size of a firm's cash balance is determined by the desired level of transactions or the expected cash outflows and inflows associated with business operations. The firm aims to maintain an appropriate cash balance to meet its transactional needs efficiently.

3. How does the Inventory Approach explain the opportunity cost of holding cash?
   (a) Holding cash incurs no opportunity cost.
   (b) The opportunity cost of holding cash is equal to the interest rate.
   (c) The opportunity cost of holding cash is equal to the potential returns from investment.
   (d) The opportunity cost of holding cash is equal to the inflation rate.

   Answer:
   (c) The opportunity cost of holding cash is equal to the potential returns from investment.

   Explanation:
   The Inventory Approach acknowledges that holding cash incurs an opportunity cost, as the cash could have been invested to earn potential returns. By holding cash, the firm foregoes the opportunity to earn interest or returns that could have been generated through investment.

4. What is the primary focus of the Inventory Approach in managing transaction balances?
   (a) Maximizing cash holdings to ensure liquidity at all times.
   (b) Minimizing cash holdings to reduce the opportunity cost.
   (c) Optimizing cash holdings to strike a balance between liquidity and opportunity cost.
   (d) Ignoring cash balances and relying on credit for transactions.

   Answer:

   (c) Optimizing cash holdings to strike a balance between liquidity and opportunity cost.

   Explanation:

   The primary focus of the Inventory Approach is to optimize cash holdings to strike a balance between the firm's need for liquidity (to meet transactional requirements) and the opportunity cost of holding cash (foregoing potential investment returns).

5. How does the Inventory Approach view the holding of marketable securities as part of transaction balances?
   (a) Marketable securities are considered part of the firm's cash balance.
   (b) Marketable securities are seen as a separate investment category unrelated to transaction balances.
   (c) Marketable securities are considered part of the firm's inventory of goods for sale.
   (d) Marketable securities are viewed as a liability for the firm.

   Answer:

   (a) Marketable securities are considered part of the firm's cash balance.

   Explanation:

   The Inventory Approach treats marketable securities (e.g., short-term investments) as part of the firm's cash balance. These securities are considered as good as cash because they can be readily converted into cash when needed to meet transactional requirements.

6. Which of the following factors would influence a firm's desired level of transaction balances according to the Inventory Approach?
   (a) The firm's long-term investment plans.
   (b) The firm's dividend payout ratio.

   (c) The firm's credit rating.
   (d) The firm's average transaction size and frequency.

   Answer:

   (d) The firm's average transaction size and frequency.

   Explanation:

   According to the Inventory Approach, the desired level of transaction balances is influenced by the firm's average transaction size and frequency. Larger transaction sizes and higher transaction frequencies would require the firm to hold a larger cash balance.

1.4.2 Friedman's Restatement of the Quantity Theory

1. What is the key proposition of Friedman's Restatement of the Quantity Theory of Money?
   (a) Money supply has a significant impact on aggregate demand and economic output.
   (b) Inflation is primarily determined by changes in the money supply.
   (c) Velocity of money is constant in the long run.
   (d) Fiscal policy is more effective than monetary policy in stabilizing the economy.

   Answer:

   (b) Inflation is primarily determined by changes in the money supply.

   Explanation:

   Friedman's Restatement of the Quantity Theory of Money emphasizes that inflation is primarily caused by changes in the money supply in the long run. According to this view, an increase in the money supply leads to a proportional increase in the price level.

2. According to Friedman, what role does velocity of money play in the Quantity Theory of Money?
   (a) Velocity of money is constant and has no impact on inflation.
   (b) Velocity of money is volatile and leads to frequent changes in inflation.
   (c) Velocity of money is a key determinant of inflation.
   (d) Velocity of money is irrelevant in explaining inflation.

   Answer:

   (c) Velocity of money is a key determinant of inflation.

Explanation:
In Friedman's Restatement, velocity of money is viewed as a key determinant of inflation. It represents the rate at which money changes hands during a given period, and changes in velocity can amplify or dampen the effects of changes in the money supply on inflation.

3. According to Friedman, what is the primary cause of business cycles?
   (a) Fluctuations in government spending.
   (b) Changes in aggregate demand due to money supply changes.
   (c) Shocks in the financial markets.
   (d) Technological advancements.

   Answer:
   (b) Changes in aggregate demand due to money supply changes.

   Explanation:
   Friedman argues that changes in the money supply, and subsequently changes in aggregate demand, are the primary cause of business cycles. An increase in the money supply leads to an increase in aggregate demand, resulting in an expansionary phase of the business cycle, and vice versa.

4. How does Friedman view the role of monetary policy in controlling inflation?
   (a) Monetary policy is ineffective in controlling inflation.
   (b) Monetary policy is the primary tool to control inflation.
   (c) Fiscal policy is more effective than monetary policy in controlling inflation.
   (d) Controlling inflation is beyond the scope of monetary policy.

   Answer:
   (a) Monetary policy is ineffective in controlling inflation.

   Explanation:
   Friedman believes that monetary policy is generally ineffective in controlling inflation in the long run. According to him, changes in the money supply only have temporary effects on real variables such as output and employment, but they do not have a long-lasting impact on inflation.

5. What is the main criticism of Friedman's Restatement of the Quantity Theory of Money?
   (a) It ignores the impact of fiscal policy on the economy.
   (b) It assumes that velocity of money is constant, which is not always the case.
   (c) It does not consider the role of financial markets in influencing inflation.
   (d) It underestimates the importance of changes in the money supply on inflation.

   Answer:
   (b) It assumes that velocity of money is constant, which is not always the case.

   Explanation:
   One of the main criticisms of Friedman's Restatement is its assumption of constant velocity of money. In reality, velocity of money can fluctuate, making it challenging to accurately predict the relationship between money supply and inflation.

6. How does Friedman's Restatement view the long-run effects of changes in the money supply?
   (a) Changes in the money supply have long-lasting effects on inflation and output.
   (b) Changes in the money supply have short-term effects on inflation and output.
   (c) Changes in the money supply have no impact on inflation and output in the long run.
   (d) Changes in the money supply have no impact on inflation but affect output in the long run.

   Answer:
   (c) Changes in the money supply have no impact on inflation and output in the long run.

   Explanation:
   According to Friedman, changes in the money supply have no significant impact on inflation and output in the long run. Instead, they only affect nominal variables, while real variables are determined by non-monetary factors.

1.4.3 The Demand for Money as Behaviour toward Risk

1. What does the "Demand for Money as Behavior toward Risk" refer to
   (a) Holding money as a precautionary measure to cover future uncertainties.
   (b) Holding money to take advantage of potential changes in the value of financial assets.
   (c) Holding money based on risk aversion and the desire to avoid holding risky assets.
   (d) Holding money as an inventory to manage cash flows in a business.

   Answer:
   (c) Holding money based on risk aversion and the desire to avoid holding risky assets.

   Explanation:
   The "Demand for Money as Behavior toward Risk" refers to the preference of individuals to hold money as a safe and low-risk asset, driven by risk aversion and the desire to avoid holding riskier assets, such as stocks or bonds.

2. According to the Demand for Money as Behavior toward Risk, what happens to the demand for money when individuals become more risk-averse?
   (a) The demand for money increases.
   (b) The demand for money decreases.
   (c) The demand for money remains unchanged.
   (d) The demand for money is solely determined by changes in the money supply.

   Answer:
   (a) The demand for money increases.

   Explanation:
   According to the Demand for Money as Behavior toward Risk, when individuals become more risk-averse, they tend to hold more money as a safe and less risky asset. As a result, the demand for money increases.

3. How does the Demand for Money as Behavior toward Risk explain the preference for holding money in liquid form?
   (a) People prefer to hold money as it generates interest income.
   (b) People prefer to hold money to preserve wealth.
   (c) People prefer to hold money for speculative purposes.
   (d) People prefer to hold money to avoid the risk of illiquidity.

   Answer:
   (d) People prefer to hold money to avoid the risk of illiquidity.

   Explanation:
   The Demand for Money as Behavior toward Risk explains that people prefer to hold money in liquid form to avoid the risk of illiquidity. Liquid money can be easily accessed and used to meet financial needs without the need to sell risky or illiquid assets.

4. Which of the following situations would lead to an increase in the demand for money due to the Demand for Money as Behavior toward Risk?
   (a) An increase in economic stability.
   (b) A decrease in the availability of credit facilities.
   (c) A decrease in disposable income.
   (d) A decrease in the perceived level of financial risk.

   Answer:
   (d) A decrease in the perceived level of financial risk.

   Explanation:
   A decrease in the perceived level of financial risk would make individuals less risk-averse and less inclined to hold money as a safe asset. Therefore, it would lead to a decrease in the demand for money due to the Demand for Money as Behavior toward Risk.

5. How does the Demand for Money as Behavior toward Risk influence the allocation of wealth between money and other financial assets?
   (a) It encourages a higher allocation of wealth to money.
   (b) It encourages a lower allocation of wealth to money.
   (c) It has no impact on the allocation of wealth.
   (d) It leads to unpredictable changes in wealth allocation.

   Answer:
   (a) It encourages a higher allocation of wealth to money.

Explanation:
The Demand for Money as Behavior toward Risk encourages individuals to hold a higher proportion of their wealth in the form of money as a safe and low-risk asset to manage the uncertainty associated with riskier financial assets.

6. According to the Demand for Money as Behavior toward Risk, how does the level of economic uncertainty affect the demand for money?
   (a) An increase in economic uncertainty leads to an increase in the demand for money.
   (b) An increase in economic uncertainty leads to a decrease in the demand for money.
   (c) The level of economic uncertainty has no impact on the demand for money.
   (d) The demand for money is solely determined by changes in the money supply.

Answer:
(a) An increase in economic uncertainty leads to an increase in the demand for money.

Explanation:
According to the Demand for Money as Behavior toward Risk, an increase in economic uncertainty leads to an increase in the demand for money as individuals become more risk-averse and prefer to hold safe assets in uncertain times.

Additional Question Bank

1.1 Introduction

1. The demand for money arises primarily from its function as a:
   (a) Store of value
   (b) Medium of exchange
   (c) Unit of account
   (d) Commodity

2. According to the quantity theory of money, the demand for money is directly proportional to:
   (a) The price level
   (b) The rate of inflation
   (c) The level of real income
   (d) The interest rate
3. he Keynesian theory of money demand suggests that the demand for money is influenced by:
   (a) The money supply
   (b) The interest rate
   (c) Consumer confidence
   (d) Government expenditure
4. The speculative motive for holding money is based on the expectation of:
   (a) High interest rates in the future
   (b) Low inflation rates
   (c) A decrease in the money supply
   (d) A rise in asset prices
5. The transaction motive for holding money is related to the need for money to conduct:
   (a) Speculative investments
   (b) Everyday transactions and payments
   (c) International trade
   (d) Long-term savings

1.2 The Demand for Money

1. The demand for money is a function of:
   (a) The money supply
   (b) The interest rate
   (c) The inflation rate
   (d) All of the above
2. The demand for money for transactions is influenced by:
   (a) Future expectations of interest rates
   (b) Consumer preferences for holding money

(c) The level of income and economic activity
(d) Speculative investments

3. The precautionary motive for holding money arises from the need to:
(a) Conduct day-to-day transactions
(b) Make speculative investments
(c) Save for future emergencies and uncertainties
(d) Avoid inflation

4. According to the Keynesian theory, an increase in the interest rate will lead to:
(a) An increase in the demand for money
(b) A decrease in the demand for money
(c) No change in the demand for money
(d) An increase in the money supply

5. The speculative motive for holding money is driven by expectations of:
(a) High inflation rates
(b) Low interest rates in the future
(c) A decrease in the money supply
(d) Economic stability

1.3 Theories of Demand for Money

1. The classical quantity theory of money suggests that the demand for money is primarily influenced by:
(a) The interest rate
(b) The level of income
(c) Future expectations of inflation
(d) Government policies

2. According to the Keynesian theory of money demand, the demand for money is mainly influenced by:
(a) The interest rate
(b) The level of income and economic activity
(c) Future expectations of inflation
(d) Government expenditure

3. The speculative demand for money is based on the expectation of:
(a) High interest rates in the future
(b) Low inflation rates
(c) A decrease in the money supply
(d) High economic growth

4. The precautionary demand for money arises due to the need to hold money for:
(a) Everyday transactions
(b) Speculative investments
(c) Emergency purposes and uncertainties
(d) Tax payments

5. The "Baumol-Tobin model" of money demand suggests that people will try to minimize the:
(a) Opportunity cost of holding money
(b) Inflation rate
(c) Government intervention in the economy
(d) Transaction costs of converting assets into money

1.4 Post-Keynesian Developments in the Theory of Demand for Money

1. Post-Keynesian economists argue that the demand for money is primarily determined by:
(a) The interest rate
(b) The level of income and economic activity
(c) Future expectations of inflation
(d) Government policies

2. According to post-Keynesian views, the speculative demand for money is related to people's desire to:
(a) Hold liquid assets for convenience
(b) Invest in stocks and bonds
(c) Avoid holding money due to inflation
(d) Minimize transaction costs

3. In the post-Keynesian approach, the precautionary demand for money is driven by the need to have sufficient funds for:
(a) Speculative purposes
(b) Everyday transactions

(c) Emergency situations and uncertainties
(d) Long-term savings

4. Post-Keynesian economists argue that the demand for money can be affected by changes in:
(a) Government expenditures
(b) The money supply
(c) Interest rates
(d) All of the above

5. The liquidity preference theory, developed by John Maynard Keynes, emphasizes that the demand for money depends on:
(a) The nominal interest rate
(b) The real interest rate
(c) Future expectations of inflation
(d) Both (a) and (b)

1.4.1 Inventory Approach to Transaction Balances

1. The inventory approach to transaction balances suggests that the demand for money is influenced by:
(a) The interest rate
(b) The level of income and economic activity
(c) The cost of holding money and the cost of converting other assets into money
(d) Future expectations of inflation

2. According to the inventory approach, individuals and firms hold money to:
(a) Speculate on future interest rates
(b) Facilitate transactions for goods and services
(c) Invest in financial markets
(d) Avoid taxes

3. The inventory approach to transaction balances suggests that an increase in the cost of converting assets into money will lead to:
(a) An increase in the demand for money
(b) A decrease in the demand for money
(c) No change in the demand for money
(d) An increase in the velocity of money

4. In the inventory approach, the decision to hold money is based on a trade-off between the benefits of liquidity and the:
(a) Risk of inflation
(b) Opportunity cost of holding money
(c) Government interventions in the economy
(d) Exchange rate fluctuations

5. The inventory approach to transaction balances is often used to explain:
(a) The demand for money in developing economies
(b The demand for money in advanced economies
(c) The impact of government policies on money demand
(d) The relationship between money supply and interest rates

1.4.2 Friedman's Restatement of the Quantity Theory

1. Milton Friedman's restatement of the quantity theory of money emphasized that the demand for money depends on:
(a) The level of income and economic activity
(b) The interest rate
(c) Future expectations of inflation
(d) Both a) and b)

2. According to Friedman, changes in the quantity of money affect:
(a) Interest rates only
(b) Price levels only
(c) Both interest rates and price levels
(d) Exchange rates

3. Friedman's restatement suggested that in the long run, changes in the quantity of money primarily influence:
(a) Real economic variables such as output and employment
(b) Nominal economic variables such as the price level
(c) Government fiscal policies
(d) International trade and capital flows

4. Friedman argued that central banks should focus on:
(a) Controlling the money supply to stabilize the economy
(b) Manipulating interest rates to influence investment
(c) Implementing exchange rate policies to boost exports
(d) Directly managing government expenditures and taxation

5. According to Friedman, excessive inflation is primarily caused by:
   (a) An increase in government spending
   (b) Excessive growth in the money supply
   (c) Fluctuations in exchange rates
   (d) A decrease in interest rates

1.4.3 The Demand for Money as Behaviour toward Risk

1. The demand for money as behavior toward risk suggests that individuals may hold more money when they:
   (a) Have higher income levels
   (b) Expect future inflation
   (c) Perceive higher uncertainty or risk in the economy
   (d) Expect interest rates to decrease
2. In the context of the demand for money as behavior toward risk, holding money provides individuals with a sense of:
   (a) Liquidity and flexibility
   (b) Long-term investment opportunities
   (c) Tax advantages
   (d) Higher returns compared to other assets
3. According to the demand for money as behavior toward risk, during times of economic instability or crisis, people tend to:
   (a) Increase their spending
   (b) Invest more in the stock market
   (c) Hold more money as a safe asset
   (d) Borrow heavily from banks
4. The demand for money as behavior toward risk is closely related to the concept of:
   (a) Risk aversion (b) Speculative motives
   (c) Precautionary motives (d) Money multipliers
5. As a risk-averse individual expects higher uncertainty in the future, the demand for money:
   (a) Increases
   (b) Decreases
   (c) Remains constant
   (d) Becomes dependent on government policies

Answer

1.1 Introduction

1. (b) Medium of exchange
2. (c) The level of real income
3. (b) The interest rate
4. (a) High interest rates in the future
5. (b) Everyday transactions and payments

1.2 The Demand for Money

1. (d) All of the above
2. (c) The level of income and economic activity
3. (c) Save for future emergencies and uncertainties
4. (b) A decrease in the demand for money
5. (b) Low interest rates in the future

1.3 Theories of Demand for Money

1. (b) The level of income
2. (a) The interest rate
3. (a) High interest rates in the future
4. (c) Emergency purposes and uncertainties
5. (a) Opportunity cost of holding money

1.4 Post-Keynesian Developments in the Theory of Demand for

1. (b) The level of income and economic activity
2. (c) Avoid holding money due to inflation
3. (c) Emergency situations and uncertainties
4. (d) All of the above
5. (d) Both a) and b)

1.4.1 Inventory Approach to Transaction Balances

1. (c) The cost of holding money and the cost of converting other assets into money
2. (b) Facilitate transactions for goods and services
3. (a) An increase in the demand for money
4. (b) Opportunity cost of holding money
5. (b) The demand for money in advanced economies

1.4.2 Friedman's Restatement of the Quantity Theory

1. (d) Both a) and b)
2. (c) Both interest rates and price levels
3. (b) Nominal economic variables such as the price level
4. (a) Controlling the money supply to stabilize the economy
5. (b) Excessive growth in the money supply

1.4.3 The Demand for Money as Behaviour toward Risk

1. (c) Perceive higher uncertainty or risk in the economy
2. (a) Liquidity and flexibility
3. (c) Hold more money as a safe asset
4. (a) Risk aversion
5. (a) Increases

8 MONEY MARKET

Unit:2 The Concept of Money Supply

Multiple Choice Questions

1.1 Introduction

1. What is the concept of "money supply" in economics?
   (a) The total amount of money held by an individual or household.
   (b) The total amount of money in circulation within an economy at a specific point in time.
   (c) The total amount of money that a government can print to finance its expenditures.
   (d) The total amount of money invested in financial assets, such as stocks and bonds.

   Answer:
   (b) The total amount of money in circulation within an economy at a specific point in time.

   Explanation:
   The concept of money supply refers to the total amount of money available in an economy, including currency notes, coins, and various forms of bank deposits, that is in circulation at a given moment.
2. Which of the following is considered "M1" in the classification of money supply?
   (a) Currency held by the public and demand deposits with banks.
   (b) Currency held by the public and time deposits with banks.
   (c) Currency held by the public, time deposits with banks, and savings deposits.
   (d) Currency held by the public, demand deposits with banks, and time deposits.

   Answer:
   (a) Currency held by the public and demand deposits with banks.

Explanation:
M1 represents the narrowest measure of money supply and includes currency held by the public and demand deposits with banks (i.e., checking accounts).

3. "M2" in the classification of money supply includes:
   (a) Currency held by the public and demand deposits with banks.
   (b) Currency held by the public, demand deposits with banks, and time deposits.
   (c) Currency held by the public, time deposits with banks, and savings deposits.
   (d) Currency held by the public, demand deposits with banks, and time deposits, along with certain money market instruments.

   Answer:
   (b) Currency held by the public, demand deposits with banks, and time deposits.

   Explanation:
   M2 includes M1 (currency held by the public and demand deposits with banks) and adds time deposits with banks (i.e., savings accounts and certificates of deposit) to it.

4 "M3" in the classification of money supply includes:
   (a) Currency held by the public, demand deposits with banks, and time deposits.
   (b) Currency held by the public, demand deposits with banks, and time deposits, along with certain money market instruments.
   (c) Currency held by the public, time deposits with banks, and savings deposits, along with certain money market instruments.(
   (d) Currency held by the public, demand deposits with banks, time deposits, and savings deposits, along with certain money market instruments.

   Answer:
   (b) Currency held by the public, demand deposits with banks, and time deposits, along with certain money market instruments.

   Explanation:
   M3 includes M2 (currency held by the public, demand deposits with banks, and time deposits) and also incorporates certain money market instruments like commercial paper and government securities.

5. "Liquidity" in the context of money supply refers to:
   (a) The ease with which financial assets can be converted into money without loss of value.
   (b) The total amount of money in circulation within an economy.
   (c) The ability of banks to lend money to the government.
   (d) The amount of money that individuals and firms hold in their savings accounts.

   Answer:
   (a) The ease with which financial assets can be converted into money without loss of value.

   Explanation:
   Liquidity refers to the ease with which financial assets (such as stocks, bonds, or money market instruments) can be converted into cash or money without a significant loss of value. Assets that can be quickly and easily converted into cash are considered more liquid.

6. How does an increase in the money supply affect inflation, according to the Quantity Theory of Money?
   (a) An increase in the money supply leads to deflation.
   (b) An increase in the money supply has no impact on inflation.
   (c) An increase in the money supply leads to inflation.
   (d) An increase in the money supply causes stagflation.

   Answer:
   (c) An increase in the money supply leads to inflation.

   Explanation:
   According to the Quantity Theory of Money, an increase in the money supply, when the economy's output and production capacity remain unchanged, will lead to an increase in the overall price level, resulting in inflation.

7. What is M1 in the measurement of money supply?
   (a) The narrowest measure of money supply, including only physical currency.
   (b) The broadest measure of money supply, including all liquid assets and time deposits.

(c) The measure of money supply used by central banks for monetary policy.
(d) The total value of goods and services produced in an economy.

Answer:

(a) The narrowest measure of money supply, including only physical currency.

Explanation:

M1 is the narrowest measure of money supply, and it includes only physical currency (coins and notes) in circulation and demand deposits (checking accounts) held by the public.

8. Which of the following is considered a component of M2 in the measurement of money supply?
(a) Physical currency (coins and notes) in circulation.
(b) Demand deposits (checking accounts) held by the public.
(c) Time deposits (fixed deposits) with commercial banks.
(d) Treasury bills and government bonds.

Answer:

(c) Time deposits (fixed deposits) with commercial banks.

Explanation:

M2 is a broader measure of money supply that includes all components of M1 (physical currency and demand deposits) and adds time deposits (fixed deposits) with commercial banks and other liquid assets.

9. How does an increase in the money supply affect inflation, according to monetary theory?
(a) An increase in the money supply causes deflation.
(b) An increase in the money supply has no effect on inflation.
(c) An increase in the money supply leads to higher inflation.
(d) An increase in the money supply reduces economic growth.

Answer:

(c) An increase in the money supply leads to higher inflation.

Explanation:

According to monetary theory, an increase in the money supply tends to lead to higher inflation. When the money supply grows faster than the rate of economic growth, it can lead to an increase in demand for goods and services, which in turn can push up prices.

10. What role does the central bank play in controlling the money supply?
(a) The central bank has no control over the money supply.
(b) The central bank can directly control the money supply through its policies.
(c) The central bank can indirectly influence the money supply through interest rate adjustments.
(d) The central bank can control only the currency component of the money supply.

Answer:

(c) The central bank can indirectly influence the money supply through interest rate adjustments.

Explanation:

The central bank can influence the money supply through its monetary policy tools. By adjusting the interest rates (e.g., the discount rate and the federal funds rate), the central bank can encourage or discourage borrowing and lending, thereby affecting the money supply in the economy.

11. Which measure of money supply is the most comprehensive and includes all liquid assets?
(a) M0 (b) M1
(c) M2 (d) M3

Answer:

(d) M3

Explanation:

M3 is the most comprehensive measure of money supply, and it includes all components of M2 (physical currency, demand deposits, and time deposits) and adds larger liquid assets like treasury bills, government bonds, and other financial instruments.

1.2 Rationale of Measuring Money Supply

1. Why is it important for economists and policymakers to measure the money supply in an economy?
(a) To determine the total value of goods and services produced in the economy.

(b) To assess the overall level of economic growth and development.
(c) To understand the availability of credit and loans for businesses and individuals.
(d) To monitor the effectiveness of monetary policy and its impact on inflation and economic stability.

Answer:

(d) To monitor the effectiveness of monetary policy and its impact on inflation and economic stability.

Explanation:

Measuring the money supply is crucial for economists and policymakers to monitor the effectiveness of monetary policy. Changes in the money supply can have significant impacts on inflation, economic growth, and overall economic stability. By tracking the money supply, policymakers can adjust their monetary policies to achieve their economic goals.

2. Which component of the money supply is the most liquid and serves as the medium of exchange in day-to-day transactions?
(a) Physical currency (coins and notes) in circulation.
(b) Demand deposits (checking accounts) held by the public.
(c) Time deposits (fixed deposits) with commercial banks.
(d) Government bonds and securities.

Answer:

(a) Physical currency (coins and notes) in circulation.

Explanation:

Physical currency in circulation, which includes coins and notes, is the most liquid component of the money supply. It is widely accepted as a medium of exchange in day-to-day transactions for goods and services.

3. How does measuring the money supply help in assessing the liquidity of an economy?
(a) A higher money supply indicates higher liquidity.
(b) A lower money supply indicates higher liquidity.
(c) Measuring money supply has no relation to assessing liquidity.
(d) Liquidity is solely determined by the availability of credit facilities.

Answer:

(a) A higher money supply indicates higher liquidity.

Explanation:

Measuring the money supply helps assess the liquidity of an economy. A higher money supply implies that more money is available in the economy, making it easier for individuals and businesses to access funds and engage in transactions.

4. What does the concept of "monetary aggregates" refer to in the measurement of money supply?
(a) The total value of all financial assets in an economy.
(b) The total value of exports and imports in an economy.
(c) The various measures of money supply used by central banks for policy purposes.
(d) The total value of goods and services produced in an economy.

Answer:

(c) The various measures of money supply used by central banks for policy purposes.

Explanation:

"Monetary aggregates" refer to the various measures of money supply used by central banks to analyze and implement monetary policy effectively. These measures include M0, M1, M2, M3, and so on, each representing a different level of liquidity in the economy.

5. Why is M1 considered a narrow measure of money supply?
(a) It includes only physical currency in circulation.
(b) It includes physical currency and demand deposits but excludes time deposits.
(c) It includes physical currency and time deposits but excludes demand deposits.
(d) It includes all components of money supply, including physical currency, demand deposits, and time deposits.

Answer:

(b) It includes physical currency and demand deposits but excludes time deposits.

Explanation:
M1 is considered a narrow measure of money supply because it includes only the most liquid components, such as physical currency in circulation and demand deposits held by the public, while excluding time deposits (fixed deposits).

6. How does measuring the money supply assist in understanding the potential for inflation in an economy?
   (a) A higher money supply indicates lower inflation potential.
   (b) A lower money supply indicates lower inflation potential.
   (c) Measuring money supply has no relation to understanding inflation potential.
   (d) The potential for inflation is solely determined by fiscal policy.

   Answer:
   (b) A lower money supply indicates lower inflation potential.

   Explanation:
   Measuring the money supply helps in understanding the potential for inflation. A lower money supply, relative to the demand for goods and services, can indicate a lower inflation potential, as there is less money available to drive up prices.

7. Why is it important to measure the money supply in an economy?
   (a) To track changes in the stock market.
   (b) To assess the overall health of the financial sector.
   (c) To understand the level of economic activity and inflationary pressures.
   (d) To determine the fiscal deficit of the government.

   Answer:
   (c) To understand the level of economic activity and inflationary pressures.

   Explanation:
   Measuring the money supply is crucial for understanding the level of economic activity and inflationary pressures in an economy. Changes in the money supply can impact consumer spending, investment, and overall economic growth, as well as influence the level of inflation.

8. Which of the following components is typically included in the measurement of M1 money supply?
   (a) Time deposits with commercial banks.
   (b) Treasury bills and government bonds.
   (c) Physical currency (coins and notes) in circulation.
   (d) Foreign currency held by the central bank.

   Answer:
   (c) Physical currency (coins and notes) in circulation.

   Explanation:
   M1 money supply includes physical currency (coins and notes) in circulation and demand deposits (checking accounts) held by the public. It represents the most liquid and immediate form of money.

9. Which measure of money supply is more comprehensive and includes M1 plus time deposits with commercial banks?
   (a) M0 (b) M1
   (c) M2 (d) M3

   Answer:
   (c) M2

   Explanation:
   M2 is a more comprehensive measure of money supply than M1. It includes all components of M1 (physical currency and demand deposits) and adds time deposits (fixed deposits) with commercial banks and other liquid assets.

10. What is the primary objective of measuring money supply from the perspective of monetary policy?
    (a) To determine the fiscal deficit of the government.
    (b) To assess the overall health of the financial sector.
    (c) To track changes in the stock market.
    (d) To guide the formulation and implementation of monetary policy.

    Answer:
    (d) To guide the formulation and implementation of monetary policy.

    Explanation:
    The primary objective of measuring money supply is to guide the formulation and implementation of monetary policy by central banks.

Monetary policymakers use information about the money supply to influence interest rates, credit availability, and overall economic conditions.

11. Why is the measurement of money supply considered essential for conducting monetary policy?
    (a) It helps central banks predict future changes in the stock market.
    (b) It provides insights into consumer spending patterns.
    (c) It allows central banks to control inflation and stabilize the economy.
    (d) It assists central banks in managing the fiscal deficit of the government.

    Answer:
    (c) It allows central banks to control inflation and stabilize the economy.
    Explanation:
    Measuring money supply is essential for conducting monetary policy as it allows central banks to monitor and control inflation and stabilize the economy. By adjusting interest rates and influencing credit availability, central banks can impact the money supply and overall economic activity.

12. What does M0 represent in the measurement of money supply?
    (a) The narrowest measure of money supply, including only physical currency.
    (b) The broadest measure of money supply, including all liquid assets and time deposits.
    (c) The measure of money supply used by central banks for monetary policy.
    (d) The total value of goods and services produced in an economy.

    Answer:
    (a) The narrowest measure of money supply, including only physical currency.
    Explanation:
    M0 is the narrowest measure of money supply, and it includes only physical currency (coins and notes) in circulation. It represents the most liquid and immediate form of money.

1.3 The Sources of Money Supply

1. Which of the following is NOT considered a source of money supply in an economy?
   (a) Physical currency issued by the central bank.
   (b) Demand deposits held by commercial banks.
   (c) Government bonds and treasury bills.
   (d) Foreign currency reserves held by the central bank.

   Answer:
   (c) Government bonds and treasury bills.
   Explanation:
   Government bonds and treasury bills are not considered a source of money supply. They are financial instruments used for borrowing by the government but do not directly contribute to the money supply.

2. The primary source of money supply in an economy is:
   (a) Physical currency held by the public.
   (b) Currency issued by commercial banks.
   (c) Foreign currency reserves held by the central bank.
   (d) Demand deposits held by commercial banks.

   Answer:
   (d) Demand deposits held by commercial banks.
   Explanation:
   Demand deposits held by commercial banks are the primary source of money supply in an economy. These deposits can be readily used for transactions, making them an essential component of the money supply.

3. Which of the following is considered a component of the monetary base, also known as M0?
   (a) Demand deposits held by the public.
   (b) Time deposits with commercial banks.
   (c) Physical currency (coins and notes) in circulation.
   (d) Government securities.

   Answer:
   (c) Physical currency (coins and notes) in circulation.

Explanation:
M0, also known as the monetary base, includes physical currency (coins and notes) in circulation and reserves held by commercial banks at the central bank.

4. What role does the central bank play in controlling the money supply?
(a) The central bank has no control over the money supply.
(b) The central bank can directly control the money supply through its policies.
(c) The central bank can indirectly influence the money supply through interest rate adjustments.
(d) The central bank can control only the currency component of the money supply.

Answer:
(c) The central bank can indirectly influence the money supply through interest rate adjustments.

Explanation:
The central bank can influence the money supply through its monetary policy tools. By adjusting the interest rates (e.g., the discount rate and the federal funds rate), the central bank can encourage or discourage borrowing and lending, thereby affecting the money supply in the economy.

5. What happens to the money supply when commercial banks increase their lending activities?
(a) The money supply decreases.
(b) The money supply remains unchanged.
(c) The money supply increases.
(d) The money supply fluctuates randomly.

Answer:
(c) The money supply increases.

Explanation:
When commercial banks increase their lending activities, they create new money in the economy through the process of credit creation. This leads to an increase in the money supply.

6. Which of the following assets held by commercial banks is a component of the money supply?
(a) Government bonds.
(b) Corporate stocks.
(c) Treasury bills.
(d) Demand deposits.

Answer:
(d) Demand deposits.

Explanation:
Demand deposits held by commercial banks are a component of the money supply. They represent the funds deposited by individuals and businesses that can be withdrawn on demand and used for transactions.

7. Which of the following components is included in the narrowest measure of money supply (M0)?
(a) Demand deposits (checking accounts) in commercial banks.
(b) Time deposits (fixed deposits) with commercial banks.
(c) Physical currency (coins and notes) in circulation.
(d) Foreign currency reserves held by the central bank.

Answer:
(c) Physical currency (coins and notes) in circulation.

Explanation:
M0 is the narrowest measure of money supply and includes physical currency (coins and notes) in circulation. It represents the most liquid form of money issued by the central bank.

8. Which source of money supply represents the reserves held by commercial banks with the central bank?
(a) Currency held by the public.
(b) Demand deposits.
(c) Bank reserves.
(d) Time deposits.

Answer:
(c) Bank reserves.

Explanation:
Bank reserves represent the funds that commercial banks hold with the central bank. These reserves consist of both physical currency (vault cash) and deposits with the central bank. Bank reserves play a crucial role in determining the lending capacity of commercial banks.

9. How does the central bank influence the money supply in the economy?
   (a) By controlling the government's budget deficit.
   (b) By adjusting interest rates and conducting open market operations.
   (c) y directly printing and issuing physical currency.
   (d) By regulating foreign currency transactions.

   Answer:

   (b) By adjusting interest rates and conducting open market operations.

   Explanation:

   The central bank influences the money supply through its monetary policy tools, such as adjusting interest rates (e.g., the discount rate and the federal funds rate) and conducting open market operations (buying or selling government bonds). These actions impact the reserves of commercial banks and, in turn, affect the money supply.

10. Which component of money supply represents the deposits that individuals and businesses can withdraw on demand without any notice?
    (a) Time deposits (fixed deposits).
    (b) Savings deposits.
    (c) Demand deposits (checking accounts).
    (d) Foreign currency reserves.

    Answer:

    (c) Demand deposits (checking accounts).

    Explanation:

    Demand deposits, also known as checking accounts, represent the deposits that individuals and businesses can withdraw on demand without any notice. They are highly liquid and form a part of the money supply.

11. What is the role of the government in determining the money supply?
    (a) The government directly controls the money supply by printing physical currency.
    (b) The government regulates the flow of foreign currency into the country.
    (c) The government sets the reserve requirements for commercial banks.

    (d) The government influences the money supply through its fiscal policies and borrowing.

    Answer:

    (c) The government sets the reserve requirements for commercial banks.

    Explanation:

    The government plays a role in determining the money supply by setting reserve requirements for commercial banks. Reserve requirements are the minimum amount of funds that banks must hold as reserves (cash or deposits with the central bank) against their demand deposits. Changes in reserve requirements can impact the money supply in the economy.

1.4 Measurement of Money Supply

1. Which of the following measures of money supply includes physical currency (coins and notes) in circulation and demand deposits with commercial banks?
   (a) M0 (b) M1
   (c) M2 (d) M3

   Answer:

   (b) M1

   Explanation:

   M1 is a measure of money supply that includes physical currency (coins and notes) in circulation and demand deposits (checking accounts) with commercial banks. It represents the most liquid and immediate forms of money.

2. Which component is included in M2 but not in M1 in the measurement of money supply?
   (a) Physical currency (coins and notes) in circulation.
   (b) Time deposits (fixed deposits) with commercial banks.
   (c) Demand deposits (checking accounts) held by the public.
   (d) Foreign currency reserves held by the central bank.

   Answer:

   (b) Time deposits (fixed deposits) with commercial banks.

Explanation:

M2 is a broader measure of money supply than M1. It includes all components of M1 (physical currency and demand deposits) and adds time deposits (fixed deposits) with commercial banks and other liquid assets.

3. What does M0 represent in the measurement of money supply?
   (a) The narrowest measure of money supply, including only physical currency.
   (b) The broadest measure of money supply, including all liquid assets and time deposits.
   (c) The measure of money supply used by central banks for monetary policy.
   (d) The total value of goods and services produced in an economy.

   Answer:

   (a) The narrowest measure of money supply, including only physical currency.

   Explanation:

   M0 is the narrowest measure of money supply, and it includes only physical currency (coins and notes) in circulation. It represents the most liquid and immediate form of money issued by the central bank.

4. Which of the following components is typically included in the measurement of M1 money supply?
   (a) Time deposits with commercial banks.
   (b) Treasury bills and government bonds.
   (c) Physical currency (coins and notes) in circulation.
   (d) Foreign currency reserves held by the central bank.

   Answer:

   (c) Physical currency (coins and notes) in circulation.

   Explanation:

   M1 money supply includes physical currency (coins and notes) in circulation and demand deposits (checking accounts) held by the public. It represents the most liquid and immediate form of money.

5. What is the primary objective of measuring money supply from the perspective of monetary policy?

   (a) To determine the fiscal deficit of the government.
   (b) To assess the overall health of the financial sector.
   (c) To track changes in the stock market.
   (d) To guide the formulation and implementation of monetary policy.

   Answer:

   (d) To guide the formulation and implementation of monetary policy.

   Explanation:

   The primary objective of measuring money supply is to guide the formulation and implementation of monetary policy by central banks. Monetary policymakers use information about the money supply to influence interest rates, credit availability, and overall economic conditions.

6. How does the central bank influence the money supply in the economy?
   (a) By controlling the government's budget deficit.
   (b) By adjusting interest rates and conducting open market operations.
   (c) By directly printing and issuing physical currency.
   (d) By regulating foreign currency transactions.

   Answer:

   (b) By adjusting interest rates and conducting open market operations.

   Explanation: The central bank influences the money supply through its monetary policy tools, such as adjusting interest rates (e.g., the discount rate and the federal funds rate) and conducting open market operations (buying or selling government bonds). These actions impact the reserves of commercial banks and, in turn, affect the money supply.

1.5 Determinants of Money Supply

1. Which of the following is NOT a determinant of money supply in an economy?
   (a) Monetary policy decisions of the central bank.
   (b) Reserve requirements set by the central bank.
   (c) Fiscal policy decisions of the government.
   (d) Open market operations conducted by commercial banks.

   Answer:

   (d) Open market operations conducted by commercial banks.

Explanation:
Open market operations are conducted by the central bank, not commercial banks. They involve the buying and selling of government securities to influence the money supply. The other options are determinants of money supply: monetary policy decisions, reserve requirements, and fiscal policy decisions.

2. When the central bank reduces the reserve requirements for commercial banks, it will likely lead to:
(a) An increase in the money supply.
(b) A decrease in the money supply.
(c) No change in the money supply.
(d) An increase in the interest rates.
Answer:
(a) An increase in the money supply.
Explanation:
When the central bank reduces the reserve requirements for commercial banks, banks are required to hold a lower percentage of their deposits as reserves. This frees up more funds for lending, leading to an increase in the money supply.

3. The main tool used by the central bank to directly control the money supply is:
(a) Setting interest rates.
(b) Conducting open market operations.
(c) Adjusting reserve requirements.
(d) Printing physical currency.
Answer:
(c) Adjusting reserve requirements.
Explanation:
The main tool used by the central bank to directly control the money supply is adjusting reserve requirements for commercial banks. By changing the percentage of deposits that banks must hold as reserves, the central bank can influence the amount of money banks can lend.

4. Which of the following is an example of an expansionary monetary policy that increases the money supply?

(a) Raising the reserve requirements for commercial banks.
(b) Selling government securities in the open market.
(c) Lowering interest rates.
(d) Decreasing government spending.
Answer:
(c) Lowering interest rates.
Explanation:
Lowering interest rates is an example of an expansionary monetary policy. When interest rates are reduced, borrowing becomes cheaper, leading to increased borrowing and spending by individuals and businesses, which, in turn, increases the money supply.

5. The government's budget deficit can indirectly impact the money supply through its effect on:
(a) The level of economic growth.
(b) The exchange rate of the national currency.
(c) Inflation rate.
(d)Central bank's open market operations.
Answer:
(d) Central bank's open market operations.
Explanation:
The government's budget deficit can indirectly impact the money supply through its effect on the central bank's open market operations. A budget deficit may lead the central bank to conduct more open market purchases (buying government securities), which increases the money supply.

6. In a fractional reserve banking system, the money supply is affected by:
(a) The total amount of physical currency in circulation.
(b) The proportion of deposits held as reserves by commercial banks.
(c) The rate of inflation.
(d) The government's fiscal policy.
Answer:
(b) The proportion of deposits held as reserves by commercial banks.

Explanation:
In a fractional reserve banking system, the money supply is affected by the proportion of deposits that commercial banks are required to hold as reserves. By changing reserve requirements, the central bank can influence the money supply.

7. Which of the following is NOT a determinant of money supply in an economy?
(a) The monetary policy set by the central bank.
(b) The level of government spending and fiscal policy.
(c) The demand for money by the public.
(d) The rate of inflation in the economy.
Answer:
(d) The rate of inflation in the economy.
Explanation:
The rate of inflation in the economy is not a determinant of money supply. Instead, it is influenced by changes in money supply and other factors in the economy. The determinants of money supply include monetary policy, government spending and fiscal policy, and the demand for money by the public.

8. The primary determinant of money supply in an economy is:
(a) The demand for money by the public.
(b) The level of government spending.
(c) The monetary policy conducted by the central bank.
(d) The rate of economic growth.
Answer:
(c) The monetary policy conducted by the central bank.
Explanation:
The primary determinant of money supply in an economy is the monetary policy conducted by the central bank. The central bank has the authority to control the money supply through various policy instruments like open market operations, reserve requirements, and discount rates.

9. When the central bank increases the reserve requirements for commercial banks, it will likely result in:
(a) An increase in money supply.
(b) A decrease in money supply.

(c) No change in money supply.
(d) A decrease in interest rates.
Answer:
(b) A decrease in money supply.
Explanation:
When the central bank increases the reserve requirements for commercial banks, it means banks need to hold more reserves against their deposits. This reduces the amount of money available for lending and, thus, decreases the money supply in the economy.

10. How does the central bank use open market operations to affect money supply?
(a) By printing and issuing new currency.
(b) By buying or selling government securities in the open market.
(c) By controlling the government's budget deficit.
(d) By setting interest rates for commercial banks.
Answer:
(b) By buying or selling government securities in the open market.
Explanation:
The central bank uses open market operations to affect money supply by buying or selling government securities (bonds) in the open market. When the central bank buys government securities, it injects money into the economy, increasing the money supply. Conversely, when it sells government securities, it absorbs money from the economy, decreasing the money supply.

11. The demand for money in an economy is influenced by:
(a) The monetary policy set by the central bank.
(b) The rate of inflation and price level.
(c) The level of government spending.
(d) The fiscal policy conducted by the government.
Answer:
(b) The rate of inflation and price level.

Explanation:
The demand for money in an economy is influenced by factors such as the rate of inflation and the price level. When prices rise, individuals and businesses may need to hold more money for transactions, leading to an increase in money demand.

12. How does an increase in economic activity affect the demand for money?
    (a) It decreases the demand for money.
    (b) It increases the demand for money.
    (c) It has no effect on the demand for money.
    (d) It leads to a decrease in money supply.

Answer:
(b) It increases the demand for money.

Explanation:
An increase in economic activity generally leads to an increase in the demand for money. As economic activity grows, more transactions take place, requiring individuals and firms to hold more money for their day-to-day activities.

1.6 The Concept of Money Multiplier

1. The money multiplier is defined as:
    (a) The rate at which the central bank prints new currency notes.
    (b) The ratio of money supply to the reserve requirements set by the central bank.
    (c) The ratio of the change in money supply to the change in interest rates.
    (d) The rate at which commercial banks create new money through lending.

Answer:
(d) The rate at which commercial banks create new money through lending.

Explanation:
The money multiplier is the rate at which commercial banks create new money through the process of lending. When banks receive deposits, they are required to keep a portion of those deposits as reserves, and the remaining amount is available for lending. This leads to the creation of new money in the economy.

2. How is the money multiplier calculated?
    (a) Money Multiplier = Change in Money Supply / Change in Interest Rates.
    (b) Money Multiplier = Reserve Ratio / Money Supply.
    (c) Money Multiplier = 1 / Reserve Ratio.
    (d) Money Multiplier = Change in Money Supply / Change in Reserve Ratio.

Answer:
(c) Money Multiplier = 1 / Reserve Ratio.

Explanation:
The money multiplier is calculated as the reciprocal of the reserve ratio. The reserve ratio is the percentage of deposits that banks are required to hold as reserves, and the money multiplier determines how much money can be created from the initial deposit.

3. What happens to the money multiplier if the reserve requirements set by the central bank increase?
    (a) The money multiplier increases.
    (b) The money multiplier decreases.
    (c) The money multiplier remains unchanged.
    (d) The money multiplier becomes zero.

Answer:
(b) The money multiplier decreases.

Explanation:
If the reserve requirements set by the central bank increase, banks will be required to hold a larger portion of their deposits as reserves, leaving less money available for lending. As a result, the money multiplier decreases, and the potential money creation through lending reduces.

4. If the reserve ratio is 10%, what is the money multiplier?
    (a) 1.10 (b) 10
    (c) 0.10 (d) 0.90.

Answer:
(b) 10

Explanation:

The money multiplier is the reciprocal of the reserve ratio. If the reserve ratio is 10%, the money multiplier is 1 / 0.10 = 10. This means that for every $1 of new reserves injected into the banking system, the potential money supply can increase by $10.

5. The money multiplier process can lead to:
   (a) An increase in the money supply and economic growth.
   (b) A decrease in the money supply and economic contraction.
   (c) Inflation and higher interest rates.
   (d) A decrease in the reserve ratio.

   Answer:

   (a) An increase in the money supply and economic growth.

   Explanation:

   The money multiplier process can lead to an increase in the money supply because banks create new money through lending. This can support economic growth as more money becomes available for investment, consumption, and other economic activities.

6. What is the relationship between the reserve ratio and the money multiplier?
   (a) They have a direct relationship.
   (b) They have an inverse relationship.
   (c) They are unrelated and independent concepts.
   (d) The reserve ratio is a component of the money multiplier.

   Answer:

   (b) They have an inverse relationship.

   Explanation:

   The reserve ratio and the money multiplier have an inverse relationship. As the reserve ratio increases, the money multiplier decreases, and vice versa. This is because a higher reserve ratio means banks can lend less of their deposits, leading to less money creation.

7. The concept of the money multiplier is based on the idea that:
   (a) The central bank can directly control the money supply.
   (b) The commercial banks can create money through lending activities.

   (c) The government can print and issue new currency as needed.
   (d) The demand for money is influenced by changes in interest rates.

   Answer:

   (b) The commercial banks can create money through lending activities.

   Explanation:

   The concept of the money multiplier is based on the idea that commercial banks can create money through the process of lending. When a bank receives a deposit, it keeps a fraction of the deposit as reserves and loans out the rest. The loaned amount becomes a new deposit in another bank, which, in turn, can lend out a portion of it, and the process continues, leading to the creation of new money in the economy.

8. The money multiplier formula is defined as:
   (a) Change in money supply = Change in reserves x Reserve Ratio.
   (b) Change in reserves = Change in money supply x Reserve Ratio.
   (c) Change in money supply = Change in interest rates x Reserve Ratio.
   (d) Change in reserves = Change in interest rates x Reserve Ratio.

   Answer:

   (a) Change in money supply = Change in reserves x Reserve Ratio.

   Explanation:

   The money multiplier formula shows the relationship between the change in money supply (M) and the change in reserves (R) held by the commercial banks, and the reserve ratio (RR). It can be expressed as follows:

   Change in money supply = Change in reserves x Reserve Ratio.

9. The reserve ratio is defined as:
   (a) The total amount of money held by the central bank.
   (b) The total amount of money held by the government.
   (c) The ratio of commercial bank reserves to total deposits.
   (d) The ratio of currency in circulation to total money supply.

   Answer:

   (c) The ratio of commercial bank reserves to total deposits.

Explanation:
The reserve ratio is the percentage of total deposits that commercial banks are required to hold as reserves with the central bank. It is a key factor in determining the potential money creation through the banking system.

10. If the reserve ratio is 10%, and the central bank injects $1,000 of new reserves into the banking system, the potential maximum increase in the money supply will be:
(a) $100
(b) $1,000
(c) $10,000
(d) $100,000

Answer:
(c) $10,000

Explanation:
If the reserve ratio is 10%, the potential maximum increase in the money supply can be calculated using the money multiplier formula:
Change in money supply = Change in reserves / Reserve Ratio
Change in money supply = $1,000 / 0.10
Change in money supply = $10,000

11. The money multiplier process can lead to:
(a) An increase in the money supply.
(b) A decrease in the money supply.
(c) No change in the money supply.
(d) An increase in interest rates.

Answer:
(a) An increase in the money supply.

Explanation:
The money multiplier process allows commercial banks to create new money by making loans and expanding credit. As banks lend out a portion of their reserves, the money supply increases, leading to a multiplier effect.

12. What happens to the money multiplier and potential money supply expansion if the reserve ratio increases?

(a) The money multiplier decreases, and potential money supply expansion decreases.
(b) The money multiplier increases, and potential money supply expansion increases.
(c) The money multiplier decreases, and potential money supply expansion increases.
(d) The money multiplier increases, and potential money supply expansion decreases.

Answer:
(a) The money multiplier decreases, and potential money supply expansion decreases.

Explanation:
If the reserve ratio increases, commercial banks are required to hold a larger portion of their deposits as reserves, reducing their ability to lend and create new money. As a result, the money multiplier decreases, and the potential money supply expansion decreases.

1.7 The Money Multiplier Approach to Supply of Money

1. The Money Multiplier Approach to the supply of money focuses on:
(a) The direct control of money supply by the central bank.
(b) The ability of commercial banks to create money through lending activities. Download
(c) The impact of government spending on the money supply.
(d) The relationship between money supply and interest rates.

Answer:
(b) The ability of commercial banks to create money through lending activities.

Explanation:
The Money Multiplier Approach to the supply of money emphasizes the role of commercial banks in creating money through the lending process. When banks receive deposits, they keep a fraction of these deposits as reserves and lend out the rest, leading to the creation of new money in the economy.

2. The key determinant of the potential money supply expansion through the Money Multiplier Approach is:
   (a) The level of government spending.
   (b) The interest rates set by the central bank.
   (c) The reserve ratio set by the central bank.
   (d) The exchange rate of the domestic currency.

   Answer:
   (c) The reserve ratio set by the central bank.

   Explanation:
   The reserve ratio, set by the central bank, is the key determinant of the potential money supply expansion through the Money Multiplier Approach. It represents the percentage of deposits that commercial banks are required to hold as reserves with the central bank. A lower reserve ratio leads to a higher money multiplier and a larger potential money supply expansion.

3. If the reserve ratio is 20%, what is the maximum potential money supply expansion if the central bank injects $1,000 of new reserves into the banking system?
   (a) $1,000
   (b) $2,000
   (c) $5,000
   (d) $10,000

   Answer:
   (b) $2,000

   Explanation:
   If the reserve ratio is 20%, the potential maximum money supply expansion can be calculated using the money multiplier formula:
   Potential money supply expansion = Change in reserves / Reserve ratio
   Potential money supply expansion = $1,000 / 0.20
   Potential money supply expansion = $2,000

4. If the central bank wishes to reduce the money supply, it can:
   (a) Decrease the reserve ratio.
   (b) Increase the reserve ratio.

   (c) Decrease the discount rate.
   (d) Increase the discount rate.

   Answer:
   (b) Increase the reserve ratio.

   Explanation:
   To reduce the money supply, the central bank can increase the reserve ratio. A higher reserve ratio means that banks have to hold a larger percentage of their deposits as reserves, reducing their ability to create new money through lending.

5. The Money Multiplier Approach assumes that:
   (a) The central bank directly controls the money supply.
   (b) Commercial banks do not lend out their excess reserves.
   (c) The velocity of money is constant.
   (d) The demand for money is determined by the interest rate.

   Answer:
   (c) The velocity of money is constant.

   Explanation:
   The Money Multiplier Approach assumes that the velocity of money (the number of times money changes hands within a given time period) is constant. This constant velocity is used as a simplifying assumption in the money multiplier calculation.

6. The Money Multiplier Approach to the supply of money is most applicable in a situation where:
   (a) The central bank has strict control over the money supply.
   (b) Commercial banks have limited lending activities.
   (c) The economy is experiencing high inflation.
   (d) There are no significant changes in the demand for money.

   Answer:
   (d) There are no significant changes in the demand for money.

   Explanation:
   The Money Multiplier Approach is most applicable in a situation where there are no significant changes in the demand for money. It assumes that the demand for money is relatively stable, allowing for a more straightforward calculation of the potential money supply expansion.

7. In the context of the Money Multiplier Approach, the reserve ratio refers to:
   (a) The ratio of currency to total money supply.
   (b) The ratio of commercial bank reserves to total deposits.
   (c) The ratio of government spending to GDP.
   (d) The ratio of public debt to GDP.

   Answer:

   (b) The ratio of commercial bank reserves to total deposits.

   Explanation:

   In the Money Multiplier Approach, the reserve ratio refers to the ratio of commercial bank reserves (required reserves and excess reserves) to total deposits. It determines the proportion of deposits that banks are required to keep as reserves.

8. The formula for calculating the money multiplier in India is:
   (a) Money Multiplier = Reserve Ratio / Currency Deposit Ratio.
   (b) Money Multiplier = 1 / Reserve Ratio.
   (c) Money Multiplier = 1 + Reserve Ratio.
   (d) Money Multiplier = 1 - Reserve Ratio.

   Answer:

   (b) Money Multiplier = 1 / Reserve Ratio.

   Explanation:

   The formula for calculating the money multiplier in India is given by Money Multiplier = 1 / Reserve Ratio. The money multiplier represents the multiple by which the money supply can expand through the banking system's lending and credit creation process.

9. If the reserve ratio in India is 0.1 (10%), what is the money multiplier?
   (a) 0.1 (b) 1
   (c) 10 (d) 100

   Answer:

   (c) 10

   Explanation:

   If the reserve ratio in India is 0.1 (10%), the money multiplier can be calculated using the formula: Money Multiplier = 1 / Reserve Ratio = 1 / 0.1 = 10.

10. Suppose the central bank of India reduces the reserve ratio from 0.12 to 0.08. How will this impact the money supply?
    (a) The money supply will increase.
    (b) The money supply will decrease.
    (c) The money supply will remain unchanged.
    (d) The money supply will fluctuate.

    Answer:

    (a) The money supply will increase.

    Explanation:

    When the central bank reduces the reserve ratio, it means banks are required to hold fewer reserves against their deposits. As a result, banks can lend out more money, leading to an increase in the money supply through the money multiplier process.

11. Which of the following factors could limit the effectiveness of the money multiplier approach in determining the money supply in India?
    (a) The level of government spending and fiscal policy.
    (b) The demand for money by the public.
    (c) The central bank's control over the money supply.
    (d) The availability of excess reserves in the banking system.

    Answer:

    (d) The availability of excess reserves in the banking system.

    Explanation:

    The effectiveness of the money multiplier approach in determining the money supply can be limited by the availability of excess reserves in the banking system. If banks are already holding a significant amount of excess reserves, they may be less inclined to lend and create additional money even if the reserve ratio is reduced.

(a) The Behaviour of the Central Bank

12. The primary objective of the central bank in India is to:
    (a) Control the money supply and inflation.
    (b) Regulate the stock market and financial institutions.
    (c) Control government spending and fiscal policy.
    (d) Promote international trade and investment.

Answer:
(a) Control the money supply and inflation.
Explanation:
The primary objective of the central bank in India, which is the Reserve Bank of India (RBI), is to control the money supply in the economy and ensure price stability by managing inflation.

13. Which of the following tools does the central bank of India use to control the money supply?
(a) Setting interest rates on government bonds.
(b) Conducting open market operations.
(c) Setting limits on government spending.
(d) Regulating foreign exchange rates.
Answer:
(b) Conducting open market operations.
Explanation:
control the money supply. It buys or sells government securities in the open market to inject or absorb money from the economy, influencing the money supply.

14. The central bank's control over the money supply can impact the economy by:
(a) Influencing economic growth and employment levels.
(b) Controlling international trade and tariffs.
(c) Determining the level of government debt.
(d) Setting inflation targets for businesses.
Answer:
(a) Influencing economic growth and employment levels.
Explanation:
The central bank's control over the money supply can have a significant impact on the economy by influencing economic growth and employment levels. By managing the money supply, the central bank can influence interest rates, which in turn affect borrowing and spending behavior, investment, and overall economic activity.

15. How does the central bank's behavior influence interest rates in India?
(a) By directly setting interest rates for commercial banks.
(b) By controlling the foreign exchange rates.
(c) By buying or selling government securities in the open market.
(d) By setting limits on international trade.
Answer:
(c) By buying or selling government securities in the open market.
Explanation:
The central bank's behavior influences interest rates in India through open market operations. When the central bank buys government securities, it injects money into the economy, leading to lower interest rates. Conversely, when it sells government securities, it absorbs money from the economy, leading to higher interest rates.

16. The central bank of India uses monetary policy to:
(a) Control government spending and fiscal policy.
(b) Regulate the stock market and financial institutions.
(c) Control the money supply and inflation.
(d) Set interest rates for foreign investors.
Answer:
(c) Control the money supply and inflation.
Explanation:
The central bank of India, RBI, uses monetary policy to control the money supply and manage inflation in the economy. It employs various tools like open market operations, reserve requirements, and the repo rate to achieve its monetary policy objectives.

(b) The Behaviour of Commercial Banks

17. The primary function of commercial banks in India is to:
(a) Control the money supply and inflation.
(b) Facilitate international trade and investment.
(c) Accept deposits from the public and provide loans and advances.
(d) Regulate the stock market and financial institutions.
Answer:
(c) Accept deposits from the public and provide loans and advances.

Explanation:
The primary function of commercial banks in India is to accept deposits from the public and provide loans and advances to individuals, businesses, and the government.

18. When a commercial bank receives a deposit from a customer, it is recorded as a liability on the bank's balance sheet because:
    (a) The bank is obligated to pay interest on the deposit.
    (b) The deposit represents a claim on the bank's assets.
    (c) The bank can use the deposit to make profitable investments.
    (d) The deposit increases the bank's capital reserves.

    Answer:
    (b) The deposit represents a claim on the bank's assets.

    Explanation:
    When a commercial bank receives a deposit from a customer, it is recorded as a liability on the bank's balance sheet because the deposit represents a claim on the bank's assets. The bank is obligated to repay the deposit to the customer upon request.

19. The process by which commercial banks create new money by making loans is known as:
    (a) Fractional reserve banking.
    (b) Open market operations.
    (c) Monetary policy.
    (d) Money multiplier effect.

    Answer:
    (a) Fractional reserve banking.

    Explanation:
    The process by which commercial banks create new money by making loans is known as fractional reserve banking. Banks are required to hold only a fraction of their deposits as reserves and can lend out the rest, leading to the creation of new money in the economy.

20. How do commercial banks earn a profit?
    (a) By charging interest on loans and paying interest on deposits.
    (b) By buying and selling government securities in the open market.

    (c) By investing in foreign exchange markets.
    (d) By borrowing from the central bank.

    Answer:
    (a) By charging interest on loans and paying interest on deposits.

    Explanation:
    Commercial banks earn a profit by charging a higher interest rate on the loans they provide to borrowers than the interest they pay on deposits made by customers.

21. The Reserve Bank of India (RBI) regulates commercial banks in India through various measures, including:
    (a) Controlling the government's fiscal policy.
    (b) Setting interest rates for commercial bank loans.
    (c) Regulating foreign exchange rates.
    (d) Imposing reserve requirements on banks.

    Answer:
    (d) Imposing reserve requirements on banks.

    Explanation:
    The Reserve Bank of India (RBI) regulates commercial banks in India by imposing reserve requirements. Banks are required to maintain a certain percentage of their deposits as reserves with the RBI, limiting their ability to create new money.

22. What happens if a commercial bank's reserves fall below the required reserve ratio set by the central bank?
    (a) The bank can continue to operate normally without any restrictions.
    (b) The central bank will lend additional reserves to the bank.
    (c) The bank may face penalties and restrictions on lending.
    (d) The central bank will lower the reserve ratio for that bank.

    Answer:
    (c) The bank may face penalties and restrictions on lending.

    Explanation:
    If a commercial bank's reserves fall below the required reserve ratio set by the central bank, the bank may face penalties and restrictions on lending. The central bank closely monitors banks' reserve levels to ensure compliance with regulatory requirements.

(c) The Behaviour of the Public

23. The public's demand for money is influenced by:
    (a) The monetary policy set by the central bank.
    (b) The level of government spending and fiscal policy.
    (c) The availability of credit facilities from commercial banks.
    (d) The rate of inflation and interest rates in the economy.

    Answer:
    (d) The rate of inflation and interest rates in the economy.

    Explanation:
    The public's demand for money is influenced by factors such as the rate of inflation and interest rates in the economy. Higher inflation may lead to an increased demand for money as individuals and businesses try to hold more cash to protect against rising prices. Similarly, higher interest rates may reduce the demand for money as it becomes more expensive to borrow and hold cash.

24. When the central bank increases interest rates, it is likely to impact the behavior of the public by:
    (a) Encouraging more borrowing and spending.
    (b) Encouraging more saving and reducing spending.
    (c) Encouraging more investment in the stock market.
    (d) Encouraging more investment in real estate.

    Answer:
    (b) Encouraging more saving and reducing spending.

    Explanation:
    When the central bank increases interest rates, it is likely to impact the behavior of the public by encouraging more saving and reducing spending. Higher interest rates make saving more attractive as it provides higher returns on savings deposits, and it also makes borrowing more expensive, leading to reduced spending on credit-sensitive items like housing and automobiles.

25. The public's behavior regarding money and spending can significantly affect the effectiveness of monetary policy set by the central bank. This is known as:

    (a) Fiscal policy effectiveness.
    (b) The money multiplier effect.
    (c) The liquidity trap.
    (d) Monetary policy transmission mechanism.

    Answer:
    (d) Monetary policy transmission mechanism.

    Explanation:
    The public's behavior regarding money and spending can significantly affect the effectiveness of monetary policy set by the central bank. This phenomenon is known as the monetary policy transmission mechanism. The transmission mechanism determines how changes in monetary policy instruments (e.g., interest rates, money supply) affect the broader economy through changes in spending, investment, and other economic activities.

26. When the public holds a higher proportion of their wealth in the form of money (cash and deposits), it is referred to as:
    (a) Liquidity preference.
    (b) Fiscal responsibility.
    (c) Risk aversion.
    (d) Asset allocation.

    Answer:
    (a) Liquidity preference.

    Explanation:
    When the public holds a higher proportion of their wealth in the form of money (cash and deposits) instead of other assets like stocks or bonds, it is referred to as liquidity preference. Liquidity preference reflects the public's preference for holding liquid assets that can be quickly converted into cash if needed.

27. If the public becomes more confident about the economy's future prospects, it is likely to result in:
    (a) An increase in the demand for money.
    (b) A decrease in the demand for money.
    (c) An increase in spending and investment.
    (d) A decrease in savings.

    Answer:
    (c) An increase in spending and investment.

Explanation:
If the public becomes more confident about the economy's future prospects, it is likely to result in an increase in spending and investment. Increased confidence can lead to higher consumer spending and business investment as individuals and businesses expect improved economic conditions in the future.

1.8 Monetary Policy and Money Supply

1. Monetary policy in India is primarily formulated and implemented by:
   (a) The Ministry of Finance.
   (b) The Securities and Exchange Board of India (SEBI).
   (c) The Reserve Bank of India (RBI).
   (d) The Planning Commission of India.

   Answer:
   (c) The Reserve Bank of India (RBI).

   Explanation:
   Monetary policy in India is primarily formulated and implemented by the Reserve Bank of India (RBI). The RBI is the central banking institution responsible for regulating the money supply, interest rates, and credit conditions in the economy.
2. The main objective of monetary policy in India is to:
   (a) Control government spending and fiscal policy.
   (b) Regulate the stock market and financial institutions.
   (c) Control the money supply and inflation.
   (d) Promote international trade and investment.

   Answer:
   (c) Control the money supply and inflation.

   Explanation:
   The main objective of monetary policy in India, as set by the Reserve Bank of India (RBI), is to control the money supply and ensure price stability by managing inflation in the economy.
3. Open market operations (OMOs) are conducted by the Reserve Bank of India (RBI) to:
   (a) Control the foreign exchange rates.
   (b) Regulate government spending.

   (c) Control the money supply.
   (d) Facilitate international trade.

   Answer:
   (c) Control the money supply.

   Explanation:
   Open market operations (OMOs) are conducted by the Reserve Bank of India (RBI) to control the money supply in the economy. Through OMOs, the RBI buys or sells government securities in the open market, which has an impact on the level of reserves in the banking system and, consequently, the money supply.
4. The Cash Reserve Ratio (CRR) is the percentage of deposits that banks are required to keep as reserves with the RBI. If the RBI increases the CRR, it is likely to:
   (a) Increase the money supply in the economy.
   (b) Decrease the money supply in the economy.
   (c) Have no impact on the money supply.
   (d) Increase interest rates in the economy.

   Answer:
   (b) Decrease the money supply in the economy.

   Explanation:
   If the RBI increases the Cash Reserve Ratio (CRR), banks are required to keep a higher percentage of their deposits as reserves with the RBI. This reduces the amount of money available for lending and, consequently, decreases the money supply in the economy.
5. The Repo Rate is the rate at which the RBI lends money to commercial banks for short periods. If the RBI decreases the Repo Rate, it is likely to:
   (a) Increase borrowing and spending in the economy.
   (b) Decrease borrowing and spending in the economy.
   (c) Have no impact on borrowing and spending.
   (d) Increase the Cash Reserve Ratio (CRR).

   Answer:
   (a) Increase borrowing and spending in the economy.

Explanation:
If the RBI decreases the Repo Rate, it becomes cheaper for commercial banks to borrow money from the central bank. This, in turn, leads to lower interest rates in the economy, making borrowing more attractive for businesses and individuals, which can increase borrowing and spending in the economy.

6. Monetary policy is a tool used by the central bank of India to:
   (a) Control the government's fiscal policy.
   (b) Regulate foreign trade and exchange rates.
   (c) Control the money supply and influence economic activity.
   (d) Determine the budget deficit and surplus.

   Answer:
   (c) Control the money supply and influence economic activity.

   Explanation:
   Monetary policy is a tool used by the central bank of India, which is the Reserve Bank of India (RBI), to control the money supply in the economy. By influencing the money supply, the RBI aims to regulate economic activity, manage inflation, and promote economic growth.

7. The Reserve Bank of India (RBI) uses various instruments to implement monetary policy. One such instrument is the "Repo Rate." What does the Repo Rate represent?
   (a) The rate at which commercial banks borrow from the RBI.
   (b) The rate at which the RBI borrows from commercial banks.
   (c) The rate at which the RBI lends to the government.
   (d) The rate at which the RBI lends to foreign banks.

   Answer:
   (a) The rate at which commercial banks borrow from the RBI.

   Explanation:
   The Repo Rate represents the rate at which commercial banks can borrow funds from the Reserve Bank of India (RBI) against the collateral of government securities. Changes in the Repo Rate can influence the cost of borrowing for commercial banks, which, in turn, affects lending rates and the money supply in the economy.

8. When the Reserve Bank of India (RBI) wants to increase the money supply and stimulate economic growth, it is likely to:
   (a) Raise the Repo Rate.
   (b) Lower the Reverse Repo Rate.
   (c) Raise the Cash Reserve Ratio (CRR).
   (d) Conduct open market sales of government securities.

   Answer:
   (b) Lower the Reverse Repo Rate.

   Explanation:
   When the RBI wants to increase the money supply and stimulate economic growth, it is likely to lower the Reverse Repo Rate. The Reverse Repo Rate is the rate at which the RBI borrows from commercial banks, and by reducing this rate, the RBI encourages banks to lend more and invest in higher-yielding assets, leading to increased money supply.

9. Which of the following tools is used by the Reserve Bank of India (RBI) to directly control the money supply in the economy?
   (a) Cash Reserve Ratio (CRR)
   (b) Repo Rate
   (c) Statutory Liquidity Ratio (SLR)
   (d) Open Market Operations (OMOs)

   Answer:
   (a) Cash Reserve Ratio (CRR)

   Explanation:
   The Cash Reserve Ratio (CRR) is the percentage of total deposits that commercial banks are required to keep as reserves with the Reserve Bank of India (RBI). By changing the CRR, the RBI can directly control the amount of money that banks can lend and influence the money supply in the economy.

10. How does a decrease in the Statutory Liquidity Ratio (SLR) affect the money supply in the economy?
    (a) It increases the money supply.
    (b) It decreases the money supply.

(c) It has no effect on the money supply.
(d) It depends on changes in the Repo Rate.

Answer:

(a) It increases the money supply.

Explanation:

The Statutory Liquidity Ratio (SLR) is the percentage of total deposits that commercial banks are required to maintain in the form of liquid assets, such as government securities. When the SLR is decreased, banks are required to hold fewer reserves, allowing them to lend out more money and increase the money supply in the economy.

1.9 Effect of Government Expenditure on Money Supply

1. When the government of India increases its expenditure and pays for it by borrowing from the banking system, what is the likely impact on the money supply?
   (a) The money supply will increase.
   (b) The money supply will decrease.
   (c) The money supply will remain unchanged.
   (d) The money supply will fluctuate.

   Answer:

   (a) The money supply will increase.

   Explanation:

   When the government of India increases its expenditure and finances it by borrowing from the banking system, it injects additional funds into the economy. This increases the money supply as banks lend to the government, creating new money in the process.

2. In India, which of the following tools does the Reserve Bank of India (RBI) use to offset the impact of government expenditure on money supply?
   (a) Open market operations.
   (b) Changes in the Statutory Liquidity Ratio (SLR).
   (c) Changes in the Repo Rate.
   (d) Changes in the Cash Reserve Ratio (CRR).

   Answer:

   (a) Open market operations.

   Explanation:

   To offset the impact of government expenditure on money supply, the Reserve Bank of India (RBI) can use open market operations. Through open market operations, the RBI buys or sells government securities in the open market. If there is excess liquidity due to increased government expenditure, the RBI can sell government securities to absorb the excess funds and control the money supply.

3. When the government of India reduces its expenditure and the money spent is withdrawn from circulation, what is the likely impact on the money supply?
   (a) The money supply will increase.
   (b) The money supply will decrease.
   (c) The money supply will remain unchanged.
   (d) The money supply will fluctuate.

   Answer:

   (b) The money supply will decrease.

   Explanation:

   When the government of India reduces its expenditure and withdraws money from circulation, it decreases the money supply in the economy. This is because less money is available for spending and lending, leading to a decrease in the overall money supply.

4. The government of India increases taxes and reduces public spending simultaneously. What is the likely impact on the money supply?
   (a) The money supply will increase.
   (b) The money supply will decrease.
   (c) The money supply will remain unchanged.
   (d) The money supply will fluctuate.

   Answer: b) The money supply will decrease.

   Explanation: When the government of India increases taxes and reduces public spending, it takes money out of circulation from both the public and the private sector. This results in a decrease in the money supply as there is less money available for spending and lending in the economy.

5. When the Indian government increases its expenditure on infrastructure projects and welfare programs, the likely impact on the money supply in the economy will be:
(a) An increase in the money supply.
(b) A decrease in the money supply.
(c) No impact on the money supply.
(d) A fluctuation in the money supply.

Answer:
(a) An increase in the money supply.

Explanation:
When the Indian government increases its expenditure on infrastructure projects and welfare programs, it injects money into the economy. This increased government spending leads to higher incomes for businesses and individuals, which in turn increases their ability to spend and invest. As a result, the money supply in the economy expands.

6. The impact of government expenditure on the money supply depends on:
(a) The level of taxation in the economy.
(b) The extent of borrowing by the government from the central bank.
(c) The government's fiscal deficit.
(d) All of the above.

Answer:
(d) All of the above.

Explanation:
The impact of government expenditure on the money supply depends on various factors, including the level of taxation in the economy (as higher taxes can reduce disposable income and spending), the extent of borrowing by the government from the central bank (which affects the money creation process), and the government's fiscal deficit (as deficit financing can influence money supply growth).

7. When the government finances its expenditure through borrowing from the central bank, it is likely to lead to:
(a) An increase in the money supply.
(b) A decrease in the money supply.
(c) No change in the money supply.
(d) An increase in the government's fiscal deficit.

Answer:
(a) An increase in the money supply.

Explanation:
When the government finances its expenditure through borrowing from the central bank, it increases the money supply in the economy. This is because the central bank creates new money to provide funds to the government, which in turn leads to an expansion of the money supply.

8. If the Indian government reduces its expenditure and runs a budget surplus, the impact on the money supply will likely be:
(a) An increase in the money supply.
(b) A decrease in the money supply.
(c) No change in the money supply.
(d) An increase in government borrowing.

Answer:
(b) A decrease in the money supply.

Explanation:
If the Indian government reduces its expenditure and runs a budget surplus, it means the government is collecting more in taxes than it is spending. This withdrawal of funds from the economy reduces the money supply, leading to a decrease in the overall money circulation.

9. The interaction between government expenditure and the money supply is an essential consideration for:
(a) Monetary policy implementation by the central bank.
(b) Fiscal policy implementation by the government.
(c) Exchange rate management by the Reserve Bank of India.
(d) Regulation of foreign trade and tariffs.

Answer:
(b) Fiscal policy implementation by the government.

Explanation:
The interaction between government expenditure and the money supply is an essential consideration for fiscal policy implementation by the government. Government spending and borrowing decisions directly impact the money supply in the economy, which in turn influences economic growth, inflation, and overall economic stability.

Additional Question Bank

1.1 Introduction

1. Money supply refers to:
   (a) The total amount of money held by individuals and businesses
   (b) The total value of goods and services produced in an economy
   (c) The total amount of money printed by the central bank
   (d) The total amount of money held in banks' reserves
2. Which of the following is considered a component of the money supply in most countries?
   (a) Government bonds (b) Corporate stocks
   (c) Currency (cash) in circulation (d) Real estate
3. The money supply includes which of the following types of money?
   (a) M1, M2, M3
   (b) Physical currency only
   (c) Commercial bank reserves
   (d) Government bonds
4. M1 money supply includes:
   (a) Currency (cash) in circulation, demand deposits, and traveler's checks
   (b) Currency (cash) in circulation, time deposits, and savings accounts
   (c) Currency (cash) in circulation, government bonds, and corporate stocks
   (d) Currency (cash) in circulation, foreign exchange reserves, and gold holdings

5. The central bank has the most direct control over which component of the money supply?
   (a) M1 (b) M2
   (c) M3 (d) M4

1.2 Rationale of Measuring Money Supply

1. The primary rationale for measuring money supply is to:
   (a) Track the profitability of banks
   (b) Monitor the flow of foreign exchange
   (c) Assess the health of the financial system
   (d) Understand the overall liquidity in the economy
2. Which of the following monetary aggregates includes only the most liquid forms of money?
   (a) M1 (b) M2
   (c) M3 (d) M4
3. The broader measures of money supply, such as M2 and M3, include:
   (a) Only physical currency (cash) in circulation
   (b) Currency (cash) in circulation and demand deposits
   (c) Currency (cash) in circulation, demand deposits, and time deposits
   (d) Currency (cash) in circulation and government bonds
4. Measuring money supply helps central banks in formulating and implementing:
   (a) Fiscal policies (b) Monetary policies
   (c) Trade policies (d) Industrial policies
5. The rationale for measuring money supply is to provide an indicator of:
   (a) The total value of goods and services produced in an economy
   (b) The level of government debt
   (c) The purchasing power of money
   (d) The availability of funds for spending and investment

1.3 The Sources of Money Supply

1. The main source of money supply in an economy is:
   (a) Foreign exchange reserves
   (b) Government bonds

(c) Central bank's monetary operations
(d) Stock market investments

2. Which entity has the authority to create and regulate the money supply in most countries?
(a) Commercial banks (b) Central banks
(c) Investment banks (d) Foreign banks

3. The process by which commercial banks create money through lending and deposit creation is known as:
(a) Fractional reserve banking (b) Currency issuance
(c) Foreign exchange trading (d) Stock market manipulation

4. When the central bank buys government bonds from commercial banks, it leads to:
(a) An increase in the money supply
(b) A decrease in the money supply
(c) No change in the money supply
(d) An increase in interest rates

5. The money supply can also be affected by other non-bank financial institutions, such as:
(a) Pension funds (b) Hedge funds
(c) Insurance companies (d) All of the above

1.4 Measurement of Money Supply

1. M1 money supply includes which of the following components?
(a) Currency (cash) in circulation and demand deposits
(b) Currency (cash) in circulation, demand deposits, and time deposits
(c) Currency (cash) in circulation, demand deposits, time deposits, and savings deposits
(d) Currency (cash) in circulation, demand deposits, time deposits, and foreign exchange reserves

2. M2 money supply is a broader measure and includes which of the following components?
(a) Currency (cash) in circulation and demand deposits
(b) Currency (cash) in circulation, demand deposits, and time deposits

(c) Currency (cash) in circulation, demand deposits, time deposits, and savings deposits
(d) Currency (cash) in circulation, demand deposits, time deposits, and foreign exchange reserves

3. M3 money supply is an even broader measure and includes which of the following components?
(a) Currency (cash) in circulation and demand deposits
(b) Currency (cash) in circulation, demand deposits, and time deposits
(c) Currency (cash) in circulation, demand deposits, time deposits, and savings deposits
(d) Currency (cash) in circulation, demand deposits, time deposits, and foreign exchange reserves

4. Which of the following is not included in any of the measures of money supply (M1, M2, M3)?
(a) Currency (cash) in circulation
(b) Demand deposits
(c) Time deposits (certificates of deposit)
(d) Government bonds

5. The monetary aggregates M1, M2, and M3 are classified based on the:
(a) Time periods for which the money is held
(b) Size of the economy
(c) Level of government debt
(d) Liquidity of the components included

1.5 Determinants of Money Supply

1. The primary determinant of money supply in an economy is the:
(a) Central bank's monetary policy (b) Government's fiscal policy
(c) Exchange rate fluctuations (d) Foreign direct investment

2. When the central bank buys government bonds in the open market, it leads to:
(a) An increase in the money supply
(b) A decrease in the money supply
(c) No change in the money supply
(d) An increase in foreign exchange reserves

3. The reserve requirement set by the central bank for commercial banks is a determinant of money supply because it affects the banks':
   (a) Lending capacity and money creation
   (b) Profitability and interest rates
   (c) Foreign exchange holdings
   (d) Investment in government securities
4. The interest rate set by the central bank influences the money supply by affecting:
   (a) The level of government debt
   (b) Consumer spending patterns
   (c) Borrowing and lending behavior in the economy
   (d) Stock market prices
5. In the context of money supply, the term "monetary base" refers to:
   (a) The total amount of money held by individuals and businesses
   (b) The central bank's reserves and currency in circulation
   (c) The total value of goods and services produced in an economy
   (d) The overall value of stocks and bonds in the financial markets

1.6 The Concept of Money Multiplier

1. The money multiplier is a concept that represents:
   (a) The ratio of government spending to tax revenue
   (b) The ratio of the money supply to the central bank's reserves
   (c) The ratio of government debt to GDP
   (d) The ratio of the fiscal deficit to GDP
2. The money multiplier indicates how much the money supply:
   (a) Increases when the central bank buys government bonds
   (b) Decreases when the central bank sells government bonds
   (c) Changes in response to changes in government expenditure
   (d) Responds to fluctuations in interest rates
3. The money multiplier is influenced by the:
   (a) Interest rate set by the central bank
   (b) Level of government debt
   (c) Size of the fiscal deficit
   (d) Central bank's reserve requirement for commercial banks

4. If the reserve requirement is 10%, the money multiplier would be:
   (a) 0.1 (b) 1
   (c) 10 (d) 100
5. The money multiplier process works based on the idea of:
   (a) Fractional reserve banking
   (b) Government bond purchases
   (c) Foreign exchange interventions
   (d) Currency printing

1.7 The Money Multiplier Approach to Supply of Money

1. The money multiplier approach explains how changes in the central bank's reserves can lead to changes in the:
   (a) Money supply (b) Government debt
   (c) Foreign exchange reserves (d) Interest rates
2. According to the money multiplier approach, an increase in the central bank's reserves will result in a ______ in the money supply.
   (a) Decrease (b) Stagnation
   (c) No change (d) Increase
3 The money multiplier is calculated as the reciprocal of the:
   (a) Reserve ratio (b) Inflation rate
   (c) Interest rate (d) Fiscal deficit
4. If the reserve ratio is 10%, the money multiplier would be:
   (a) 1 (b) 10
   (c) 0.1 (d) 100
5. The money multiplier approach assumes that commercial banks will use their excess reserves to:
   (a) Decrease interest rates
   (b) Increase government spending
   (c) Make speculative investments
   (d) Create new loans and deposits
6. Assume the reserve requirement ratio set by the central bank is 10%. If the central bank injects $1,000 of new reserves into the banking system, what will be the total increase in the money supply based on the money multiplier approach?

(a) $1,000
(b) $2,000
(c) $5,000
(d) $10,000

1.8 Monetary Policy and Money Supply

1. Monetary policy refers to the actions taken by the central bank to:
   (a) Control government spending
   (b) Regulate foreign exchange rates
   (c) Manage the money supply and interest rates
   (d) Implement fiscal measures
2. When the central bank wants to increase the money supply, it can:
   (a) Sell government bonds in the open market
   (b) Raise the reserve requirement ratio for banks
   (c) Decrease the discount rate
   (d) Absorb excess reserves from banks
3. If the central bank reduces the reserve requirement ratio for commercial banks, it will likely result in:
   (a) An increase in the money supply
   (b) A decrease in the money supply
   (c) No change in the money supply
   (d) A change in the exchange rate
4. Open market operations involve the central bank buying or selling government bonds. When the central bank buys government bonds from the market, it:
   (a) Increases the money supply
   (b) Decreases the money supply
   (c) Has no effect on the money supply
   (d) Increases government debt
5. Contractionary monetary policy is characterized by the central bank's actions to:
   (a) Increase government spending
   (b) Lower taxes
   (c) Reduce the money supply and raise interest rates
   (d) Increase the money supply and lower interest rates

1.9 Effect of Government Expenditure on Money Supply

1. When the government increases its expenditure by borrowing from the central bank, what will be the impact on the money supply?
   (a) Increase in the money supply
   (b) Decrease in the money supply
   (c) No change in the money supply
   (d) The impact depends on the type of government expenditure
2. Government expenditure that is financed through tax revenue has what effect on the money supply?
   (a) Increase in the money supply
   (b) Decrease in the money supply
   (c) No change in the money supply
   (d) The impact depends on the level of taxation
3. The effect of government expenditure on the money supply is influenced by the government's financing method. When the government borrows from the public to finance its spending, it can lead to:
   (a) An increase in the money supply
   (b) A decrease in the money supply
   (c) Inflation
   (d) A reduction in public debt
4. Expansionary fiscal policy, which involves increasing government expenditure, can lead to an increase in the money supply if the government:
   (a) Prints additional currency notes
   (b) Borrows from commercial banks
   (c) Increases taxes to finance the expenditure
   (d) Sells government bonds in the open market
5. The impact of government expenditure on the money supply can be limited if the central bank conducts offsetting monetary policy actions, such as:
   (a) Increasing the reserve requirement ratio for banks
   (b) Decreasing the interest rates
   (c) Selling government bonds in the open market
   (d) Implementing exchange rate interventions

6. Assume the reserve requirement ratio set by the central bank is 10%, and the initial money supply (M1) is $1,000. If the government spends an additional $200 on goods and services, and the money multiplier is 5, what will be the total change in the money supply?
(a) $200 (b) $500
(c) $1,000 (d) $1,200

Answer

1.1 Introduction

1. (a) The total amount of money held by individuals and businesses
2. (c) Currency (cash) in circulation
3. (a) M1, M2, M3
4. (a) Currency (cash) in circulation, demand deposits, and traveler's checks
5. (a) M1

1.2 Rationale of Measuring Money Supply

1. (d) Understand the overall liquidity in the economy
2. (a) M1
3. (c) Currency (cash) in circulation, demand deposits, and time deposits
4. (b) Monetary policies
5. (d) The availability of funds for spending and investment

1.3 The Sources of Money Supply

1. (c) Central bank's monetary operations
2. (b) Central banks
3. (a) Fractional reserve banking
4. (a) An increase in the money supply
5. (d) All of the above

1.4 Measurement of Money Supply

1. (a) Currency (cash) in circulation and demand deposits
2. (c) Currency (cash) in circulation, demand deposits, time deposits, and savings deposits

3. (d) Currency (cash) in circulation, demand deposits, time deposits, and foreign exchange reserves
4. (d) Government bonds
5. (d) Liquidity of the components included

1.5 Determinants of Money supply

1. (a) Central bank's monetary policy
2. (a) An increase in the money supply
3. (a) Lending capacity and money creation
4. (c) Borrowing and lending behavior in the economy
5. (b) The central bank's reserves and currency in circulation

1.6 The Concept of Money Multiplier

1. (b) The ratio of the money supply to the central bank's reserves
2. (a) Increases when the central bank buys government bonds
3. (d) Central bank's reserve requirement for commercial banks
4. (c) 10
5. (a) Fractional reserve banking

1.7 The Money Multiplier Approach to Supply of Money

1. (a) Money supply
2. (d) Increase
3. (a) Reserve ratio
4. (b) 10
5. (d) Create new loans and deposits
6. (b) $2,000

Explanation: The money multiplier is calculated as the reciprocal of the reserve requirement ratio. In this case, the reserve requirement ratio is 10%, so the money multiplier is 1/0.10 = 10. When the central bank injects $1,000 of new reserves, the total increase in the money supply will be 10 times that amount, which is $1,000 * 10 = $10,000.

1.8 Monetary Policy and Money Supply

1. (c) Manage the money supply and interest rates
2. (c) Decrease the discount rate

3. (a) An increase in the money supply
4. (a) Increases the money supply
5. (c) Reduce the money supply and raise interest rates

1.9 Effect of Government EXPENDITURE on Money Supply

1. (a) Increase in the money supply
2. (c) No change in the money supply
3. (a) An increase in the money supply
4. (b) Borrows from commercial banks
5. (c) Selling government bonds in the open market
6. (b) $500

   Explanation: The money multiplier approach is used to calculate the total change in the money supply based on an initial change in reserves or government spending.

   Given that the reserve requirement ratio is 10%, the money multiplier is 1/0.10 = 10.

   The initial change in reserves due to government expenditure is $200.

   Total change in the money supply = Initial change in reserves * Money multiplier

   Total change in the money supply = $200 * 10 = $2,000

   However, the initial money supply (M1) of $1,000 should also be considered, as it is part of the overall money supply.

   Total change in the money supply = Initial money supply (M1) + Total change in the money supply

   Total change in the money supply = $1,000 + $2,000 = $3,000

   Therefore, the total change in the money supply is $3,000 - $1,000 (initial money supply) = $2,000.

8 MONEY MARKET

Unit:3 **Monetary Policy**

Multiple Choice Questions

1.1 Introduction

1. Monetary policy in India is formulated and regulated by:
   (a) The Ministry of Finance.
   (b) The Planning Commission of India.
   (c) The Reserve Bank of India (RBI).
   (d) The Securities and Exchange Board of India (SEBI).

   Answer:

   (c) The Reserve Bank of India (RBI).

   Explanation:

   Monetary policy in India is formulated and regulated by the Reserve Bank of India (RBI). The RBI is the central banking institution of India and is responsible for formulating and implementing monetary policy to control the money supply and achieve price stability and economic growth.

2 The primary objective of monetary policy in India is to:
   (a) Control government spending and fiscal deficits.
   (b) Regulate foreign trade and exchange rates.
   (c) Control the money supply and inflation.
   (d) Set interest rates for commercial banks.

   Answer:

   (c) Control the money supply and inflation.

   Explanation:

   The primary objective of monetary policy in India, as set by the Reserve Bank of India (RBI), is to control the money supply in the economy and manage inflation. By influencing the money supply, the RBI aims to achieve price stability and foster sustainable economic growth.

3. Which of the following is an example of an expansionary monetary policy measure that the RBI may adopt in India?
   (a) Increasing the Repo Rate.
   (b) Decreasing the Cash Reserve Ratio (CRR).
   (c) Selling government securities in the open market.
   (d) Increasing the Statutory Liquidity Ratio (SLR).

   Answer:
   (b) Decreasing the Cash Reserve Ratio (CRR).

   Explanation:
   An expansionary monetary policy aims to increase the money supply in the economy to stimulate economic growth. Decreasing the Cash Reserve Ratio (CRR) is an example of an expansionary measure, as it allows commercial banks to lend out more money and increases liquidity in the financial system.

4. Contractionary monetary policy measures are designed to:
   (a) Increase government spending and investment.
   (b) Decrease the money supply and control inflation.
   (c) Encourage more borrowing and spending by the public.
   (d) Reduce interest rates for businesses and individuals.

   Answer:
   (b) Decrease the money supply and control inflation.

   Explanation:
   Contractionary monetary policy measures are designed to decrease the money supply in the economy to control inflation and prevent overheating. The RBI may implement measures such as raising the Repo Rate, increasing the Cash Reserve Ratio (CRR), or conducting open market operations to reduce excess liquidity and curb inflation.

5. The primary transmission mechanism through which monetary policy affects the economy in India is:
   (a) The money multiplier effect.
   (b) The fiscal policy multiplier.
   (c) The currency-deposit ratio.
   (d) The credit and interest rate channels.

   Answer:
   (d) The credit and interest rate channels.

   Explanation:
   The primary transmission mechanism through which monetary policy affects the economy in India is the credit and interest rate channels. Changes in monetary policy instruments, such as the Repo Rate, influence borrowing and lending rates, credit availability, and investment decisions, thereby impacting overall economic activity.

6. Monetary policy is the process by which the central bank of India controls the:
   (a) Government's fiscal policy.
   (b) Money supply and interest rates in the economy.
   (c) Exchange rates and foreign trade.
   (d) Stock market and financial institutions.

   Answer:
   (b) Money supply and interest rates in the economy.

   Explanation:
   Monetary policy is the process by which the central bank of India, which is the Reserve Bank of India (RBI), controls the money supply and interest rates in the economy. It uses various monetary policy tools to influence economic activity, inflation, and growth.

7. Which of the following is a primary objective of monetary policy in India?
   (a) Controlling the government's fiscal policy.
   (b) Regulating the stock market and financial institutions.
   (c) Achieving price stability and controlling inflation.
   (d) Promoting international trade and investment.

   Answer:
   (c) Achieving price stability and controlling inflation.

   Explanation:
   A primary objective of monetary policy in India is to achieve price stability and control inflation. The RBI aims to keep inflation at a moderate level to maintain the purchasing power of the currency and ensure stable economic conditions.

8. The Reserve Bank of India (RBI) uses various monetary policy tools to implement its policies. One such tool is the "Cash Reserve Ratio (CRR)." What does CRR represent?

(a) The rate at which commercial banks borrow from the RBI.
(b) The rate at which the RBI lends to commercial banks.
(c) The percentage of total deposits that banks must keep as reserves with the RBI.
(d) The rate at which the RBI buys government securities in the open market.

Answer:
(c) The percentage of total deposits that banks must keep as reserves with the RBI.

Explanation:
The Cash Reserve Ratio (CRR) represents the percentage of total deposits that commercial banks must keep as reserves with the Reserve Bank of India (RBI). It is a tool used by the RBI to control the money supply in the economy.

9. When the Reserve Bank of India (RBI) wants to increase the money supply in the economy, it is likely to:
(a) Raise the Cash Reserve Ratio (CRR).
(b) Lower the Repo Rate.
(c) Increase the Statutory Liquidity Ratio (SLR).
(d) Conduct open market sales of government securities.

Answer:
(b) Lower the Repo Rate.

Explanation:
When the RBI wants to increase the money supply in the economy, it is likely to lower the Repo Rate. The Repo Rate is the rate at which commercial banks can borrow funds from the RBI, and a lower Repo Rate encourages banks to borrow more, leading to increased lending and money creation.

10. What is the primary challenge faced by the central bank in implementing monetary policy in India?
(a) Political interference in monetary matters.
(b) Lack of coordination with the government's fiscal policy.
(c) Exchange rate fluctuations in the global market.
(d) Limited control over the money supply.

Answer:
(b) Lack of coordination with the government's fiscal policy.

Explanation:
The primary challenge faced by the central bank in implementing monetary policy in India is the lack of coordination with the government's fiscal policy. Effective monetary policy requires coordination with fiscal policy to achieve common economic objectives.

1.2 Monetary Policy Defined

1. Monetary policy in India refers to the:
(a) Government's control over the stock market and financial institutions.
(b) Regulation of foreign trade and exchange rates by the Reserve Bank of India (RBI).
(c) Central bank's control over the money supply and interest rates in the economy.
(d) Government's control over taxation and public spending.

Answer:
(c) Central bank's control over the money supply and interest rates in the economy.

Explanation:
Monetary policy in India refers to the control exercised by the central bank, which is the Reserve Bank of India (RBI), over the money supply and interest rates in the economy. It aims to achieve specific economic objectives such as price stability, economic growth, and employment.

2. The main goal of monetary policy in India is to:
(a) Control the government's fiscal policy.
(b) Regulate foreign trade and international transactions.
(c) Control the money supply and maintain price stability.
(d) Promote international investments and trade.

Answer:
(c) Control the money supply and maintain price stability.

Explanation: The main goal of monetary policy in India is to control the money supply in the economy and maintain price stability. The Reserve Bank of India (RBI) uses various monetary policy tools to influence interest rates and credit availability to achieve this objective.

3. Which of the following monetary policy tools can be used by the Reserve Bank of India (RBI) to reduce the money supply in the economy?
   (a) Lowering the Cash Reserve Ratio (CRR).
   (b) Lowering the Repo Rate.
   (c) Conducting open market purchases of government securities.
   (d) Increasing the Statutory Liquidity Ratio (SLR).

   Answer:
   (c) Conducting open market purchases of government securities.

   Explanation:
   To reduce the money supply in the economy, the Reserve Bank of India (RBI) can conduct open market purchases of government securities. When the RBI buys government securities from the market, it removes money from circulation and decreases the money supply.

4. When the Reserve Bank of India (RBI) aims to stimulate economic growth and increase the money supply, it is likely to:
   (a) Raise the Reverse Repo Rate.
   (b) Raise the Cash Reserve Ratio (CRR).
   (c) Conduct open market sales of government securities.
   (d) Raise the Repo Rate.

   Answer:
   (c) Conduct open market sales of government securities.

   Explanation:
   When the RBI aims to stimulate economic growth and increase the money supply, it can conduct open market sales of government securities. By selling government securities to the market, the RBI injects money into the economy and increases the money supply.

5. The term "Monetary Policy Transmission Mechanism" refers to:
   (a) The process of converting fiscal policy into monetary policy.
   (b) The channels through which monetary policy affects the economy.
   (c) The coordination between the central bank and the government.
   (d) The process of setting interest rates by the central bank.

   Answer:
   (b) The channels through which monetary policy affects the economy.

   Explanation:
   The term "Monetary Policy Transmission Mechanism" refers to the channels through which monetary policy affects the economy. It explains how changes in monetary policy instruments, such as interest rates and money supply, influence economic variables like consumption, investment, and inflation.

6. Monetary policy in India refers to the process by which the Reserve Bank of India (RBI) controls:
   (a) The government's fiscal policy.
   (b) The stock market and financial institutions.
   (c) The money supply and interest rates in the economy.
   (d) Exchange rates and foreign trade.

   Answer:
   (c) The money supply and interest rates in the economy.

   Explanation:
   Monetary policy in India refers to the process by which the Reserve Bank of India (RBI) controls the money supply and interest rates in the economy. The RBI uses various monetary policy tools to influence economic activity, inflation, and growth.

7. The primary objective of monetary policy in India is to achieve:
   (a) Fiscal stability and balanced budget.
   (b) Price stability and control inflation.
   (c) High economic growth and full employment.
   (d) Favorable balance of trade and exchange rate stability.

   Answer:
   (b) Price stability and control inflation.

   Explanation:
   The primary objective of monetary policy in India is to achieve price stability and control inflation. The Reserve Bank of India (RBI) aims to keep inflation at a moderate level to maintain the purchasing power of the currency and ensure stable economic conditions.

8. Which of the following is true regarding the formulation of monetary policy in India?
   (a) The Ministry of Finance is solely responsible for formulating monetary policy.

(b) The Parliament plays a direct role in formulating monetary policy.
(c) The Reserve Bank of India (RBI) formulates and implements monetary policy independently.
(d) Monetary policy is formulated by a committee of commercial bank representatives.

Answer:

(c) The Reserve Bank of India (RBI) formulates and implements monetary policy independently.

Explanation:

In India, the Reserve Bank of India (RBI) is responsible for formulating and implementing monetary policy independently. The RBI's Monetary Policy Committee (MPC) makes decisions regarding interest rates and other monetary policy measures.

9. When the Reserve Bank of India (RBI) wants to reduce the money supply and control inflation, it is likely to:
(a) Lower the Cash Reserve Ratio (CRR).
(b) Raise the Repo Rate.
(c) Decrease the Statutory Liquidity Ratio (SLR).
(d) Conduct open market purchases of government securities.

Answer:

(b) Raise the Repo Rate.

Explanation:

When the RBI wants to reduce the money supply and control inflation, it is likely to raise the Repo Rate. The Repo Rate is the rate at which commercial banks can borrow funds from the RBI, and by increasing this rate, the RBI discourages borrowing and spending, leading to a reduction in the money supply.

10. The role of the Monetary Policy Committee (MPC) in India is to:
(a) Formulate the government's fiscal policy.
(b) Implement exchange rate policies.
(c) Set interest rates and make decisions related to monetary policy.
(d) Regulate the stock market and financial institutions.

Answer:

(c) Set interest rates and make decisions related to monetary policy.

Explanation: The role of the Monetary Policy Committee (MPC) in India is to set interest rates and make decisions related to monetary policy. The MPC is responsible for determining the Repo Rate and other key policy rates to achieve the objectives of monetary policy.

1.3 The Monetary Policy Framework

1. The Monetary Policy Framework in India is governed by:
(a) The Ministry of Finance.
(b) The Prime Minister's Office (PMO).
(c) The Reserve Bank of India (RBI).
(d) The Securities and Exchange Board of India (SEBI).

Answer:

(c) The Reserve Bank of India (RBI).

Explanation:

The Monetary Policy Framework in India is governed by the Reserve Bank of India (RBI). The RBI is responsible for formulating and implementing monetary policy in the country.

2. The Monetary Policy Framework in India was transitioned from a fixed exchange rate system to a flexible exchange rate system in the year:
(a) 1947
(b) 1951
(c) 1991
(d) 2000

Answer:

(c) 1991.

Explanation:

The Monetary Policy Framework in India was transitioned from a fixed exchange rate system to a flexible exchange rate system in the year 1991. This move was part of the economic reforms initiated in India to liberalize the economy.

3. The Monetary Policy Committee (MPC) in India consists of members from:
(a) Commercial banks and financial institutions.
(b) The Ministry of Finance and the RBI.

(c) Academia, the RBI, and the government.
(d) The World Bank and the International Monetary Fund (IMF).

Answer:

(c) Academia, the RBI, and the government.

Explanation:

The Monetary Policy Committee (MPC) in India consists of six members, with three members from the RBI (including the RBI Governor) and three external members. The external members are experts from academia, chosen by the central government in consultation with the RBI.

4. The primary objective of the Monetary Policy Framework in India is to achieve:
(a) High economic growth and full employment.
(b) Fiscal stability and balanced budget.
(c) Price stability and controlled inflation.
(d) Favorable balance of trade and exchange rate stability.

Answer:

(c) Price stability and controlled inflation.

Explanation:

The primary objective of the Monetary Policy Framework in India is to achieve price stability and controlled inflation. The Reserve Bank of India (RBI) aims to keep inflation at a moderate level to maintain the purchasing power of the currency and ensure stable economic conditions.

5. The "Liquidity Adjustment Facility (LAF)" is a significant instrument used in the Monetary Policy Framework in India. What does LAF primarily aim to do?
(a) Regulate the foreign exchange market.
(b) Control the money supply in the economy.
(c) Encourage foreign direct investment (FDI).
(d) Regulate the stock market.

Answer:

(b) Control the money supply in the economy.

Explanation:

The Liquidity Adjustment Facility (LAF) is an instrument used in the Monetary Policy Framework in India to control the money supply in the economy. Through LAF, the RBI manages the liquidity in the banking system by conducting daily repo and reverse repo operations.

1.3.1 The Objectives of Monetary Policy

1. The primary objective of monetary policy in India is to:
(a) Achieve high economic growth and full employment.
(b) Control the government's fiscal policy.
(c) Regulate the stock market and financial institutions.
(d) Achieve price stability and controlled inflation.

Answer:

(d) Achieve price stability and controlled inflation.

Explanation:

The primary objective of monetary policy in India is to achieve price stability and controlled inflation. The Reserve Bank of India (RBI) aims to keep inflation at a moderate level to maintain the purchasing power of the currency and ensure stable economic conditions.

2. In addition to price stability, monetary policy in India also aims to:
(a) Regulate foreign trade and exchange rates.
(b) Control the money supply and interest rates.
(c) Encourage foreign direct investment (FDI).
(d) Reduce the government's fiscal deficit.

Answer:

(b) Control the money supply and interest rates.

Explanation:

In addition to price stability, monetary policy in India also aims to control the money supply and interest rates in the economy. The Reserve Bank of India (RBI) uses various monetary policy tools to influence economic activity, inflation, and growth.

3. One of the secondary objectives of monetary policy in India is to promote:
(a) Government spending and fiscal expansion.
(b) Foreign trade and export-oriented industries.

(c) Financial inclusion and banking services.
(d) Equity and social justice.

Answer:

(c) Financial inclusion and banking services.

Explanation:

One of the secondary objectives of monetary policy in India is to promote financial inclusion and banking services. The RBI encourages initiatives to provide banking services to the unbanked and underserved population, promoting financial access and inclusion.

4. Which of the following is NOT an objective of monetary policy in India?
(a) Controlling inflation and maintaining price stability.
(b) Promoting foreign direct investment (FDI).
(c) Facilitating economic growth and development.
(d) Ensuring financial stability in the banking system.

Answer:

(b) Promoting foreign direct investment (FDI).

Explanation:

While promoting foreign direct investment (FDI) is essential for economic growth, it is not a direct objective of monetary policy in India. The primary objectives of monetary policy are price stability, controlled inflation, economic growth, and financial stability.

5. The objectives of monetary policy in India are set by:
(a) The Ministry of Finance.
(b) The Reserve Bank of India (RBI).
(c) The Securities and Exchange Board of India (SEBI).
(d) The Parliament of India.

Answer:

(b) The Reserve Bank of India (RBI).

Explanation:

The objectives of monetary policy in India are set and implemented by the Reserve Bank of India (RBI). The RBI formulates and implements monetary policy independently to achieve its set objectives.

1.3.2 Transmission of Monetary Policy

1. The transmission of monetary policy in India refers to:
(a) The process of formulating monetary policy objectives.
(b) The implementation of fiscal policy measures by the government.
(c) The process by which changes in monetary policy affect the economy.
(d) The coordination between the Ministry of Finance and the Reserve Bank of India.

Answer:

(c) The process by which changes in monetary policy affect the economy.

Explanation:

The transmission of monetary policy in India refers to the process by which changes in monetary policy, such as interest rates and liquidity measures, affect the various sectors of the economy, influencing economic activity, inflation, and growth.

2. When the Reserve Bank of India (RBI) reduces the repo rate, it is likely to impact the economy by:
(a) Increasing borrowing costs for consumers and businesses.
(b) Encouraging commercial banks to lower lending rates.
(c) Discouraging foreign direct investment (FDI).
(d) Lowering government expenditure.

Answer:

(b) Encouraging commercial banks to lower lending rates.

Explanation:

When the RBI reduces the repo rate, it aims to encourage commercial banks to lower their lending rates. The lower lending rates make borrowing cheaper for consumers and businesses, stimulating spending and investment and supporting economic growth.

3. The "Bank Rate" is one of the key policy rates used by the Reserve Bank of India (RBI). An increase in the Bank Rate is likely to impact the economy by:
(a) Encouraging banks to increase their lending activities.
(b) Reducing interest rates for consumers and businesses.

(c) Discouraging borrowing and spending.
(d) Promoting exports and foreign trade.

Answer:

(c) Discouraging borrowing and spending.

Explanation:

An increase in the Bank Rate by the RBI is likely to discourage borrowing and spending by making borrowing more expensive for commercial banks. Higher borrowing costs can lead to reduced credit availability and slower economic activity.

4. How does the transmission of monetary policy impact the stock market in India?
(a) An expansionary monetary policy leads to a bearish market.
(b) A contractionary monetary policy leads to a bullish market.
(c) Monetary policy has no direct impact on the stock market.
(d) An expansionary monetary policy leads to a bullish market.

Answer:

(d) An expansionary monetary policy leads to a bullish market.

Explanation:

An expansionary monetary policy, which involves measures to increase money supply and lower interest rates, can lead to a bullish stock market. Lower interest rates may encourage investors to shift from bonds to equities, driving up stock prices.

5. The transmission of monetary policy in India occurs through various channels, including:
(a) Fiscal policy measures implemented by the government.
(b) Changes in the foreign exchange rate.
(c) Changes in government borrowing and expenditure.
(d) Changes in bank lending rates and credit availability.

Answer:

(d) Changes in bank lending rates and credit availability.

Explanation:

The transmission of monetary policy in India occurs through changes in bank lending rates and credit availability. When the RBI changes its policy rates, such as the Repo Rate or Cash Reserve Ratio (CRR), it affects the cost and availability of credit in the economy, influencing borrowing and spending behavior.

Channels of Monetary policy Transmission

Saving and Investment Channel

6. The Saving and Investment Channel of monetary policy in India refers to:
(a) The process of promoting saving and investment through government policies.
(b) The impact of changes in interest rates on saving and investment behavior.
(c) The role of the stock market in mobilizing savings and facilitating investments.
(d) The coordination between the Ministry of Finance and the Reserve Bank of India.

Answer:

(b) The impact of changes in interest rates on saving and investment behavior.

Explanation:

The Saving and Investment Channel of monetary policy in India refers to the impact of changes in interest rates on the saving and investment behavior of individuals, businesses, and financial institutions. When the central bank adjusts its policy rates (e.g., Repo Rate, Reverse Repo Rate), it affects the cost of borrowing and lending, influencing the propensity to save and invest in the economy.

7. When the Reserve Bank of India (RBI) lowers interest rates, it is likely to impact saving and investment by:
(a) Encouraging more saving and less investment.
(b) Encouraging less saving and more investment.
(c) Discouraging both saving and investment.
(d) Having no impact on saving and investment.

Answer:

(b) Encouraging less saving and more investment.

Explanation:

When the RBI lowers interest rates, it makes borrowing cheaper for businesses and individuals. As a result, the cost of investment decreases, encouraging more borrowing for investment purposes. On the other hand, lower interest rates on savings may discourage saving, as the returns on savings deposits may be comparatively lower.

8. The impact of the Saving and Investment Channel on the economy is that lower interest rates can lead to:
(a) Increased aggregate demand and economic expansion.
(b) Reduced government expenditure and fiscal contraction.
(c) A decrease in foreign direct investment (FDI).
(d) A decrease in consumer spending and increased saving.
Answer:
(a) Increased aggregate demand and economic expansion.
Explanation:
Lower interest rates through the Saving and Investment Channel can lead to increased borrowing and investment by businesses, higher consumer spending, and overall increased aggregate demand. This can stimulate economic expansion and growth.

9. When the RBI raises interest rates, the impact on saving and investment in India is likely to be:
(a) Higher saving and lower investment.
(b) Lower saving and higher investment.
(c) A decrease in aggregate demand and economic contraction.
(d) An increase in the government's fiscal deficit.
Answer:
(a) Higher saving and lower investment.
Explanation:
When the RBI raises interest rates, it makes borrowing more expensive, leading to reduced borrowing and investment by businesses and individuals. Higher interest rates on savings deposits may also encourage higher saving rates.

10. The Saving and Investment Channel is an essential mechanism through which monetary policy affects the real economy in India. How does this channel influence economic growth?
(a) By directly controlling government spending and fiscal policy.
(b) By influencing saving and investment behavior to stimulate economic activity.

(c) By regulating foreign trade and exchange rates.
(d) By promoting foreign direct investment (FDI) and exports.
Answer:
(b) By influencing saving and investment behavior to stimulate economic activity.
Explanation:
The Saving and Investment Channel influences saving and investment behavior in India through changes in interest rates, which, in turn, can stimulate economic activity, leading to economic growth. This channel affects consumer spending, business investment decisions, and overall aggregate demand in the economy.

Cash-flow Channel

11. The Cash-flow Channel of monetary policy in India refers to:
(a) The impact of changes in interest rates on cash flows of businesses and households.
(b) The process of managing the government's cash reserves.
(c) The role of the Reserve Bank of India (RBI) in printing and distributing currency notes.
(d) The coordination between the Ministry of Finance and the RBI in managing cash transactions.
Answer:
(a) The impact of changes in interest rates on cash flows of businesses and households.
Explanation:
The Cash-flow Channel of monetary policy in India refers to the impact of changes in interest rates on the cash flows of businesses and households. When the central bank adjusts its policy rates (e.g., Repo Rate, Reverse Repo Rate), it affects the cost of borrowing and lending, influencing the cash flows of borrowers and lenders, and subsequently impacting spending and investment decisions.

12. When the Reserve Bank of India (RBI) lowers interest rates, the Cash-flow Channel is likely to affect the economy by:
(a) Reducing the government's fiscal deficit.
(b) Encouraging businesses to invest more and increase spending.

(c) Encouraging individuals to save more and reduce spending.
(d) Having no impact on the cash flows of businesses and households.

Answer:

(b) Encouraging businesses to invest more and increase spending.

Explanation:

When the RBI lowers interest rates, it makes borrowing cheaper for businesses, leading to lower interest expenses and improved cash flows. This encourages businesses to invest more, increase spending, and undertake expansionary activities.

13. The impact of the Cash-flow Channel on the economy is that lower interest rates can lead to:
(a) Reduced government borrowing and increased fiscal discipline.
(b) A decrease in foreign direct investment (FDI).
(c) An increase in consumer spending and economic growth.
(d) A decrease in aggregate demand and economic contraction.

Answer:

(c) An increase in consumer spending and economic growth.

Explanation:

Lower interest rates through the Cash-flow Channel can lead to reduced interest expenses for households, increasing their disposable income. This can encourage higher consumer spending and contribute to economic growth through increased aggregate demand.

14. When the RBI raises interest rates, the Cash-flow Channel is likely to impact the economy by:
(a) Encouraging more borrowing and spending by households.
(b) Discouraging businesses from undertaking new investment projects.
(c) Having no impact on the cash flows of businesses and households.
(d) Reducing the fiscal deficit and promoting government savings.

Answer:

(b) Discouraging businesses from undertaking new investment projects.

Explanation:

When the RBI raises interest rates, borrowing becomes more expensive for businesses, leading to higher interest expenses and reduced cash flows. This may discourage businesses from undertaking new investment projects and expansionary activities.

15. The Cash-flow Channel is an essential mechanism through which monetary policy affects the real economy in India. How does this channel influence financial markets?
(a) By directly regulating stock market transactions.
(b) By influencing the flow of currency in the economy.
(c) By impacting the cash flows and investment decisions of financial institutions.
(d) By controlling the government's fiscal policy.

Answer:

(c) By impacting the cash flows and investment decisions of financial institutions.

Explanation:

The Cash-flow Channel influences the cash flows and investment decisions of financial institutions, such as banks and non-banking financial companies. Changes in interest rates can affect their borrowing and lending activities, impacting liquidity conditions in the financial markets.

These two effects work in opposite directions, but a reduction in interest rates can be expected to increase spending in the Indian economy through this channel (with the first effect larger than the second)

Asset Prices and Wealth Channel

16. The Asset Prices and Wealth Channel of monetary policy in India refers to:
(a) The impact of changes in interest rates on the prices of assets like stocks and real estate.
(b) The management of the country's foreign exchange reserves.
(c) The role of the Reserve Bank of India (RBI) in controlling commodity prices.
(d) The coordination between the Ministry of Finance and the RBI in managing financial assets.

Answer:

(a) The impact of changes in interest rates on the prices of assets like stocks and real estate.

Explanation:
The Asset Prices and Wealth Channel of monetary policy in India refers to the impact of changes in interest rates on the prices of various assets, such as stocks, real estate, and bonds. Changes in interest rates can influence asset prices and the overall wealth of households and businesses, thereby affecting their spending and investment decisions.

17. When the Reserve Bank of India (RBI) lowers interest rates, the Asset Prices and Wealth Channel is likely to affect the economy by:
(a) Encouraging more borrowing and spending by households and businesses.
(b) Decreasing the prices of assets like stocks and real estate.
(c) Increasing the value of financial assets and overall wealth.
(d) Having no impact on asset prices and wealth.

Answer:
(c) Increasing the value of financial assets and overall wealth.

Explanation:
When the RBI lowers interest rates, it reduces the cost of borrowing, which can lead to higher investment and spending. Additionally, lower interest rates make bonds and other fixed-income assets less attractive, prompting investors to shift towards riskier assets like stocks and real estate, thereby increasing their prices and overall wealth.

18. The impact of the Asset Prices and Wealth Channel on the economy is that rising asset prices and increased wealth can lead to:
(a) Reduced consumption and decreased economic growth.
(b) Higher borrowing costs and decreased investment.
(c) Increased consumer spending and improved economic activity.
(d) A decrease in government expenditure and fiscal discipline.

Answer:
(c) Increased consumer spending and improved economic activity.

Explanation:
Rising asset prices and increased wealth through the Asset Prices and Wealth Channel can lead to improved consumer confidence and increased spending by households. This increased consumer spending can contribute to improved economic activity and overall economic growth.

19. When the RBI raises interest rates, the Asset Prices and Wealth Channel is likely to impact the economy by:
(a) Increasing the prices of financial assets and overall wealth.
(b) Encouraging more borrowing and investment by businesses.
(c) Discouraging borrowing and spending by households and businesses.
(d) Reducing the government's fiscal deficit.

Answer:
(c) Discouraging borrowing and spending by households and businesses.

Explanation:
When the RBI raises interest rates, it increases the cost of borrowing, which can discourage borrowing and spending by households and businesses. Higher interest rates can lead to reduced investment and consumption, impacting economic activity.

20. The Asset Prices and Wealth Channel is an essential mechanism through which monetary policy affects the real economy in India. How does this channel influence consumer behavior?
(a) By directly regulating consumer spending and saving rates.
(b) By influencing the prices of consumer goods and services.
(c) By impacting the overall wealth and financial positions of consumers.
(d) By controlling the government's fiscal policy.

Answer:
(c) By impacting the overall wealth and financial positions of consumers.

Explanation:
The Asset Prices and Wealth Channel impacts consumer behavior by affecting the overall wealth and financial positions of consumers. Changes in asset prices influence household wealth, which, in turn, can influence consumer spending and saving decisions.

Exchange Rate Channel

21. The Exchange Rate Channel of monetary policy in India refers to:
    (a) The impact of changes in the exchange rate on the domestic economy.
    (b) The management of the country's foreign exchange reserves.
    (c) The role of the Reserve Bank of India (RBI) in controlling import and export activities.
    (d) The coordination between the Ministry of Finance and the RBI in managing exchange rates.

    Answer:
    (a) The impact of changes in the exchange rate on the domestic economy.

    Explanation:
    The Exchange Rate Channel of monetary policy in India refers to the impact of changes in the exchange rate of the domestic currency (such as INR) on the domestic economy. Fluctuations in the exchange rate can affect import and export competitiveness, balance of trade, inflation, and overall economic conditions.

22. When the Reserve Bank of India (RBI) allows the domestic currency to appreciate, it is likely to impact the economy by:
    (a) Making imports cheaper and increasing import volumes.
    (b) Making exports more expensive and decreasing export volumes.
    (c) Encouraging more foreign direct investment (FDI).
    (d) Having no impact on the economy.

    Answer:
    (b) Making exports more expensive and decreasing export volumes.

    Explanation:
    When the RBI allows the domestic currency to appreciate, it means that the value of the domestic currency strengthens compared to other currencies. This makes exports more expensive for foreign buyers and reduces the competitiveness of domestic goods in international markets, leading to a decrease in export volumes.

23. The impact of the Exchange Rate Channel on the economy is that a depreciating domestic currency can lead to:
    (a) Increased export volumes and improved balance of trade.
    (b) Higher import costs and increased inflation.
    (c) A decrease in foreign direct investment (FDI).
    (d) Decreased government spending and fiscal discipline.

    Answer:
    (a) Increased export volumes and improved balance of trade.

    Explanation:
    A depreciating domestic currency makes exports cheaper for foreign buyers, leading to increased export volumes. This, in turn, improves the balance of trade by increasing export earnings and reducing the trade deficit.

24. When the RBI intervenes in the foreign exchange market to stabilize the domestic currency, the Exchange Rate Channel is likely to impact the economy by:
    (a) Encouraging more borrowing and spending by households and businesses.
    (b) Influencing the flow of currency in the economy.
    (c) Having no impact on the economy's external sector.
    (d) Maintaining stable exchange rates to support trade and investment.

    Answer:
    (d) Maintaining stable exchange rates to support trade and investment.

    Explanation:
    When the RBI intervenes in the foreign exchange market, it aims to stabilize exchange rates and prevent excessive volatility in the domestic currency. Stable exchange rates support trade and investment by providing a predictable environment for international transactions.

25. The Exchange Rate Channel is an essential mechanism through which monetary policy affects the real economy in India. How does this channel influence inflation?
    (a) By directly regulating consumer prices and wages.
    (b) By impacting the cost of imported goods and commodities.

(c) By controlling the government's fiscal policy.
(d) By regulating the money supply in the economy.

Answer:

(b) By impacting the cost of imported goods and commodities.

Explanation:

The Exchange Rate Channel influences inflation by impacting the cost of imported goods and commodities. A depreciating domestic currency makes imports more expensive, leading to higher prices for imported goods in the domestic market, contributing to inflationary pressures.

1.3.3 Operating Procedures and Instruments

1. Operating Procedures and Instruments of Monetary Policy in India are designed to:
(a) Manage the government's fiscal deficit and public debt.
(b) Regulate the country's foreign exchange reserves.
(c) Control the money supply and influence interest rates.
(d) Coordinate the monetary policy with fiscal policy measures.

Answer:

(c) Control the money supply and influence interest rates.

Explanation:

Operating Procedures and Instruments of Monetary Policy in India are designed to control the money supply in the economy and influence interest rates. By adjusting policy rates, open market operations, and other instruments, the central bank (Reserve Bank of India - RBI) aims to regulate liquidity, credit availability, and interest rates to achieve its monetary policy objectives.

2. The primary instrument used by the Reserve Bank of India (RBI) to control short-term interest rates is:
(a) The Cash Reserve Ratio (CRR).
(b) The Statutory Liquidity Ratio (SLR).
(c) The Repo Rate.
(d) The Bank Rate.

Answer:

(c) The Repo Rate.

Explanation:

The primary instrument used by the RBI to control short-term interest rates is the Repo Rate. The Repo Rate is the rate at which the RBI lends money to commercial banks for a short duration, and changes in this rate have a direct impact on borrowing costs and short-term interest rates in the economy.

3. Open Market Operations (OMOs) is one of the tools used by the RBI to influence the money supply. What does OMOs involve?
(a) The RBI's intervention in the foreign exchange market.
(b) The sale and purchase of government securities in the open market.
(c) The regulation of foreign direct investment (FDI) flows.
(d) The control of inflation through price ceilings.

Answer:

(b) The sale and purchase of government securities in the open market.

Explanation:

Open Market Operations (OMOs) involve the sale and purchase of government securities (bonds) in the open market by the RBI. When the RBI sells government securities, it reduces the money supply as banks buy these securities, and their reserves decrease. Conversely, when the RBI purchases government securities, it injects liquidity into the system and increases the money supply.

4. The Cash Reserve Ratio (CRR) is another tool used by the RBI to regulate the money supply. What does CRR represent?
(a) The percentage of cash banks must maintain with the RBI as a reserve.
(b) The interest rate at which banks can borrow from the RBI.
(c) The percentage of cash banks must keep with the RBI for foreign exchange transactions.
(d) The rate at which the RBI lends money to banks for long-term purposes.

Answer:

(a) The percentage of cash banks must maintain with the RBI as a reserve.

Explanation:
The Cash Reserve Ratio (CRR) is the percentage of cash that commercial banks are required to maintain as reserves with the RBI on their net demand and time liabilities. By adjusting the CRR, the RBI can influence the amount of funds available with banks for lending and thereby impact the money supply.

5. The Reverse Repo Rate is an important tool used by the RBI for monetary policy operations. What does the Reverse Repo Rate represent?
   (a) The rate at which the RBI borrows from commercial banks.
   (b) The rate at which the RBI lends to commercial banks.
   (c) The rate at which commercial banks borrow from each other.
   (d) The rate at which the RBI intervenes in the foreign exchange market.

   Answer:
   (a) The rate at which the RBI borrows from commercial banks.

   Explanation:
   The Reverse Repo Rate is the rate at which the RBI borrows money from commercial banks for a short duration. It is used to absorb excess liquidity from the banking system and control inflationary pressures.

1.4 The Organisational Structure for Monetary Policy Decisions

1. In India, the responsibility for formulating and implementing monetary policy lies with:
   (a) The Ministry of Finance.
   (b) The Reserve Bank of India (RBI).
   (c) The Securities and Exchange Board of India (SEBI).
   (d) The Indian Parliament.

   Answer:
   (b) The Reserve Bank of India (RBI).

   Explanation:
   In India, the responsibility for formulating and implementing monetary policy lies with the Reserve Bank of India (RBI), which is the central bank

of the country. The RBI is entrusted with the task of regulating the money supply, credit availability, and interest rates to achieve the monetary policy objectives.

2. The highest decision-making body for monetary policy in India is:
   (a) The Board of Directors of the Reserve Bank of India (RBI).
   (b) The Finance Minister of India.
   (c) The Prime Minister of India.
   (d) The Monetary Policy Committee (MPC) of the RBI.

   Answer:
   (d) The Monetary Policy Committee (MPC) of the RBI.

   Explanation:
   The highest decision-making body for monetary policy in India is the Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI). The MPC is responsible for setting the policy interest rates and making decisions regarding monetary policy to achieve the targeted inflation rate.

3. The Monetary Policy Committee (MPC) consists of members from:
   (a) The Ministry of Finance and external economists.
   (b) The Indian Parliament and the banking sector.
   (c) The Ministry of Commerce and the corporate sector.
   (d) The Reserve Bank of India (RBI) and foreign central banks.

   Answer:
   (a) The Ministry of Finance and external economists.

   Explanation:
   The Monetary Policy Committee (MPC) consists of six members, including three officials from the Reserve Bank of India (RBI) and three external economists appointed by the Government of India's Ministry of Finance. The committee follows a collective decision-making process to arrive at monetary policy decisions.

4. The Governor of the Reserve Bank of India (RBI) serves as the:
   (a) Chairman of the Monetary Policy Committee (MPC).
   (b) Secretary of the Ministry of Finance.
   (c) Chief Executive Officer (CEO) of the RBI.
   (d) Head of the Indian Parliament.

Answer:

(a) Chairman of the Monetary Policy Committee (MPC).

Explanation:

The Governor of the Reserve Bank of India (RBI) serves as the Chairman of the Monetary Policy Committee (MPC). The Governor presides over the meetings of the MPC and has the casting vote in case of a tie in the voting process.

5. The primary mandate of the Monetary Policy Committee (MPC) is to:
   (a) Regulate the foreign exchange market and maintain exchange rate stability.
   (b) Control inflation and achieve the targeted inflation rate.
   (c) Manage the government's fiscal deficit and public debt.
   (d) Promote economic growth and increase employment opportunities.

Answer:

(b) Control inflation and achieve the targeted inflation rate.

Explanation:

The primary mandate of the Monetary Policy Committee (MPC) is to control inflation and achieve the targeted inflation rate set by the Government of India. The MPC formulates monetary policy measures to keep inflation within a specified range while supporting economic growth.

6. The Monetary Policy Committee (MPC) in India is responsible for:
   (a) Managing the country's foreign exchange reserves.
   (b) Setting the government's fiscal policy measures.
   (c) Formulating and determining monetary policy decisions.
   (d) Implementing the government's public expenditure programs.

Answer:

(c) Formulating and determining monetary policy decisions.

Explanation:

The Monetary Policy Committee (MPC) in India is responsible for formulating and determining the country's monetary policy decisions, including setting policy interest rates such as the Repo Rate and Reverse Repo Rate. It consists of members from the Reserve Bank of India (RBI) and external experts appointed by the government.

7. The MPC in India meets at regular intervals to review and decide on monetary policy actions. How often does the MPC typically hold its meetings?
   (a) Monthly
   (b) Quarterly
   (c) Biannually
   (d) Annually

Answer:

(b) Quarterly

Explanation:

The MPC in India typically holds its meetings every quarter (once every three months) to review the economic conditions, inflation trends, and other relevant factors to decide on monetary policy actions, including changes in policy interest rates.

8. The Governor of the Reserve Bank of India (RBI) is the ex-officio chairperson of the Monetary Policy Committee. Additionally, how many external members are appointed by the government to the MPC?
   (a) Two (b) Three
   (c) Four (d) Five

Answer:

(b) Three

Explanation:

The Governor of the RBI is the ex-officio chairperson of the Monetary Policy Committee, and there are three external members appointed by the government to the MPC. Thus, the total strength of the MPC is six members.

9. The decisions of the Monetary Policy Committee (MPC) are taken by a majority vote. What is the casting vote rule in case of a tie?
   (a) The RBI Governor gets the casting vote.
   (b) The external members get the casting vote.
   (c) The government's representative gets the casting vote.
   (d) The Deputy Governor of RBI gets the casting vote.

Answer:

(a) The RBI Governor gets the casting vote.

Explanation:
In case of a tie in the voting on monetary policy decisions, the RBI Governor, who is the ex-officio chairperson of the MPC, gets the casting vote. This provision is to ensure a decisive outcome in case of an equal number of votes.

10. What is the primary objective of the Monetary Policy Committee (MPC) in India?
(a) To promote economic growth and employment.
(b) To manage the government's fiscal deficit.
(c) To regulate the country's foreign exchange rates.
(d) To oversee the functioning of commercial banks.

Answer:
(a) To promote economic growth and employment.

Explanation:
The primary objective of the Monetary Policy Committee (MPC) in India is to maintain price stability while keeping in mind the objective of economic growth. It aims to achieve an inflation target set by the government, which ultimately contributes to sustainable economic growth and employment generation.

Additional Question Bank

1.1 Introduction

1. Monetary policy is a tool used by the central bank to:
(a) Regulate foreign trade
(b) Control inflation and stabilize the economy
(c) Manage government expenditures
(d) Influence fiscal policy
2. Which of the following is an example of an expansionary monetary policy?
(a) Increasing the reserve requirement ratio
(b) Selling government bonds in the open market

(c) Decreasing the discount rate
(d) Raising taxes
3. Contractionary monetary policy aims to:
(a) Boost economic growth and employment
(b) Increase the money supply and lower interest rates
(c) Reduce inflation and cool down an overheated economy
(d) Encourage borrowing and spending
4. The interest rate at which the central bank lends to commercial banks is known as:
(a) The discount rate
(b) The federal funds rate
(c) The prime rate
(d) The benchmark rate
5. When the central bank buys government bonds from the market, it:
(a) Increases the money supply
(b) Decreases the money supply
(c) Has no effect on the money supply
(d) Increases government debt

1.2 Monetary Policy Defined

1. Monetary policy is a macroeconomic policy that is primarily concerned with:
(a) Managing government expenditures
(b) Regulating foreign trade
(c) Controlling the money supply and interest rates
(d) Implementing tax policies
2. The main objective of monetary policy is to:
(a) Maximize government revenue
(b) Stabilize foreign exchange rates
(c) Promote economic growth and employment
(d) Control inflation and reduce government debt
3. In a contractionary monetary policy, the central bank takes actions to:
(a) Increase the money supply and lower interest rates
(b) Reduce government spending and increase taxes

(c) Decrease the money supply and raise interest rates
(d) Encourage borrowing and spending

4. The Federal Reserve in the United States and the European Central Bank are examples of:
(a) Fiscal policy authorities
(b) Commercial banks
(c) Investment banks
(d) Central banks responsible for monetary policy

5. Which of the following is not a monetary policy tool used by central banks?
(a) Open market operations
(b) Reserve requirement ratio
(c) Government bonds issuance
(d) Discount rate

1.3 The Monetary Policy Framework

1. The monetary policy framework outlines the strategies and tools used by the central bank to achieve its monetary policy objectives. Which of the following is not a typical objective of a central bank's monetary policy?
(a) Price stability and controlling inflation
(b) Promoting economic growth and employment
(c) Regulating foreign exchange rates
(d) Ensuring financial stability and supervision

2. The two main types of monetary policy frameworks are:
(a) Inflation targeting and exchange rate targeting
(b) Fiscal policy and monetary targeting
(c) Open market operations and reserve requirements
(d) Price stability and financial stability

3. In an inflation targeting framework, the central bank aims to achieve a specific target for:
(a) The money supply growth rate
(b) Unemployment rate
(c) Economic growth rate
(d) Inflation rate

4. Exchange rate targeting involves the central bank pegging the domestic currency to:
(a) A basket of foreign currencies
(b) Gold or other precious metals
(c) The inflation rate of a major trading partner
(d) The interest rate set by the central bank

5. An advantage of an inflation targeting framework is that it provides:
(a) Flexibility for the central bank to adjust its policy based on changing economic conditions
(b) Fixed and rigid monetary policy rules that do not require adjustments
(c) Complete independence of the central bank from the government's fiscal policies
(d) No need for central bank communication with the public and financial markets

1.4 The Organisational Structure for Monetary Policy Decisions

1. In most countries, monetary policy decisions are made by:
(a) The President or Prime Minister
(b) The Treasury Department
(c) The Ministry of Finance
(d) The central bank's monetary policy committee or board

2. The central bank's monetary policy committee or board is responsible for:
(a) Implementing fiscal policies
(b) Setting interest rates and managing the money supply
(c) Regulating foreign trade
(d) Issuing government bonds

3. The monetary policy committee or board typically consists of:
(a) Elected government officials
(b) Financial market analysts
(c) Representatives from commercial banks
(d) Key decision-makers from the central bank

4. The primary objective of the monetary policy committee or board is to:
   (a) Maximize government revenue
   (b) Control foreign exchange rates
   (c) Achieve price stability and economic growth
   (d) Influence fiscal policy decisions
5. In some countries, the central bank's monetary policy decisions may be influenced by the:
   (a) Ministry of Foreign Affairs
   (b) World Bank
   (c) International Monetary Fund (IMF)
   (d) Ministry of Education

Answer

1.1 Introduction

1. (b) Control inflation and stabilize the economy
2. (c) Decreasing the discount rate
3. (c) Reduce inflation and cool down an overheated economy
4. (a) The discount rate
5. (a) Increases the money supply

1.2 Monetary Policy Defined

1. (c) Controlling the money supply and interest rates
2. (c) Promote economic growth and employment
3. (c) Decrease the money supply and raise interest rates
4. (d) Central banks responsible for monetary policy
5. (c) Government bonds issuance

1.3 The Monetary Policy Framework

1. (c) Regulating foreign exchange rates
2. (a) Inflation targeting and exchange rate targeting
3. (d) Inflation rate

4. (a) A basket of foreign currencies
5. (a) Flexibility for the central bank to adjust its policy based on changing economic conditions

1.4 The Organisational Structure for Monetary Policy Decisions

1. (d) The central bank's monetary policy committee or board
2. (b) Setting interest rates and managing the money supply
3. (d) Key decision-makers from the central bank
4 (c) Achieve price stability and economic growth
5. (c) International Monetary Fund (IMF)

9 INTERNATIONAL TRADE

Unit:1 **Theories of International Trade**

Multiple Choice Questions

1.1 Introduction

1. Which theory suggests that a country should specialize in producing goods in which it has an absolute advantage?
   (a) Comparative Advantage Theory
   (b) Mercantilism Theory
   (c) Absolute Advantage Theory
   (d) Factor Proportions Theory

   Answer:
   (c) Absolute Advantage Theory

   Explanation:
   The Absolute Advantage Theory, proposed by Adam Smith, suggests that a country should specialize in producing goods in which it has an absolute advantage over other countries. Absolute advantage refers to a country's ability to produce a good more efficiently using fewer resources compared to other countries.

2. According to the Comparative Advantage Theory, trade between two countries can be beneficial if:
   (a) Both countries have the same resources and technology.
   (b) Both countries have a balanced trade.
   (c) One country has an absolute advantage in all goods.
   (d) Each country specializes in producing goods in which it has a lower opportunity cost.

   Answer:
   (d) Each country specializes in producing goods in which it has a lower opportunity cost.

   Explanation:
   The Comparative Advantage Theory, introduced by David Ricardo, states that trade between two countries can be mutually beneficial if each country specializes in producing goods in which it has a lower opportunity cost. Opportunity cost is the cost of forgoing the next best alternative when making a decision.

3. The theory that emphasizes the role of factor endowments as the basis for trade is known as:
   (a) Absolute Advantage Theory
   (b) Heckscher-Ohlin Theory
   (c) New Trade Theory
   (d) Porter's Diamond Model

   Answer:
   (b) Heckscher-Ohlin Theory

   Explanation:
   The Heckscher-Ohlin Theory, developed by Eli Heckscher and Bertil Ohlin, emphasizes that a country will export goods that utilize its abundant factors of production and import goods that require factors of production that are scarce in the country. It is also known as the factor proportions theory.

4. Which theory of international trade explains trade patterns based on economies of scale and product differentiation?
   (a) Comparative Advantage Theory
   (b) Mercantilism Theory
   (c) New Trade Theory
   (d) Absolute Advantage Theory

   Answer:
   (c) New Trade Theory

   Explanation:
   The New Trade Theory, introduced by Paul Krugman, explains trade patterns based on economies of scale and product differentiation. It suggests that economies of scale can lead to lower production costs, which can result in increased exports and international trade.

5. The theory that states a country should protect its domestic industries in order to build national wealth and power is called:
   (a) Absolute Advantage Theory
   (b) Mercantilism Theory
   (c) Comparative Advantage Theory
   (d) Factor Proportions Theory

   Answer:

   (b) Mercantilism Theory

   Explanation:

   The Mercantilism Theory is an outdated economic theory that was prevalent in the 16th to 18th centuries. It suggests that a country should protect its domestic industries, maximize exports, and minimize imports to build national wealth and power.

1.2 Important Theories of International Trade

1. The theory that suggests that a country should specialize in producing and exporting goods in which it has a comparative advantage, and import goods in which it has a comparative disadvantage, is known as:
   (a) The Mercantilist Theory
   (b) The Theory of Absolute Advantage
   (c) The Theory of Comparative Advantage
   (d) The Heckscher-Ohlin Theory

   Answer:

   (c) The Theory of Comparative Advantage

   Explanation:

   The Theory of Comparative Advantage, proposed by David Ricardo, suggests that a country should specialize in producing and exporting goods in which it has a lower opportunity cost (comparative advantage) and import goods in which it has a higher opportunity cost.

2. According to the Theory of Absolute Advantage, trade between two countries can be mutually beneficial if:
   (a) Both countries have the same level of productivity.
   (b) One country can produce all goods at a lower cost than the other.

   (c) Both countries have the same resources and technology.
   (d) Both countries impose high tariffs on imports.

   Answer:

   (b) One country can produce all goods at a lower cost than the other.

   Explanation:

   The Theory of Absolute Advantage, proposed by Adam Smith, suggests that trade between two countries can be mutually beneficial if one country can produce all goods at a lower cost (absolute advantage) than the other country.

3. The Heckscher-Ohlin Theory of International Trade emphasizes that trade is influenced by differences in:
   (a) Absolute advantage between countries.
   (b) Comparative advantage between countries.
   (c) Factor endowments between countries.
   (d) Monetary policies between countries.

   Answer:

   (c) Factor endowments between countries.

   Explanation:

   The Heckscher-Ohlin Theory of International Trade emphasizes that trade is influenced by differences in factor endowments, such as labor, capital, and land, between countries. Countries tend to export goods that use their abundant factors more intensively and import goods that use their scarce factors more intensively.

4. The Mercantilist Theory of International Trade advocates that a country should:
   (a) Encourage imports to promote domestic industries.
   (b) Export more than it imports to accumulate wealth in the form of precious metals.
   (c) Adopt a policy of free trade to promote global cooperation.
   (d) Reduce tariffs and barriers to trade.

   Answer:

   (b) Export more than it imports to accumulate wealth in the form of precious metals.

Explanation:
The Mercantilist Theory of International Trade advocates that a country should try to export more than it imports to accumulate wealth, especially in the form of precious metals like gold and silver. This approach was prevalent during the mercantilist era but is not considered a viable trade policy in modern times.

5. According to the Product Life Cycle Theory of International Trade, in which stage of a product's life cycle is a country likely to export it?
(a) Introduction stage (b) Growth stage
(c) Maturity stage (d) Decline stage
Answer:
(a) Introduction stage
Explanation:
The Product Life Cycle Theory of International Trade suggests that a country is likely to export a product during its introduction stage when it is a new and innovative product. As the product becomes widely adopted and enters the maturity stage, production may be shifted to other countries with lower production costs.

6. The theory that suggests that a country should specialize in producing goods in which it has an absolute advantage and then trade with other countries to maximize overall efficiency is known as:
(a) The Theory of Comparative Advantage
(b) The Theory of Absolute Advantage
(c) The Theory of Factor Proportions
(d) The Theory of International Product Life Cycle
Answer:
(b) The Theory of Absolute Advantage
Explanation:
The Theory of Absolute Advantage, proposed by Adam Smith, suggests that a country should specialize in producing goods in which it has an absolute advantage over other countries (i.e., it can produce those goods more efficiently) and then trade with other countries to maximize overall efficiency and welfare.

7. The theory that explains how countries benefit from trade by focusing on the opportunity cost of producing different goods is known as:
(a) The Theory of Comparative Advantage
(b) The Theory of Absolute Advantage
(c) The Theory of Factor Proportions
(d) The Theory of International Product Life Cycle
Answer:
(a) The Theory of Comparative Advantage
Explanation:
The Theory of Comparative Advantage, proposed by David Ricardo, explains that countries benefit from trade by focusing on the opportunity cost of producing different goods. A country should specialize in producing goods with lower opportunity costs and trade with other countries to gain from the efficiency gains.

8. The theory that emphasizes the importance of factor endowments (such as labor and capital) in determining a country's trade patterns is known as:
(a) The Theory of Comparative Advantage
(b) The Theory of Absolute Advantage
(c) The Theory of Factor Proportions
(d) The Theory of International Product Life Cycle
Answer:
(c) The Theory of Factor Proportions
Explanation:
The Theory of Factor Proportions, also known as the Heckscher-Ohlin Theory, emphasizes the role of factor endowments (e.g., labor, capital) in determining a country's trade patterns. It suggests that countries will export goods that use their abundant factors of production and import goods that use their scarce factors.

9. The theory that explains how a product's life cycle influences a country's trade patterns and the direction of trade is known as:
(a) The Theory of Comparative Advantage
(b) The Theory of Absolute Advantage

(c) The Theory of Factor Proportions
(d) The Theory of International Product Life Cycle

Answer:

(d) The Theory of International Product Life Cycle

Explanation:

The Theory of International Product Life Cycle, proposed by Raymond Vernon, explains how a product's life cycle influences a country's trade patterns and the direction of trade. It suggests that a product initially produced in a developed country may shift production to developing countries over time as the product matures.

10. The theory that takes into account the economies of scale and imperfect competition in international trade is known as:
(a) The Theory of Comparative Advantage
(b) The Theory of Absolute Advantage
(c) The Theory of Factor Proportions
(d) The Theory of New Trade

Answer:

(d) The Theory of New Trade

Explanation:

The Theory of New Trade, developed by Paul Krugman, takes into account the economies of scale and imperfect competition in international trade. It suggests that firms' ability to exploit economies of scale and product differentiation can lead to trade even in similar products.

1.2.1 The Mercantilists' View of International Trade

1. The Mercantilists' view of international trade primarily focused on:
(a) Promoting free trade and unrestricted movement of goods.
(b) Accumulating precious metals and maintaining a favorable balance of trade.
(c) Achieving absolute advantage in the production of all goods.
(d) Reducing tariffs and trade barriers between nations.

Answer:

(b) Accumulating precious metals and maintaining a favorable balance of trade.

Explanation:

The Mercantilists' view of international trade emphasized the accumulation of precious metals, particularly gold and silver, as a measure of a country's wealth and power. They believed that a favorable balance of trade, achieved through exporting more than importing, would lead to the inflow of precious metals, contributing to a nation's prosperity.

2. According to the Mercantilists, the best way for a country to increase its wealth was to:
(a) Encourage imports to meet domestic demand.
(b) Maintain a balanced trade with other nations.
(c) Export more goods than it imported.
(d) Focus on domestic production and self-sufficiency.

Answer:

(c) Export more goods than it imported.

Explanation:

According to the Mercantilists, a country should strive to export more goods than it imported to generate a positive balance of trade. This positive trade balance would lead to an inflow of precious metals, which they considered a measure of wealth.

3. Mercantilists believed that colonies were essential for a country's economic success because:
(a) Colonies provided cheap labor for domestic industries.
(b) Colonies were a source of raw materials and markets for finished goods.
(c) Colonies ensured a steady supply of precious metals for the mother country.
(d) Colonies contributed to the development of free trade principles.

Answer:

(b) Colonies were a source of raw materials and markets for finished goods.

Explanation:

Mercantilists believed that colonies played a crucial role in providing the mother country with access to abundant raw materials and serving as captive markets for finished goods. This allowed the mother country to increase its exports and strengthen its economic position.

4. One of the main criticisms of the Mercantilist view of international trade was that it:
   (a) Promoted economic cooperation and mutual benefits among nations.
   (b) Encouraged countries to focus on producing goods with comparative advantage.
   (c) Led to excessive competition and conflicts over trade and resources.
   (d) Ignored the importance of accumulating precious metals in trade.

   Answer:

   (d) Ignored the importance of accumulating precious metals in trade.

   Explanation:

   One of the main criticisms of the Mercantilist view of international trade was that it overly focused on the accumulation of precious metals (bullionism) as the sole measure of a country's wealth. Critics argued that economic prosperity should be based on productive capacities, efficient resource allocation, and mutual trade benefits rather than the accumulation of precious metals.

5. Mercantilism was the dominant economic philosophy during which historical period?
   (a) The 18th century (b) The 19th century
   (c) The 17th century (d) The 20th century

   Answer:

   (c) The 17th century

   Explanation:

   Mercantilism was the dominant economic philosophy during the 17th century and part of the 18th century. It was prevalent in European countries and influenced their economic policies related to international trade and colonization.

6. The Mercantilists' view of international trade primarily focused on:
   (a) Encouraging imports to promote domestic industries.
   (b) Accumulating precious metals like gold and silver through exports.
   (c) Promoting free trade and open markets.
   (d) Reducing government intervention in trade.

   Answer:

   (b) Accumulating precious metals like gold and silver through exports.

   Explanation:

   The Mercantilists' view of international trade emphasized the accumulation of precious metals like gold and silver through exports. They believed that a country's wealth and power could be increased by maintaining a favorable balance of trade, where exports exceed imports, leading to a net inflow of gold and silver.

7. The Mercantilists believed that a positive balance of trade would lead to:
   (a) An increase in domestic production and employment.
   (b) A decrease in the country's foreign exchange reserves.
   (c) A decrease in the country's wealth and power.
   (d) A decline in the country's industrial development.

   Answer:

   (a) An increase in domestic production and employment.

   Explanation:

   The Mercantilists believed that a positive balance of trade, where a country exports more than it imports, would lead to an increase in domestic production and employment. They thought that exporting goods would bring in precious metals, which would stimulate economic growth.

8. The Mercantilists' view on imports was that they should be:
   (a) Encouraged to promote international cooperation.
   (b) Avoided as they can lead to a trade deficit.
   (c) Limited to essential goods not produced domestically.
   (d) Unrestricted to benefit consumers with more choices.

   Answer:

   (b) Avoided as they can lead to a trade deficit.

   Explanation:

   The Mercantilists' view on imports was that they should be limited or avoided, as imports were believed to lead to a trade deficit. They were concerned that an excess of imports over exports could result in an outflow of precious metals, which would negatively impact the country's wealth.

9. The Mercantilists' policy recommendations to achieve a positive balance of trade included:
   (a) Subsidizing exports and imposing tariffs on imports.
   (b) Encouraging free trade agreements with other nations.
   (c) Eliminating all trade barriers and restrictions.
   (d) Adopting a laissez-faire approach to international trade.

   Answer:

   (a) Subsidizing exports and imposing tariffs on imports.

   Explanation:

   The Mercantilists' policy recommendations to achieve a positive balance of trade included subsidizing exports to make them more competitive in foreign markets and imposing tariffs or duties on imports to discourage their inflow.

10. The Mercantilists' view of international trade was prevalent during the:
    (a) 19th century
    (b) 18th century
    (c) 17th century
    (d) 20th century

    Answer:

    (c) 17th century

    Explanation:

    The Mercantilists' view of international trade was prevalent during the 17th century. It was the dominant economic theory during that period and influenced the trade policies of many European countries.

1.2.2 The Theory of Absolute Advantage

1. The Theory of Absolute Advantage, proposed by Adam Smith, states that a country has an absolute advantage in the production of a good when:
   (a) It can produce that good at a lower opportunity cost compared to other countries.
   (b) It can produce that good using fewer resources compared to other countries.

   (c) It can produce that good using the latest technology and machinery.
   (d) It can produce that good and export it without any restrictions.

   Answer:

   (b) It can produce that good using fewer resources compared to other countries.

   Explanation:

   According to the Theory of Absolute Advantage, a country has an absolute advantage in the production of a good when it can produce that good using fewer resources (inputs) compared to other countries. This means that the country is more efficient in producing the good and can potentially produce more of it using the same amount of resources.

2. The Theory of Absolute Advantage suggests that countries should specialize in producing goods in which they have an absolute advantage and then engage in international trade to:
   (a) Reduce competition in the domestic market.
   (b) Protect domestic industries from foreign competition.
   (c) Maximize overall efficiency and welfare.
   (d) Decrease the employment rate in the country.

   Answer:

   (c) Maximize overall efficiency and welfare.

   Explanation:

   The Theory of Absolute Advantage proposes that countries should specialize in producing goods in which they have an absolute advantage (i.e., they are more efficient in production) and then engage in international trade. By doing so, countries can maximize overall efficiency and welfare, as trade allows them to obtain goods they cannot produce efficiently themselves.

3. Which of the following is an essential assumption of the Theory of Absolute Advantage?
   (a) Constant opportunity cost of production.
   (b) The availability of perfect competition in the markets.
   (c) Identical resources and technologies across all countries.
   (d) The absence of trade barriers and restrictions.

   Answer:

   (c) Identical resources and technologies across all countries.

Explanation:
An essential assumption of the Theory of Absolute Advantage is that there are identical resources and technologies across all countries. This assumption allows for a clear comparison of absolute advantages in the production of goods.

4. The Theory of Absolute Advantage highlights that international trade can lead to mutual benefits for countries because:
(a) Each country has a comparative advantage in producing all goods.
(b) Each country can import goods that it cannot produce efficiently.
(c) Each country can export goods that it produces at a higher opportunity cost.
(d) Each country can accumulate vast amounts of wealth through trade.
Answer:
(b) Each country can import goods that it cannot produce efficiently.
Explanation:
The Theory of Absolute Advantage suggests that international trade can lead to mutual benefits for countries because each country can specialize in producing goods in which it has an absolute advantage and then import goods that it cannot produce efficiently. This allows countries to consume a broader range of goods and improve overall economic welfare.

5. The Theory of Absolute Advantage laid the foundation for understanding the gains from international trade and served as a basis for:
(a) The development of the Theory of Comparative Advantage.
(b) The imposition of trade barriers and tariffs.
(c) The establishment of international trade organizations.
(d) The promotion of self-sufficiency and autarky.
Answer:
(a) The development of the Theory of Comparative Advantage.
Explanation:
The Theory of Absolute Advantage laid the foundation for understanding the gains from international trade. It was later expanded and refined by David Ricardo into the Theory of Comparative Advantage, which provides a more nuanced explanation of the benefits of trade based on opportunity costs.

As an AI language model, I don't have access to a specific database of s with solutions. However, I can provide you with some sample multiple-choice questions related to the Theory of Absolute Advantage, along with explanations:

6. The Theory of Absolute Advantage, proposed by Adam Smith, states that a country has an absolute advantage in producing a good if it can:
(a) Produce the good at a lower opportunity cost than another country.
(b) Produce the good using fewer resources than another country.
(c) Produce the good using advanced technology and machinery.
(d) Produce the good in larger quantities than another country.
Answer:
(b) Produce the good using fewer resources than another country.
Explanation:
The Theory of Absolute Advantage suggests that a country has an absolute advantage in producing a good if it can produce that good using fewer resources (e.g., labor, capital) compared to another country. This means the country can produce the same quantity of the good with less input or can produce more of the good with the same input.

7. According to the Theory of Absolute Advantage, when two countries specialize in producing the goods in which they have an absolute advantage and then trade with each other:
(a) Both countries will benefit from trade due to efficiency gains.
(b) One country will gain, and the other country will lose from trade.
(c) Both countries will lose as they become dependent on each other.
(d) The terms of trade will always favor one country over the other.
Answer:
(a) Both countries will benefit from trade due to efficiency gains.
Explanation:
According to the Theory of Absolute Advantage, when two countries specialize in producing the goods in which they have an absolute advantage and then trade with each other, both countries will benefit from trade due to efficiency gains. Each country will produce and export the goods in which it has an absolute advantage, and through trade, they can acquire goods from the other country at a lower opportunity cost.

8. The Theory of Absolute Advantage suggests that international trade allows countries to:
   (a) Increase government revenue through export tariffs.
   (b) Accumulate precious metals like gold and silver through exports.
   (c) Achieve balanced trade with all trading partners.
   (d) Specialize in producing goods efficiently and enjoy a wider range of consumption.

   Answer:

   (d) Specialize in producing goods efficiently and enjoy a wider range of consumption.

   Explanation:

   The Theory of Absolute Advantage suggests that through international trade, countries can specialize in producing goods in which they have an absolute advantage. This specialization allows them to produce these goods more efficiently, leading to an increase in overall production and a wider range of consumption possibilities for both countries.

9. The Theory of Absolute Advantage focuses on:
   (a) The impact of economies of scale in international trade.
   (b) The importance of factor endowments in determining trade patterns.
   (c) The opportunity cost of producing different goods.
   (d) The comparative cost differences between countries.

   Answer:

   (b) The importance of factor endowments in determining trade patterns.

   Explanation:

   The Theory of Absolute Advantage focuses on the importance of factor endowments (e.g., labor, capital) in determining trade patterns. It emphasizes that a country should specialize in producing goods in which it has an absolute advantage due to its more efficient use of resources.

10. The Theory of Absolute Advantage is associated with the work of which economist?
   (a) David Ricardo (b) John Maynard Keynes
   (c) Adam Smith (d) Paul Samuelson

   Answer:

   (c) Adam Smith

   Explanation:

   The Theory of Absolute Advantage was proposed by the Scottish economist Adam Smith in his seminal work "The Wealth of Nations" published in 1776.

11. The Theory of Absolute Advantage, proposed by Adam Smith, states that a country has an absolute advantage in producing a good if it can:
   (a) Produce the good at a lower opportunity cost than another country.
   (b) Produce the good using fewer resources than another country.
   (c) Produce the good using advanced technology and machinery.
   (d) Produce the good in larger quantities than another country.

   Answer:

   (b) Produce the good using fewer resources than another country.

   Explanation:

   The Theory of Absolute Advantage suggests that a country has an absolute advantage in producing a good if it can produce that good using fewer resources (e.g., labor, capital) compared to another country. This means the country can produce the same quantity of the good with less input or can produce more of the good with the same input.

12. According to the Theory of Absolute Advantage, when two countries specialize in producing the goods in which they have an absolute advantage and then trade with each other:
   (a) Both countries will benefit from trade due to efficiency gains.
   (b) One country will gain, and the other country will lose from trade.
   (c) Both countries will lose as they become dependent on each other.
   (d) The terms of trade will always favor one country over the other.

   Answer:

   (a) Both countries will benefit from trade due to efficiency gains.

   Explanation:

   According to the Theory of Absolute Advantage, when two countries specialize in producing the goods in which they have an absolute advantage and then trade with each other, both countries will benefit from trade due to efficiency gains. Each country will produce and export the goods in which it has an absolute advantage, and through trade, they can acquire goods from the other country at a lower opportunity cost.

13. The Theory of Absolute Advantage suggests that international trade allows countries to:
   (a) Increase government revenue through export tariffs.
   (b) Accumulate precious metals like gold and silver through exports.
   (c) Achieve balanced trade with all trading partners.
   (d) Specialize in producing goods efficiently and enjoy a wider range of consumption.

   Answer:
   (d) Specialize in producing goods efficiently and enjoy a wider range of consumption.

   Explanation:
   The Theory of Absolute Advantage suggests that through international trade, countries can specialize in producing goods in which they have an absolute advantage. This specialization allows them to produce these goods more efficiently, leading to an increase in overall production and a wider range of consumption possibilities for both countries.

14. The Theory of Absolute Advantage focuses on:
   (a) The impact of economies of scale in international trade.
   (b) The importance of factor endowments in determining trade patterns.
   (c) The opportunity cost of producing different goods.
   (d) The comparative cost differences between countries.

   Answer:
   (b) The importance of factor endowments in determining trade patterns.

   Explanation:
   The Theory of Absolute Advantage focuses on the importance of factor endowments (e.g., labor, capital) in determining trade patterns. It emphasizes that a country should specialize in producing goods in which it has an absolute advantage due to its more efficient use of resources.

15. The Theory of Absolute Advantage is associated with the work of which economist?
   (a) David Ricardo (b) John Maynard Keynes
   (c) Adam Smith (d) Paul Samuelson

   Answer:
   (c) Adam Smith

   Explanation:
   The Theory of Absolute Advantage was proposed by the Scottish economist Adam Smith in his seminal work "The Wealth of Nations" published in 1776.

1.2.3 The Theory of Comparative Advantage

1. The Theory of Comparative Advantage, developed by David Ricardo, suggests that countries should specialize in producing goods in which they have a comparative advantage. What does "comparative advantage" mean in this context?
   (a) The ability to produce a good at a lower opportunity cost than another country.
   (b) The ability to produce a good using fewer resources than another country.
   (c) The ability to produce a good at the same cost as another country.
   (d) The ability to produce a good more efficiently than another country.

   Answer:
   (a) The ability to produce a good at a lower opportunity cost than another country.

   Explanation:
   The Theory of Comparative Advantage states that countries should specialize in producing goods in which they have a comparative advantage, i.e., the ability to produce a good at a lower opportunity cost than another country. It implies that a country should focus on producing goods in which it is relatively more efficient compared to other goods it could produce.

2. According to the Theory of Comparative Advantage, when countries specialize in producing goods based on their comparative advantages and then trade with each other:
   (a) Only one country will benefit, while the other will lose from trade.
   (b) Both countries will benefit from trade due to efficiency gains.
   (c) Both countries will experience a decrease in overall production.
   (d) The terms of trade will always favor one country over the other.

   Answer:
   (b) Both countries will benefit from trade due to efficiency gains.

Explanation:
The Theory of Comparative Advantage suggests that when countries specialize in producing goods based on their comparative advantages and then trade with each other, both countries will benefit from trade due to efficiency gains. Each country will produce and export the goods in which it has a comparative advantage, and through trade, they can acquire goods from the other country at a lower opportunity cost.

3. The Theory of Comparative Advantage is based on the concept of:
(a) Economies of scale in production.
(b) Factor endowments and resource availability.
(c) Opportunity cost and trade-offs.
(d) Absolute cost differences between countries.

Answer:
(c) Opportunity cost and trade-offs.

Explanation:
The Theory of Comparative Advantage is based on the concept of opportunity cost and trade-offs. It emphasizes that countries should specialize in producing goods in which they have a lower opportunity cost compared to other goods. In doing so, they can allocate their resources more efficiently and maximize overall production.

4. The Theory of Comparative Advantage suggests that even if one country is more efficient in producing all goods compared to another country, both countries can still benefit from trade if they:
(a) Engage in barter trade instead of monetary transactions.
(b) Implement strict trade barriers and tariffs.
(c) Exchange goods based on their relative efficiency.
(d) Sign free trade agreements with each other.

Answer:
(c) Exchange goods based on their relative efficiency.

Explanation:
The Theory of Comparative Advantage suggests that even if one country is more efficient in producing all goods compared to another country, both countries can still benefit from trade if they exchange goods based on their relative efficiency (comparative advantage). By specializing and trading based on their comparative advantages, both countries can improve their welfare and overall well-being.

5. The Theory of Comparative Advantage is associated with the work of which economist?
(a) Adam Smith
(b) John Maynard Keynes
(c) David Ricardo
(d) Paul Samuelson

Answer:
(c) David Ricardo

Explanation:
The Theory of Comparative Advantage was developed by the British economist David Ricardo and was first published in his book "Principles of Political Economy and Taxation" in 1817.

6. The Theory of Comparative Advantage, developed by David Ricardo, suggests that a country should specialize in producing a good in which it has:
(a) The highest absolute advantage.
(b) The lowest opportunity cost.
(c) The most advanced technology.
(d) The highest level of exports.

Answer:
(b) The lowest opportunity cost.

Explanation:
The Theory of Comparative Advantage suggests that a country should specialize in producing a good in which it has the lowest opportunity cost. Opportunity cost refers to the value of the next best alternative foregone when making a choice. By specializing in producing goods with lower opportunity costs, a country can gain from trade with other countries.

7. According to the Theory of Comparative Advantage, even if a country does not have an absolute advantage in producing any good, it can still benefit from trade if it:
(a) Produces goods for which it has the lowest opportunity cost.
(b) Engages in international trade with multiple partners simultaneously.

(c) Adopts protectionist trade policies to restrict imports.
(d) Promotes the domestic industry through subsidies and tariffs.

Answer:

(a) Produces goods for which it has the lowest opportunity cost.

Explanation:

According to the Theory of Comparative Advantage, a country can still benefit from trade even if it does not have an absolute advantage in producing any good. It should produce and export goods for which it has the lowest opportunity cost, and through trade, it can acquire goods from other countries at a lower opportunity cost than producing them domestically.

8. The Theory of Comparative Advantage suggests that international trade allows countries to:
(a) Maximize their exports to generate higher revenue.
(b) Reduce their dependence on imports and foreign goods.
(c) Focus on producing a limited range of goods.
(d) Benefit from mutual gains and specialization in production.

Answer:

(d) Benefit from mutual gains and specialization in production.

Explanation:

The Theory of Comparative Advantage suggests that international trade allows countries to benefit from mutual gains and specialization in production. By specializing in producing goods with lower opportunity costs and engaging in trade, countries can collectively increase their overall production and consumption possibilities.

9. The Theory of Comparative Advantage is based on the assumption that:
(a) All countries have the same level of technological advancement.
(b) Labor is the only factor of production considered in trade.
(c) Opportunity costs are constant and do not change over time.
(d) International trade is always balanced with no trade deficits.

Answer:

(c) Opportunity costs are constant and do not change over time.

Explanation:

The Theory of Comparative Advantage is based on the assumption that opportunity costs are constant and do not change over time. This assumption allows for a simplified analysis of trade patterns and outcomes.

10. The concept of comparative advantage is often used to explain why countries engage in international trade and:
(a) Focus on self-sufficiency and autarky.
(b) Form regional trade blocs to protect domestic industries.
(c) Seek to increase tariffs and trade restrictions.
(d) Specialize in producing goods based on relative efficiency.

Answer:

(d) Specialize in producing goods based on relative efficiency.

Explanation:

The concept of comparative advantage is used to explain why countries engage in international trade and specialize in producing goods based on relative efficiency. Countries can produce goods in which they have a comparative advantage and trade with others to benefit from efficiency gains and a wider range of consumption possibilities.

1.2.4 The Heckscher-Ohlin Theory of Trade

1. The Heckscher-Ohlin Theory of Trade suggests that a country will export the good that uses its abundant factor of production more intensively because:
(a) The country wants to promote domestic industries.
(b) It wants to reduce its dependence on imports.
(c) The abundant factor of production is relatively cheaper.
(d) The abundant factor of production is scarce.

Answer:

(c) The abundant factor of production is relatively cheaper.

Explanation: The Heckscher-Ohlin Theory of Trade suggests that a country will export the good that uses its abundant factor of production more intensively because the abundant factor of production is relatively cheaper in that country. As a result, the country can produce the export good at a lower cost and be competitive in the international market.

2. According to the Heckscher-Ohlin Theory, trade occurs between countries that have differences in their:
   (a) Absolute advantage in production.
   (b) Size of population.
   (c) Factor endowments, such as labor and capital.
   (d) Industrialization levels.

   Answer:

   (c) Factor endowments, such as labor and capital.

   Explanation:

   According to the Heckscher-Ohlin Theory, trade occurs between countries that have differences in their factor endowments, such as labor and capital. Countries with abundant labor may export labor-intensive goods, while countries with abundant capital may export capital-intensive goods.

3. The Heckscher-Ohlin Theory predicts that a country with a relatively large endowment of skilled labor is likely to export:
   (a) Capital-intensive goods.
   (b) Labor-intensive goods.
   (c) Natural resources.
   (d) Services.

   Answer:

   (a) Capital-intensive goods.

   Explanation:

   The Heckscher-Ohlin Theory predicts that a country with a relatively large endowment of skilled labor is likely to export capital-intensive goods. Skilled labor is often associated with the use of advanced machinery and technology, which are typical characteristics of capital-intensive production.

4. The Heckscher-Ohlin Theory of Trade assumes that factors of production are:
   (a) Mobile and can move freely between countries.
   (b) Immobile and cannot move between countries.

   (c) Equally distributed among all countries.
   (d) Constantly changing due to technological advancements.

   Answer:

   (a) Mobile and can move freely between countries.

   Explanation:

   The Heckscher-Ohlin Theory of Trade assumes that factors of production, such as labor and capital, are mobile and can move freely between countries in response to changes in demand and supply conditions. This assumption allows factors to be allocated efficiently across industries and countries.

5. The Heckscher-Ohlin Theory of Trade is also known as the theory of:
   (a) Absolute Advantage
   (b) Comparative Advantage
   (c) Factor Proportions
   (d) International Product Life Cycle

   Answer:

   (c) Factor Proportions

   Explanation:

   The Heckscher-Ohlin Theory of Trade is also known as the theory of Factor Proportions. It emphasizes the role of factor endowments (labor and capital) in determining a country's trade patterns.

6. The Heckscher-Ohlin Theory of Trade emphasizes the importance of which factor(s) in determining a country's trade patterns?
   (a) Differences in technology and innovation.
   (b) Differences in consumer preferences.
   (c) Differences in factor endowments, such as labor and capital.
   (d) Differences in government trade policies.

   Answer:

   (c) Differences in factor endowments, such as labor and capital.

   Explanation:

   The Heckscher-Ohlin Theory of Trade emphasizes the role of differences in factor endowments, such as labor, capital, and land, in determining a country's trade patterns. It suggests that a country will export goods that use its abundant factors of production and import goods that use its scarce factors.

7. According to the Heckscher-Ohlin Theory, a country with an abundance of capital relative to labor is likely to:
   (a) Import capital-intensive goods and export labor-intensive goods.
   (b) Import labor-intensive goods and export capital-intensive goods.
   (c) Import goods that use equal amounts of labor and capital.
   (d) Not engage in international trade due to balanced factor endowments.

   Answer:

   (b) Import labor-intensive goods and export capital-intensive goods.

   Explanation:

   According to the Heckscher-Ohlin Theory, a country with an abundance of capital relative to labor is likely to export capital-intensive goods because it can efficiently use its abundant capital. On the other hand, it will import labor-intensive goods because they are relatively more labor-intensive and the country may have a scarcity of labor.

8. The Heckscher-Ohlin Theory of Trade predicts that trade will lead to:
   (a) Convergence in factor endowments between trading partners.
   (b) Divergence in factor endowments between trading partners.
   (c) A decrease in specialization and comparative advantage.
   (d) Complete self-sufficiency in all goods.

   Answer:

   (a) Convergence in factor endowments between trading partners.

   Explanation:

   The Heckscher-Ohlin Theory predicts that trade will lead to a convergence in factor endowments between trading partners. As countries specialize in producing goods that use their abundant factors of production, trade can lead to the transfer of factors between countries, reducing the initial differences in factor endowments.

9. The Heckscher-Ohlin Theory assumes that factors of production are:
   (a) Perfectly mobile between industries within a country.
   (b) Perfectly immobile between industries within a country.
   (c) Perfectly mobile between countries.
   (d) Perfectly immobile between countries.

   Answer:

   (a) Perfectly mobile between industries within a country.

   Explanation: The Heckscher-Ohlin Theory assumes that factors of production (e.g., labor, capital) are perfectly mobile between industries within a country. This assumption allows for the efficient allocation of factors to industries based on their factor requirements.

10. The Heckscher-Ohlin Theory of Trade is an extension of which earlier trade theory?
   (a) The Theory of Absolute Advantage
   (b) The Theory of Comparative Advantage
   (c) The Theory of Factor Proportions
   (d) The Theory of International Product Life Cycle

   Answer:

   (b) The Theory of Comparative Advantage

   Explanation:

   The Heckscher-Ohlin Theory of Trade is an extension of the Theory of Comparative Advantage. It builds upon the concept of comparative advantage and introduces factor endowments as a key determinant of trade patterns.

1.2.5 Globalization and New International Trade Theory

1. Globalization is characterized by:
   (a) The increased integration and interdependence of economies and cultures worldwide.
   (b) A focus on promoting self-sufficiency and domestic industries.
   (c) A decrease in international trade and cross-border transactions.
   (d) A shift towards protectionist trade policies.

   Answer:

   (a) The increased integration and interdependence of economies and cultures worldwide.

   Explanation:

   Globalization refers to the increased integration and interdependence of economies and cultures worldwide. It involves the free flow of goods, services, capital, and information across national borders, leading to increased economic and cultural interconnectedness.

2. The New International Trade Theory emphasizes the role of:
   (a) Factor endowments and comparative advantage.
   (b) Economies of scale and product differentiation.
   (c) Changes in consumer preferences and tastes.
   (d) Tariffs and trade barriers.

   Answer:
   (b) Economies of scale and product differentiation.

   Explanation:
   The New International Trade Theory emphasizes the role of economies of scale and product differentiation in international trade. It suggests that firms' ability to achieve economies of scale and produce differentiated products can lead to international trade, even in similar products.

3. Globalization has led to an increase in international trade due to:
   (a) Reduced barriers to trade and investment.
   (b) A decline in the importance of multinational corporations.
   (c) A decrease in cross-border communication and technology.
   (d) An increase in self-sufficiency and closed economies.

   Answer:
   (a) Reduced barriers to trade and investment.

   Explanation:
   Globalization has led to an increase in international trade due to reduced barriers to trade and investment. Trade agreements, lowering of tariffs, and improved transportation and communication technologies have facilitated international trade:

4. The New International Trade Theory suggests that in certain industries with significant economies of scale, the world market can support:
   (a) Only a limited number of firms.
   (b) A large number of small firms.
   (c) Only domestic firms and not foreign firms.
   (d) A single monopolistic firm.

   Answer:
   (a) Only a limited number of firms.

   Explanation: The New International Trade Theory suggests that in certain industries with significant economies of scale, the world market can support only a limited number of firms. These industries may be dominated by a few large firms that can exploit economies of scale to reduce costs and gain a competitive advantage in the global market.

5. Globalization has led to increased cross-border movement of:
   (a) Labor and capital.
   (b) Trade barriers and restrictions.
   (c) Domestic industries and subsidies.
   (d) Agricultural products and raw materials.

   Answer:
   (a) Labor and capital.

   Explanation:
   Globalization has led to increased cross-border movement of labor and capital. The free flow of labor and capital across national borders has facilitated international business activities and investment.

6. The New International Trade Theory suggests that firms can gain a competitive advantage and achieve economies of scale through:
   (a) Expanding their domestic market share.
   (b) Limiting their product range to specialized niche markets.
   (c) Engaging in international trade and global operations.
   (d) Reducing their production output to maintain high-quality standards.

   Answer:
   (c) Engaging in international trade and global operations.

   Explanation:
   The New International Trade Theory suggests that firms can gain a competitive advantage and achieve economies of scale by engaging in international trade and global operations. By expanding into international markets, firms can access a larger customer base and reduce costs through increased production and distribution.

7. Globalization refers to the:
   (a) Process of increasing trade barriers and protectionist measures.
   (b) Integration and interdependence of economies and cultures worldwide.

(c) Concentration of economic power in the hands of a few multinational corporations.
(d) Isolation of countries from international markets and trade.

Answer:

(b) Integration and interdependence of economies and cultures worldwide.

Explanation:

Globalization refers to the integration and interdependence of economies and cultures worldwide. It involves the flow of goods, services, capital, and ideas across national borders, leading to increased interconnectedness and interdependence between countries.

8. Which of the following factors has contributed to the growth of globalization in recent decades?
(a) A decline in international trade and investment.
(b) A shift towards protectionist trade policies.
(c) Advancements in technology and communication.
(d) An increase in trade barriers and tariffs.

Answer:

(c) Advancements in technology and communication.

Explanation:

Advancements in technology and communication, such as the internet, improved transportation, and faster communication networks, have played a significant role in facilitating globalization. These advancements have made it easier for businesses to engage in international trade and connect with global markets.

9. The New International Trade Theory emphasizes the importance of which factor in explaining international trade patterns?
(a) Factor endowments, such as labor and capital.
(b) Differences in consumer preferences and tastes.
(c) The absolute advantage of countries in specific industries.
(d) Historical trade patterns and colonial legacies.

Answer:

(b) Differences in consumer preferences and tastes.

Explanation:

The New International Trade Theory emphasizes the importance of differences in consumer preferences and tastes in explaining international trade patterns. It suggests that firms can differentiate their products to meet the preferences of consumers in different markets, allowing them to gain a competitive advantage.

10. Globalization has led to increased:
(a) Economic self-sufficiency and reliance on domestic resources.
(b) Isolationism and reduced international cooperation.
(c) Income inequality and poverty in developing countries.
(d) Interconnectedness and cross-border flows of goods, services, and capital.

Answer:

(d) Interconnectedness and cross-border flows of goods, services, and capital.

Explanation:

Globalization has led to increased interconnectedness and cross-border flows of goods, services, and capital. It has facilitated international trade, foreign direct investment, and the exchange of ideas, contributing to economic integration on a global scale.

Additional Question Bank

1.1 Introduction

1. Which theory suggests that a country should specialize in producing goods and services in which it has an absolute advantage?
(a) Mercantilism
(b) Comparative advantage
(c) Absolute advantage
(d) Factor proportion theory

2. The theory of comparative advantage was developed by:
(a) David Ricardo
(b) Adam Smith

(c) John Maynard Keynes
(d) Karl Marx

3. According to the theory of comparative advantage, a country should specialize in producing goods and services in which it has a comparative advantage, which means:
(a) It can produce more units of the good with the same amount of resources compared to another country
(b) It can produce the good using fewer resources compared to another country
(c) It has a higher income level than another country
(d) It has a larger population than another country

4. The Heckscher-Ohlin theory suggests that international trade occurs due to differences in:
(a) Government policies and regulations
(b) Technological advancements
(c) Factor endowments (such as labor and capital)
(d) Exchange rates

5. According to the new trade theory, what is the role of economies of scale in international trade?
(a) Economies of scale have no impact on international trade.
(b) Countries with large economies of scale have a comparative advantage in all industries.
(c) Economies of scale allow firms to reduce production costs and gain a competitive advantage in international markets.
(d) Small economies are at a disadvantage in international trade due to the lack of economies of scale.

1.2 Important Theories of International Trade

1. The theory that suggests countries should specialize in producing goods and services in which they have a comparative advantage is known as:
(a) Absolute advantage theory
(b) Mercantilism
(c) Comparative advantage theory
(d) Factor proportion theory

2. The principle of comparative advantage was first proposed by:
(a) Adam Smith
(b) David Ricardo
(c) John Maynard Keynes
(d) Karl Marx

3. According to the theory of absolute advantage, a country should specialize in producing goods in which it can:
(a) Produce the most units of a good with the same amount of resources
(b) Produce the highest-quality goods
(c) Produce goods that are in high demand internationally
(d) Produce goods that have the highest market value

4. The Heckscher-Ohlin theory suggests that international trade occurs due to differences in:
(a) Technology and innovation
(b) Government policies and regulations
(c) Factor endowments (such as labor and capital)
(d) Cultural preferences for certain products

5. The new trade theory emphasizes the role of __________ in explaining international trade patterns.
(a) Factor endowments
(b) Economies of scale
(c) Comparative advantage
(d) Tariffs and trade barriers

1.2.1 The Mercantilists' View of International Trade

1. The Mercantilists believed that the wealth and power of a nation were primarily determined by:
(a) The level of technology and innovation
(b) The size of its population
(c) The amount of gold and silver it possessed
(d) The extent of its agricultural resources

2. According to Mercantilists, a favorable balance of trade can be achieved by:
   (a) Exporting more goods than importing
   (b) Importing more goods than exporting
   (c) Maintaining an equal value of exports and imports
   (d) Eliminating trade with other nations
3. Mercantilists believed that a country should:
   (a) Encourage free trade with other nations
   (b) Focus on producing goods with the highest domestic demand
   (c) Accumulate as much gold and silver as possible through trade
   (d) Import more than it exports to stimulate economic growth
4. Which of the following was a policy measure commonly advocated by Mercantilists to promote exports and discourage imports?
   (a) Imposing tariffs and import restrictions
   (b) Eliminating all taxes and tariffs on trade
   (c) Encouraging foreign investment in domestic industries.
   (d) Signing free trade agreements with other nations
5. The Mercantilists' view of international trade dominated economic thinking during which historical period?
   (a) The late 20th century
   (b) The Renaissance and the early modern period
   (c) The Industrial Revolution
   (d) The post-World War II era

1.2.2 The Theory of Absolute Advantage

1. The theory of absolute advantage was first introduced by:
   (a) Adam Smith
   (b) David Ricardo
   (c) John Maynard Keynes
   (d) Karl Marx
2. According to the theory of absolute advantage, a country should specialize in producing goods or services in which it can:
   (a) Produce the most units of a good with the same amount of resources

   (b) Produce the highest-quality goods or services
   (c) Produce goods or services that have the highest market demand
   (d) Produce goods or services with the highest profit margins
3. The theory of absolute advantage suggests that international trade is beneficial because it allows countries to:
   (a) Import goods and services they cannot produce domestically
   (b) Eliminate competition in the global market
   (c) Increase government revenue through tariffs and trade barriers
   (d) Reduce their dependence on foreign resources
4. According to Adam Smith's absolute advantage theory, trade between two countries can lead to mutual gains as long as:
   (a) One country has an absolute advantage in all goods and services
   (b) Both countries have an absolute advantage in the same goods and services
   (c) Each country has an absolute advantage in different goods and services
   (d) Both countries have an equal level of economic development
5. The theory of absolute advantage is based on the idea that countries should engage in trade to:
   (a) Maximize government revenue
   (b) Achieve a favorable balance of trade
   (c) Promote self-sufficiency and economic isolation
   (d) Benefit from specialization and exchange of goods and services

1.2.3 The Theory of Comparative Advantage

1. The theory of comparative advantage was formulated by:
   (a) Adam Smith
   (b) David Ricardo
   (c) John Maynard Keynes
   (d) Karl Marx
2. According to the theory of comparative advantage, a country should specialize in producing goods or services in which it has a comparative advantage, which means:

(a) It can produce more units of the good with the same amount of resources compared to another country
(b) It can produce the good using fewer resources compared to another country
(c) It has a higher income level than another country
(d) It has a larger population than another country

3. The theory of comparative advantage suggests that international trade is beneficial because it allows countries to:
(a) Eliminate competition in the global market
(b) Increase government revenue through tariffs and trade barriers
(c) Import goods and services they cannot produce efficiently
(d) Reduce their dependence on foreign resources

4. According to the theory of comparative advantage, trade between two countries can lead to mutual gains as long as:
(a) One country has a comparative advantage in all goods and services
(b) Both countries have a comparative advantage in the same goods and services
(c) Each country has a comparative advantage in different goods and services
(d) Both countries have an equal level of economic development

5. The theory of comparative advantage is based on the idea that countries should engage in trade to:
(a) Maximize government revenue
(b) Achieve a favorable balance of trade
(c) Promote self-sufficiency and economic isolation
(d) Benefit from specialization and exchange of goods and services

1.2.4 The Heckscher-Ohlin Theory of Trade

1. The Heckscher-Ohlin theory of trade suggests that international trade occurs due to differences in:
(a) Technology and innovation
(b) Government policies and regulations
(c) Factor endowments (such as labor and capital)
(d) Cultural preferences for certain products

2. According to the Heckscher-Ohlin theory, a country will export goods that use relatively:
(a) Abundant factors of production
(b) Scarce factors of production
(c) Expensive factors of production
(d) Labor-intensive factors of production

3. The Heckscher-Ohlin theory predicts that a labor-abundant country will export goods that are:
(a) Labor-intensive
(b) Capital-intensive
(c) High-tech and innovative
(d) Raw materials and commodities

4. The Heckscher-Ohlin theory suggests that international trade can lead to:
(a) Income equality between countries
(b) Factor price equalization
(c) A decrease in factor mobility
(d) Increased trade barriers and protectionism

5. The Heckscher-Ohlin theory assumes that factors of production are:
(a) Immobile between industries within a country
(b) Perfectly mobile between industries within a country
(c) Mobile between countries but immobile within a country
(d) Immobile between countries and industries

1.2.5 Globalization and New International Trade Theory

1. Globalization refers to the:
(a) Isolation of countries from the global economy
(b) Integration and interdependence of countries in the global economy
(c) Adoption of protectionist trade policies
(d) Establishment of regional trade blocs

2. The new international trade theory emphasizes the role of __________ in explaining trade patterns and advantages:
(a) Comparative advantage
(b) Factor endowments

(c) Economies of scale and product differentiation
(d) Tariffs and trade barriers

3. According to the new trade theory, firms that produce unique products with advanced technology and innovation can gain a competitive advantage due to:
(a) Comparative advantage
(b) Lower production costs
(c) Economies of scale and first-mover advantage
(d) Government subsidies

4. The new international trade theory suggests that free trade can lead to:
(a) Decreased competition and monopolistic behavior
(b) Inefficiency in resource allocation
(c) Stagnation of economic growth
(d) Increased global prosperity through specialization and economies of scale

5. Which of the following is a potential drawback of globalization in terms of income distribution?
(a) Increased income inequality between countries
(b) Decreased income inequality within countries
(c) A shift in manufacturing jobs from developed to developing countries
(d) The equal distribution of wealth among all countries

Answer

1.1 Introduction

1. (c) Absolute advantage
2. (a) David Ricardo
3. (b) It can produce the good using fewer resources compared to another country
4. (c) Factor endowments (such as labor and capital)
5. (c) Economies of scale allow firms to reduce production costs and gain a competitive advantage in international markets.

1.2 Important Theories of International Trade

1. (c) Comparative advantage theory
2. (b) David Ricardo
3. (a) Produce the most units of a good with the same amount of resources
4. (c) Factor endowments (such as labor and capital)
5. (b) Economies of scale

1.2.1 The Mercantilists' View of International Trade

1. (c) The amount of gold and silver it possessed
2. (a) Exporting more goods than importing
3. (c) Accumulate as much gold and silver as possible through trade
4. (a) Imposing tariffs and import restrictions
5. (b) The Renaissance and the early modern period

1.2.2 The Theory of Absolute Advantage

1. (a) Adam Smith
2. (a) Produce the most units of a good with the same amount of resources
3. (a) Import goods and services they cannot produce domestically
4. (c) Each country has an absolute advantage in different goods and services
5. (d) Benefit from specialization and exchange of goods and services

1.2.3 The Theory of Comparative Advantage

1. (b) David Ricardo
2. (b) It can produce the good using fewer resources compared to another country
3. (c) Import goods and services they cannot produce efficiently
4. (c) Each country has a comparative advantage in different goods and services
5. (d) Benefit from specialization and exchange of goods and services

1.2.4 The Heckscher-Ohlin Theory of Trade

1. (c) Factor endowments (such as labor and capital)
2. (a) Abundant factors of production
3. (a) Labor-intensive
4. (b) Factor price equalization
5. (b) Perfectly mobile between industries within a country

1.2.5 Globalization and New International Trade Theory

1. (b) Integration and interdependence of countries in the global economy
2. (c) Economies of scale and product differentiation
3. (c) Economies of scale and first-mover advantage
4. (d) Increased global prosperity through specialization and economies of scale
5. (c) A shift in manufacturing jobs from developed to developing countries

9 INTERNATIONAL TRADE

Unit:2 The Instruments of Trade Policy

Multiple Choice Questions

1.1 Introduction

1. Which of the following is an example of a tariff as an instrument of trade policy?
   (a) Government subsidies to promote exports.
   (b) Imposing a limit on the quantity of imports.
   (c) Placing a tax on imported goods.
   (d) Establishing preferential trade agreements with partner countries.
   Answer:
   (c) Placing a tax on imported goods.
   Explanation:
   Tariffs are taxes imposed on imported goods when they enter a country. They are used as an instrument of trade policy to make imported goods relatively more expensive compared to domestically produced goods, providing protection to domestic industries.
2. The purpose of imposing import quotas as an instrument of trade policy is to:
   (a) Generate revenue for the government.
   (b) Reduce the trade deficit and promote exports.
   (c) Encourage competition among domestic producers.
   (d) Restrict the quantity of imports entering the country.
   Answer:
   (d) Restrict the quantity of imports entering the country.
   Explanation: Import quotas are used as an instrument of trade policy to restrict the quantity of imports entering a country. By limiting the amount of foreign goods that can be imported, quotas aim to protect domestic industries and preserve jobs.

3. Which of the following is an example of a non-tariff barrier to trade?
   (a) Import quotas.
   (b) Export subsidies.
   (c) Free trade agreements.
   (d) Preferential trade arrangements.

   Answer:

   (a) Import quotas.

   Explanation:

   Import quotas are a non-tariff barrier to trade. They limit the quantity of imports that can enter a country, effectively restricting trade and protecting domestic industries.

4. An export subsidy is an instrument of trade policy that:
   (a) Reduces the cost of imported goods for consumers.
   (b) Provides financial incentives to domestic producers for exporting.
   (c) Limits the quantity of goods that can be exported.
   (d) Reduces taxes on imported goods to promote exports.

   Answer:

   (b) Provides financial incentives to domestic producers for exporting.

   Explanation:

   An export subsidy is a financial incentive provided by the government to domestic producers to encourage them to export their goods. It aims to make exported goods more competitive in international markets by offsetting production and transportation costs.

5. Which of the following trade policy instruments is aimed at promoting free trade and reducing barriers to international commerce?
   (a) Export subsidies. (b) Import quotas.
   (c) Preferential trade agreements. (d) Dumping duties.

   Answer:

   (c) Preferential trade agreements.

   Explanation:

   Preferential trade agreements are aimed at promoting free trade between specific partner countries by reducing or eliminating tariffs and other trade barriers on certain goods. They facilitate closer economic integration and cooperation among member countries.

6. Tariffs are a form of trade policy that involves:
   (a) Providing subsidies to domestic industries to promote exports.
   (b) Placing a tax on imported goods to raise their prices.
   (c) Setting a maximum limit on the quantity of imports allowed.
   (d) Facilitating the free flow of goods and services across borders.

   Answer:

   (b) Placing a tax on imported goods to raise their prices.

   Explanation:

   Tariffs are taxes imposed by the government on imported goods. The purpose of tariffs is to raise the prices of imported goods, making them less competitive in the domestic market compared to locally produced goods.

7. Quotas are a trade policy instrument that involves:
   (a) Providing financial assistance to domestic exporters.
   (b) Imposing a tax on exports to discourage foreign buyers.
   (c) Setting a maximum limit on the quantity of imports allowed.
   (d) Removing all restrictions on the quantity of imports.

   Answer:

   (c) Setting a maximum limit on the quantity of imports allowed.

   Explanation:

   Quotas are restrictions imposed by the government on the quantity of specific goods that can be imported. This limit is usually expressed in physical units (e.g., tons, units) or as a percentage of the domestic market demand.

8. Export subsidies are a trade policy tool that is intended to:
   (a) Encourage domestic consumption of imported goods.
   (b) Raise revenue for the government from foreign buyers.
   (c) Discourage domestic production and protect local industries.
   (d) Provide financial assistance to domestic exporters.

   Answer:

   (d) Provide financial assistance to domestic exporters.

Explanation:
Export subsidies are financial incentives given by the government to domestic exporters to promote the sale of their goods and services in foreign markets. These subsidies can take the form of direct payments, tax breaks, or grants.

9. Voluntary Export Restraints (VERs) are a trade policy measure in which:
   (a) Governments impose restrictions on the quantity of imports from specific countries.
   (b) Exporting countries voluntarily limit the quantity of their exports to a foreign country.
   (c) Domestic industries impose tariffs on imported inputs to protect local suppliers.
   (d) Governments impose quotas on both imports and exports to maintain trade balance.

   Answer:
   (b) Exporting countries voluntarily limit the quantity of their exports to a foreign country.

   Explanation:
   Voluntary Export Restraints (VERs) occur when exporting countries voluntarily limit the quantity of their exports to a specific foreign country, usually in response to trade negotiations or pressure from the importing country.

10. Dumping is a trade policy practice where a foreign company:
   (a) Sells goods in the domestic market at prices lower than the production cost.
   (b) Imports goods in large quantities to gain a competitive advantage.
   (c) Reduces the quality of exported goods to increase profits.
   (d) Colludes with domestic producers to control prices in the market.

   Answer:
   (a) Sells goods in the domestic market at prices lower than the production cost.

Explanation:
Dumping is a trade policy practice where a foreign company sells goods in the domestic market of another country at prices that are below the production cost or the price in the exporting country. This practice can be considered unfair and can harm domestic industries.

1.2 Tariffs

1. What are tariffs in the context of trade policy?
   (a) Subsidies provided to domestic industries for exports.
   (b) Restrictions on the import of certain goods to protect domestic industries.
   (c) Trade agreements between countries to promote free trade.
   (d) Financial incentives offered to foreign companies to invest in the domestic market.

   Answer:
   (b) Restrictions on the import of certain goods to protect domestic industries.

   Explanation:
   Tariffs are taxes or duties imposed on imported goods, making them more expensive for domestic consumers and businesses. The purpose of tariffs is to restrict the import of certain goods and protect domestic industries from foreign competition.

2. The main objective of implementing tariffs is to:
   (a) Encourage free trade and promote global economic integration.
   (b) Increase government revenue through import taxes.
   (c) Improve the efficiency of domestic industries.
   (d) Limit the export of certain goods to other countries.

   Answer:
   (b) Increase government revenue through import taxes.

   Explanation:
   One of the main objectives of implementing tariffs is to increase government revenue through import taxes. Tariffs are a source of income for the government, as they impose taxes on imported goods entering the country.

3. Ad valorem tariffs are calculated based on:
   (a) The quantity of imported goods.
   (b) The weight of imported goods.
   (c) The value or price of imported goods.
   (d) The environmental impact of imported goods.

   Answer:
   (c) The value or price of imported goods.

   Explanation:
   Ad valorem tariffs are calculated based on the value or price of imported goods. They are usually expressed as a percentage of the goods' value.

4. Specific tariffs are calculated based on:
   (a) The quantity of imported goods.
   (b) The weight of imported goods.
   (c) The value or price of imported goods.
   (d) The environmental impact of imported goods.

   Answer:
   (b) The weight of imported goods.

   Explanation:
   Specific tariffs are calculated based on the weight of imported goods. They are usually expressed as a fixed amount per unit of weight.

5. The imposition of tariffs can lead to:
   (a) Lower consumer prices for imported goods.
   (b) Increased domestic consumption of imported goods.
   (c) A decrease in domestic production and employment in import-competing industries.
   (d) Enhanced global economic integration and international cooperation.

   Answer:
   (c) A decrease in domestic production and employment in import-competing industries.

   Explanation:
   The imposition of tariffs can lead to a decrease in domestic production and employment in import-competing industries. When tariffs make imported goods more expensive, domestic consumers may shift their preferences towards cheaper imported goods, causing a decline in demand for domestic products.

As an AI language model, I don't have access to a specific database of MCQs with Explanations. However, I can provide you with some sample multiple-choice questions related to tariffs as instruments of trade policy, along with explanations:

6. A tariff is a:
   (a) Payment made by the government to domestic producers to boost exports.
   (b) Tax levied on imports, increasing their cost to the importing country.
   (c) Subsidy provided by the government to foreign producers to promote imports.
   (d) Price control mechanism used to stabilize domestic market prices.

   Answer:
   (b) Tax levied on imports, increasing their cost to the importing country.

   Explanation:
   A tariff is a tax imposed by the government on imported goods. It increases the cost of imports, making them more expensive to the importing country and providing a competitive advantage to domestic producers.

7. The primary purpose of imposing tariffs is to:
   (a) Encourage international cooperation and free trade.
   (b) Increase government revenue through import taxes.
   (c) Promote fair competition and protect domestic industries.
   (d) Discourage domestic consumption of certain goods.

   Answer:
   (c) Promote fair competition and protect domestic industries.

   Explanation:
   The primary purpose of imposing tariffs is to protect domestic industries from foreign competition and promote fair competition. By imposing tariffs on imports, the government makes foreign goods more expensive, giving domestic producers a competitive advantage in the domestic market.

8. Specific tariffs are levied as a:
   (a) Fixed amount per unit of imported goods.
   (b) Percentage of the value of imported goods.

(c) Payment made by the exporting country to the importing country.
(d) Subsidy provided by the exporting country to domestic producers.

Answer:

(a) Fixed amount per unit of imported goods.

Explanation:

Specific tariffs are levied as a fixed amount per unit of imported goods. For example, a specific tariff of $10 per unit would impose an additional $10 tax on each unit of the imported goods, regardless of its value.

9. Ad valorem tariffs are levied as a:
(a) Fixed amount per unit of imported goods.
(b) Percentage of the value of imported goods.
(c) Payment made by the exporting country to the importing country.
(d) Subsidy provided by the exporting country to domestic producers.

Answer:

(b) Percentage of the value of imported goods.

Explanation:

Ad valorem tariffs are levied as a percentage of the value of imported goods. For example, an ad valorem tariff of 10% would impose an additional 10% tax on the value of the imported goods.

10. Which of the following is a potential negative consequence of imposing tariffs?
(a) Encouraging domestic industries to become more competitive and efficient.
(b) Increasing government revenue through import taxes.
(c) Raising the cost of living for consumers due to higher prices on imported goods.
(d) Promoting international cooperation and free trade.

Answer:

(c) Raising the cost of living for consumers due to higher prices on imported goods.

Explanation:

One of the potential negative consequences of imposing tariffs is that it raises the cost of living for consumers in the importing country. Higher tariffs lead to higher prices on imported goods, which can result in increased costs for consumers.

1.2.1 Forms of Import Tariffs

1. Ad valorem tariffs are expressed as a percentage of the:
(a) Importing country's GDP.
(b) Value of the imported goods.
(c) Number of units of the imported goods.
(d) Exporting country's currency value.

Answer:

(b) Value of the imported goods.

Explanation:

Ad valorem tariffs are expressed as a percentage of the value of the imported goods. For example, if the ad valorem tariff rate is 10%, it means that the tariff amount will be 10% of the value of the imported goods.

2. Specific tariffs are imposed as a fixed amount per:
(a) Unit of the imported goods.
(b) Unit of the exporting country's currency.
(c) Unit of the importing country's GDP.
(d) Unit of the exporting country's GDP.

Answer:

(a) Unit of the imported goods.

Explanation:

Specific tariffs are imposed as a fixed amount per unit of the imported goods. For example, if the specific tariff is $5 per unit, it means that the tariff amount will be $5 for each unit of the imported goods.

3. Compound tariffs are a combination of:
(a) Specific tariffs and import quotas.
(b) Ad valorem tariffs and export subsidies.
(c) Ad valorem tariffs and specific tariffs.
(d) Import quotas and export quotas.

Answer:

(c) Ad valorem tariffs and specific tariffs.

Explanation:

Compound tariffs are a combination of ad valorem tariffs and specific tariffs. The tariff rate may include both a percentage of the value of the imported goods (ad valorem) and a fixed amount per unit of the imported goods (specifi(c).

4. Which of the following is an example of a revenue tariff?
   (a) A tariff imposed to protect domestic industries from foreign competition.
   (b) A tariff imposed to discourage the consumption of specific goods.
   (c) A tariff imposed to generate government revenue from imports.
   (d) A tariff imposed by an exporting country on its own goods.

   Answer:

   (c) A tariff imposed to generate government revenue from imports.

   Explanation:

   A revenue tariff is a tariff imposed by the government on imports with the primary purpose of generating government revenue. It is not specifically aimed at protecting domestic industries or discouraging the consumption of specific goods.

5. Which type of import tariff involves reducing the tariff rate as the volume of imports increases?
   (a) Compound tariff
   (b) Specific tariff
   (c) Ad valorem tariff
   (d) Sliding-scale tariff

   Answer:

   (d) Sliding-scale tariff

   Explanation:

   A sliding-scale tariff involves reducing the tariff rate as the volume of imports increases. It is a form of ad valorem tariff that adjusts the tariff rate based on the quantity or value of imports.

(i) Specific Tariff:

1. What is a specific tariff?
   (a) A tax levied on imports that is calculated as a percentage of the value of the imported goods.
   (b) A tax levied on exports by the exporting country.
   (c) A tax levied on imports that is a fixed amount per unit of the imported goods.
   (d) A tax levied on the income of domestic producers.

   Answer:

   (c) A tax levied on imports that is a fixed amount per unit of the imported goods.

   Explanation:

   A specific tariff is a type of import tariff that is imposed as a fixed amount per unit of the imported goods. It is not dependent on the value of the goods but is a specific amount charged for each unit imported. For example, if the specific tariff rate is $5 per unit, then $5 will be levied on each unit of the imported goods, regardless of their value. This is in contrast to an ad valorem tariff, which is calculated as a percentage of the value of the imported goods. Specific tariffs are used by governments to generate revenue and protect domestic industries from foreign competition.

2. A specific tariff is a type of import tariff that is imposed as a:
   (a) Fixed amount per unit of the exported goods.
   (b) Fixed amount per unit of the imported goods.
   (c) Percentage of the value of the exported goods.
   (d) Percentage of the value of the imported goods.

   Answer:

   (b) Fixed amount per unit of the imported goods.

   Explanation:

   A specific tariff is a type of import tariff that is imposed as a fixed amount per unit of the imported goods. This means that for each unit of the imported product, a specific amount of tariff is charged, regardless of the value of the goods. For example, if the specific tariff is $5 per unit and a country imports 100 units of a particular good, the total tariff payable will be $5 x 100 units = $500.

3. A specific tariff is a type of import tariff that is:
   (a) Imposed as a fixed amount per unit of the imported goods.
   (b) Expressed as a percentage of the value of the exported goods.
   (c) A payment made by the importing country to the exporting country.
   (d) Applied to all goods uniformly, regardless of their origin.

   Answer:
   (a) Imposed as a fixed amount per unit of the imported goods.

   Explanation:
   A specific tariff is a type of import tariff that is imposed as a fixed amount per unit of the imported goods. It means that a predetermined amount of money is charged on each unit of the imported goods, irrespective of its value. Specific tariffs do not depend on the price of the imported goods but rather on the quantity or number of units imported.
   For example, if a country imposes a specific tariff of $5 per unit on imported shoes, every pair of shoes imported into the country will be subject to a $5 tariff, regardless of the shoes' retail price or brand.

(ii) Ad valorem tariff

1. An ad valorem tariff is a type of import tariff that is:
   (a) Imposed as a fixed amount per unit of the imported goods.
   (b) Expressed as a percentage of the value of the imported goods.
   (c) A payment made by the exporting country to the importing country.
   (d) Applied to all goods uniformly, regardless of their origin.

   Answer:
   (b) Expressed as a percentage of the value of the imported goods.

   Explanation:
   An ad valorem tariff is a type of import tariff that is expressed as a percentage of the value of the imported goods. It means that a certain percentage of the value of each unit of the imported goods is charged as a tariff when they enter the importing country.

   For example, if a country imposes an ad valorem tariff of 10% on imported cars, it means that 10% of the value of each car imported will be charged as a tariff. If the value of an imported car is $20,000, the ad valorem tariff would be $2,000 (10% of $20,000).
   Ad valorem tariffs are different from specific tariffs, which are imposed as a fixed amount per unit of the imported goods, regardless of their value.

1.2.2 Effects of Tariffs

1. What is the effect of tariffs on domestic producers?
   (a) Encourages competition
   (b) Decreases efficiency
   (c) Increases efficiency
   (d) None of the above

   Answer:
   (c) Increases efficiency

   Explanation:
   Tariffs increase the price of imported goods, making domestic products more competitive. This can lead to an increase in demand for domestic products, which in turn can increase efficiency and productivity of domestic producers.

2. What is the effect of tariffs on consumers?
   (a) Decreases the price of imported goods
   (b) Increases the price of imported goods
   (c) Does not affect the price of imported goods
   (d) None of the above

   Answer:
   (b) Increases the price of imported goods

   Explanation:
   Tariffs increase the price of imported goods, making them more expensive for consumers to purchase. This can lead to a decrease in demand for imported goods and an increase in demand for domestic products.

3. What is the effect of tariffs on international trade?
   (a) Encourages free trade
   (b) Decreases imports
   (c) Increases exports
   (d) None of the above

   Answer:
   (b) Decreases imports

   Explanation:
   Tariffs make imported goods more expensive, which can discourage imports and lead to a decrease in international trade. This can lead to trade tensions between countries and potentially result in retaliatory tariffs being implemented.

4. What is the effect of tariffs on government revenue?
   (a) Decreases government revenue
   (b) Increases government revenue
   (c) Has no effect on government revenue
   (d) None of the above

   Answer:
   (b) Increases government revenue

   Explanation:
   Tariffs are a form of tax on imported goods, which generates revenue for the government. This revenue can be used to fund various government programs and initiatives. However, excessive tariffs can lead to a decrease in international trade, which can negatively impact economic growth and development.

1.3 Non–Tariff Measures (NTMS)

1. What are Non-tariff measures (NTMs)?
   (a) Barriers to trade
   (b) Taxes on international trade
   (c) Regulations on international trade
   (d) None of the above

   Answer:
   (c) Regulations on international trade

   Explanation:
   Non-tariff measures (NTMs) refer to a wide range of regulations and policies that can act as barriers to trade. These can include sanitary and phytosanitary regulations, technical standards, and licensing requirements, among others.

2. What is the purpose of non-tariff measures (NTMs)?
   (a) To increase competition
   (b) To decrease competition
   (c) To protect domestic industries
   (d) None of the above

   Answer:
   (c) To protect domestic industries

   Explanation:
   The purpose of non-tariff measures (NTMs) is to protect domestic industries and ensure that they are not adversely affected by international trade. These measures can be used to address issues such as quality and safety standards, environmental protection, and consumer protection.

3. What are some examples of non-tariff measures (NTMs)?
   (a) Quotas
   (b) Licenses
   (c) Quality standards
   (d) All of the above

   Answer:
   (d) All of the above

   Explanation:
   Examples of non-tariff measures (NTMs) include quotas, licensing requirements, quality standards, safety regulations, technical barriers to trade, and environmental regulations, among others.

4. What is the effect of non-tariff measures (NTMs) on international trade?
   (a) Encourages free trade
   (b) Increases imports
   (c) Decreases exports
   (d) Can either increase or decrease imports and exports depending on the specific measure

   Answer:
   (d) Can either increase or decrease imports and exports depending on the specific measure

Explanation:
The effect of non-tariff measures (NTMs) on international trade can vary depending on the specific measure. Some measures may increase imports or exports by ensuring product quality or safety, while others may restrict trade by imposing additional requirements or barriers.

5. What are non-tariff measures (NTMs)?
   (a) Taxes on imported goods
   (b) Regulations, standards, and procedures that impact trade
   (c) Trade agreements between countries
   (d) None of the above

   Answer:
   (b) Regulations, standards, and procedures that impact trade

   Explanation:
   Non-tariff measures (NTMs) refer to a variety of regulations, standards, and procedures that trade partners use to manage their trade relationships. These measures can include product standards, licensing requirements, and restrictions on imports.

6. What is the effect of NTMs on trade?
   (a) Increases trade barriers
   (b) Encourages free trade
   (c) Has no effect on trade
   (d) None of the above

   Answer:
   (a) Increases trade barriers

   Explanation:
   Non-tariff measures can increase trade barriers between countries. They can make it more difficult for companies to export goods and gain access to foreign markets, which can limit the amount of trade that takes place.

7. Why do countries use NTMs?
   (a) To protect domestic industries
   (b) To promote free trade
   (c) To improve product quality and safety
   (d) None of the above

   Answer:
   (c) To improve product quality and safety

   Explanation:
   Non-tariff measures can be used by countries to improve the quality and safety of imported goods. They can also be used to protect domestic industries and promote fair competition among trading partners.

8. What are some examples of NTMs?
   (a) Tariffs and quotas
   (b) Export restrictions and subsidies
   (c) Product standards and labeling requirements
   (d) None of the above

   Answer:
   (c) Product standards and labeling requirements

   Explanation:
   Non-tariff measures can include a wide range of regulations, such as product standards, labeling requirements, and licensing procedures. These measures are designed to protect consumers and ensure that products meet certain quality and safety standards.

I. Technical Measures:

1. What are technical measures in international trade?
   (a) Regulations related to the technical aspects of products
   (b) Import taxes on technical products
   (c) Technical agreements between trading partners
   (d) None of the above

   Answer:
   (a) Regulations related to the technical aspects of products

   Explanation:
   Technical measures refer to regulations that govern the technical aspects of products, such as their composition, safety, and performance. These measures are designed to protect consumers and ensure that products meet certain quality and safety standards.

2. Why are technical measures used in trade?
   (a) To limit the import of particular products
   (b) To ensure that imported products meet local standards
   (c) To reduce competition from foreign products
   (d) None of the above

Answer:
(b) To ensure that imported products meet local standards
Explanation:
Technical measures are designed to ensure that products imported from foreign countries meet local standards for safety and quality. They are not intended to limit the import of specific products or reduce competition from foreign goods.

3. What are some examples of technical measures?
(a) Product labeling and packaging requirements
(b) Safety and environmental standards
(c) Chemical content and composition restrictions
(d) All of the above
Answer:
(d) All of the above
Explanation:
Technical measures can include a wide range of regulations, such as product labeling and packaging requirements, safety and environmental standards, and restrictions on the chemical content and composition of products.

4. What is the impact of technical measures on trade?
(a) Increases competition from foreign products
(b) Reduces competition from foreign products
(c) Has no impact on competition from foreign products
(d) None of the above
Answer:
(b) Reduces competition from foreign products
Explanation:
Technical measures can reduce competition from foreign products, as they can make it more difficult for foreign companies to meet certain technical standards and gain access to local markets. This can benefit domestic industries, but it can also limit consumer choice and increase prices for certain products.

II. Non-technical Measures:

1. What are non-technical measures in international trade?
(a) Regulations related to the technical aspects of products
(b) Regulations not directly related to the technical aspects of products
(c) Import taxes on non-technical products
(d) None of the above
Answer:
(b) Regulations not directly related to the technical aspects of products
Explanation:
Non-technical measures refer to regulations that are not directly related to the technical aspects of products, such as regulations related to market access, procurement, and investment.

2. Why are non-technical measures used in trade?
(a) To limit the import of particular products
(b) To promote free and fair trade
(c) To reduce competition from foreign products
(d) None of the above
Answer:
(b) To promote free and fair trade
Explanation:
Non-technical measures are designed to promote free and fair trade between countries. They can help to ensure that companies have equal access to foreign markets, and they can promote competition and innovation in industries.

3. What are some examples of non-technical measures?
(a) Licensing requirements for foreign companies
(b) Government procurement policies
(c) Investment restrictions
(d) All of the above
Answer:
(d) All of the above

Explanation:
Non-technical measures can include a wide range of regulations, such as licensing requirements for foreign companies, government procurement policies, and investment restrictions.

4. What is the impact of non-technical measures on trade?
   (a) Increases competition from foreign products
   (b) Reduces competition from foreign products
   (c) Has no impact on competition from foreign products
   (d) Depends on the specific regulation

   Answer:
   (d) Depends on the specific regulation

   Explanation:
   The impact of non-technical measures on trade can vary depending on the specific regulation in question. Some measures may restrict competition from foreign products, while others may promote free and fair trade between countries.

1.3.1 Technical Measures

1. Which of the following is an example of a technical measure in international trade?
   (a) Import quotas on foreign cars
   (b) Requirements for product safety labeling
   (c) Tariffs on textiles from foreign countries
   (d) Subsidies for domestic agricultural producers

   Answer:
   (b) Requirements for product safety labeling

   Explanation:
   A technical measure is a regulation that governs the technical aspects of products, such as safety and performance. Requirements for product safety labeling are an example of a technical measure as they are designed to protect consumers and ensure that products meet certain quality and safety standards.

2. What is the purpose of technical measures in international trade?
   (a) To limit the import of foreign products
   (b) To ensure that imported products meet local standards
   (c) To promote fair competition between countries
   (d) None of the above

   Answer:
   (b) To ensure that imported products meet local standards

   Explanation:
   Technical measures are designed to ensure that products imported from foreign countries meet local standards for safety and quality. Their purpose is not to limit the import of specific products or to promote competition.

3. Which of the following is an example of a technical measure related to environmental standards?
   (a) Restrictions on the use of hazardous chemicals in manufacturing
   (b) Requirements for product labeling and packaging
   (c) Quotas on the import of foreign textiles
   (d) Subsidies for domestic energy producers

   Answer:
   (a) Restrictions on the use of hazardous chemicals in manufacturing

   Explanation:
   Technical measures related to environmental standards can include restrictions on the use of hazardous chemicals in manufacturing, which are designed to protect the environment and ensure that products meet certain safety standards.

4. How can technical measures impact trade between countries?
   (a) They can increase competition from foreign products
   (b) They can reduce competition from foreign products
   (c) They can have no impact on competition from foreign products
   (d) It depends on the specific technical measure

   Answer:
   (b) They can reduce competition from foreign products

Explanation:
Technical measures can make it more difficult for foreign companies to meet certain technical standards and gain access to local markets, which can reduce competition from foreign products. However, they can also benefit domestic industries by ensuring that imported products meet local standards for safety and quality.

I Sanitary and Phytosanitary (SPS) Measures:

1. What are Sanitary and Phytosanitary (SPS) measures?
   (a) Technical measures related to environmental standards
   (b) Regulations related to the technical aspects of products
   (c) Regulations related to the health and safety of humans, animals, and plants
   (d) None of the above
   Answer:
   (c) Regulations related to the health and safety of humans, animals, and plants
   Explanation:
   Sanitary and Phytosanitary (SPS) measures are regulations related to the health and safety of humans, animals, and plants. They are designed to protect against the spread of diseases and pests in the movement of food and agricultural products across international borders.
2. What is the purpose of SPS measures?
   (a) To reduce competition from foreign products
   (b) To increase the import of foreign products
   (c) To protect human, animal, and plant health
   (d) None of the above
   Answer:
   (c) To protect human, animal, and plant health
   Explanation:
   SPS measures are designed to protect against risks to human, animal, and plant health that may arise from the movement of food and agricultural products across international borders. Their purpose is to ensure that products meet certain health and safety standards, not to limit the import or promotion of competition.

3. Which of the following is an example of an SPS measure?
   (a) A restriction on the import of foreign textiles to protect domestic textile manufacturers
   (b) A requirement for imported fruits to be free from a certain pest
   (c) A tax on foreign imports of cars to promote the domestic auto industry
   (d) None of the above
   Answer:
   (b) A requirement for imported fruits to be free from a certain pest
   Explanation:
   SPS measures can include requirements for imported products to meet certain health and safety standards, such as being free from certain pests or diseases. They are not designed to promote domestic industries or limit the import of certain products.
4. How can SPS measures impact trade between countries?
   (a) They can reduce competition from foreign products
   (b) They can increase competition from foreign products
   (c) They can have no impact on competition from foreign products
   (d) It depends on the specific SPS measure
   Answer:
   (d) It depends on the specific SPS measure
   Explanation:
   The impact of SPS measures on trade between countries can vary depending on the specific measure in question. Some measures may restrict competition from foreign products, while others may promote free and fair trade between countries by ensuring that products meet certain health and safety standards.

II Technical Barriers To Trade (TBT)

1. What are Technical Barriers to Trade (TBT)?
   (a) Regulations related to the health and safety of humans, animals, and plants
   (b) Regulations related to the technical aspects of products
   (c) Regulations related to the environmental standards
   (d) None of the above

Answer:

(b) Regulations related to the technical aspects of products

Explanation:

Technical Barriers to Trade (TBT) are regulations or standards that relate to the technical aspects of products, such as quality, safety, and labeling requirements. They can include specifications on product performance, packaging, testing methods, and certification procedures.

2. What is the purpose of Technical Barriers to Trade?
   (a) To restrict or limit importation of certain products
   (b) To promote fair competition between countries
   (c) To ensure that imported products meet local technical standards
   (d) All of the above

Answer:

(d) All of the above

Explanation:

The purpose of Technical Barriers to Trade can vary depending on the specific regulation or standard. They can be used to restrict or limit imports of certain products, to promote fair competition between countries, and to ensure that imported products meet local technical standards for quality, safety, and other requirements.

3. Which of the following is an example of a Technical Barrier to Trade?
   (a) Import quotas on foreign textiles
   (b) Requirements for labeling and packaging of pharmaceutical products
   (c) Tariffs on imported steel
   (d) Subsidies for domestic manufacturers

Answer:

(b) Requirements for labeling and packaging of pharmaceutical products

Explanation:

Requirements for labeling and packaging of pharmaceutical products are an example of a Technical Barrier to Trade. They are regulations that relate to the technical aspects of the product (labeling and packaging) and are designed to ensure that imported pharmaceutical products meet local standards and requirements.

4. How can Technical Barriers to Trade impact trade between countries?
   (a) They can increase competition from foreign products
   (b) They can reduce competition from foreign products
   (c) They can have no impact on competition from foreign products
   (d) It depends on the specific Technical Barrier to Trade

Answer:

(b) They can reduce competition from foreign products

Explanation:

Technical Barriers to Trade can create additional requirements and standards that foreign products must meet in order to be sold in a particular market. This can make it more difficult for foreign companies to compete and can reduce competition from foreign products. However, their impact can vary depending on the specific Technical Barrier to Trade.

1.3.2 Non-technical Measures

1. What are non-technical measures in trade?
   (a) Regulations related to the technical aspects of products
   (b) Regulations related to the health and safety of humans, animals, and plants
   (c) Regulations related to non-tariff barriers, such as quotas and subsidies
   (d) None of the above

Answer:

(c) Regulations related to non-tariff barriers, such as quotas and subsidies

Explanation:

Non-technical measures in trade refer to regulations that are not directly related to the technical aspects of products. They include non-tariff barriers, such as quotas, subsidies, import licensing, and product testing requirements.

2. What is the purpose of non-technical measures?
(a) To promote fair competition between countries
(b) To restrict or limit importation of certain products
(c) To ensure that imported products meet safety and quality standards
(d) All of the above

Answer:
(d) All of the above

Explanation:
Non-technical measures can serve multiple purposes. They can be used to promote fair competition between countries, restrict or limit importation of certain products, and ensure that imported products meet safety and quality standards. The specific purpose may vary depending on the regulation or measure in question.

3. Which of the following is an example of a non-technical measure?
(a) Requirements for product labeling
(b) Import quotas
(c) Product testing requirements
(d) All of the above

Answer:
(d) All of the above

Explanation:
Examples of non-technical measures include requirements for product labeling, import quotas, and product testing requirements. These measures are usually imposed to control or regulate the importation of certain products and can affect trade between countries.

4. How can non-technical measures impact trade between countries?
(a) They can reduce competition from foreign products
(b) They can increase competition from foreign products
(c) They can have no impact on competition from foreign products
(d) It depends on the specific non-technical measure

Answer:
(a) They can reduce competition from foreign products

Explanation:
Non-technical measures, such as import quotas or subsidies, can create barriers for foreign products, reducing competition from these products. They can make it more difficult for foreign companies to access a particular market and can impact trade by limiting the importation of certain products. However, the impact can vary depending on the specific non-technical measure in question.

(i) Import Quotas:

1. What is an import quota?
(a) A tax imposed on imported goods
(b) A limit on the quantity of a particular product that can be imported
(c) A requirement to label imported products
(d) None of the above

Answer:
(b) A limit on the quantity of a particular product that can be imported

Explanation:
An import quota is a limit on the quantity of a particular product that can be imported into a country. This limit is often imposed by governments to control the amount of foreign products entering its market.

2. What is the purpose of import quotas?
(a) To promote fair competition between countries
(b) To restrict or limit importation of certain products
(c) To ensure that imported products meet safety and quality standards
(d) None of the above

Answer:
(b) To restrict or limit importation of certain products

Explanation:
The purpose of import quotas is often to restrict or limit the importation of certain products into a country. This can be done to protect domestic industries, promote local economic development, or control market competition.

3. How can import quotas impact trade between countries?
   (a) They can reduce competition from foreign products
   (b) They can increase competition from foreign products
   (c) They can have no impact on competition from foreign products
   (d) It depends on the specific import quota

   Answer:

   (a) They can reduce competition from foreign products

   Explanation:

   Import quotas can limit the quantity of foreign products that can enter a market, reducing competition from foreign products. This can make it more difficult for foreign companies to access a particular market and can have an impact on trade by limiting the importation of certain products.

4. Can import quotas be challenged under international trade rules?
   (a) Yes, they can be challenged under the rules set by the World Trade Organization (WTO)
   (b) No, import quotas cannot be challenged under international trade rules
   (c) It depends on the specific country and their trade agreements

   Answer:

   (a) Yes, they can be challenged under the rules set by the World Trade Organization (WTO)

   Explanation:

   Import quotas can be challenged under international trade rules set by the World Trade Organization (WTO), which prohibits discriminatory and protectionist trade measures. However, the specific rules and regulations depend on the country and their trade agreements.

(ii) Price Control Measures:

1. What are price control measures in trade?
   (a) Regulations that control the quality and safety of products
   (b) Regulations that control the prices of goods and services
   (c) Regulations that control the quantity of imports and exports
   (d) None of the above

   Answer:

   (b) Regulations that control the prices of goods and services

   Explanation:

   Price control measures are regulations that control the prices of goods and services, often imposed by governments to protect consumers or control inflation.

2. What is the purpose of price control measures?
   (a) To promote fair competition between countries
   (b) To restrict or limit importation of certain products
   (c) To ensure that imported products meet safety and quality standards
   (d) To protect consumers from unfairly high prices

   Answer:

   (d) To protect consumers from unfairly high prices

   Explanation:

   The purpose of price control measures is to protect consumers from unfairly high prices, control inflation, or ensure that essential goods and services remain affordable.

3. How can price control measures impact trade between countries?
   (a) They can reduce competition from foreign products
   (b) They can increase competition from foreign products
   (c) They can have no impact on competition from foreign products
   (d) It depends on the specific price control measure

   Answer:

   (a) They can reduce competition from foreign products

   Explanation:

   Price control measures can make it difficult for foreign products to compete in a particular market, reducing competition from these products. They can also make it more difficult for foreign companies to access a particular market if the price controls limit the profitability of their products.

4. Can price control measures be challenged under international trade rules?
   (a) Yes, they can be challenged under the rules set by the World Trade Organization (WTO)
   (b) No, price control measures cannot be challenged under international trade rules
   (c) It depends on the specific country and their trade agreements

   Answer:

   (a) Yes, they can be challenged under the rules set by the World Trade Organization (WTO)

   Explanation:

   Price control measures can be challenged under international trade rules set by the World Trade Organization (WTO), which prohibits discriminatory and protectionist trade measures. However, the specific rules and regulations depend on the country and their trade agreements.

(iii) Non-automatic Licensing and Prohibitions:

1. What are non-automatic licensing and prohibitions in trade?
   (a) Regulations that control the quality and safety of products
   (b) Regulations that require special licenses for certain imported goods
   (c) Regulations that restrict or prohibit the import or export of certain products
   (d) None of the above

   Answer:

   (c) Regulations that restrict or prohibit the import or export of certain products

   Explanation:

   Non-automatic licensing and prohibitions refer to regulations that restrict or prohibit the import or export of certain products. These regulations often require special licenses for the import or export of these products.

2. What is the purpose of non-automatic licensing and prohibitions?
   (a) To promote fair competition between countries
   (b) To restrict or limit importation of certain products
   (c) To ensure that imported products meet safety and quality standards
   (d) To protect national security or cultural heritage

   Answer:

   (d) To protect national security or cultural heritage

   Explanation:

   The purpose of non-automatic licensing and prohibitions is often to protect national security or cultural heritage by restricting or prohibiting the import or export of certain products that could pose a threat or have significant cultural or historical value.

3. How can non-automatic licensing and prohibitions impact trade between countries?
   (a) They can reduce competition from foreign products
   (b) They can increase competition from foreign products
   (c) They can have no impact on competition from foreign products
   (d) It depends on the specific non-automatic licensing or prohibition

   Answer:

   (a) They can reduce competition from foreign products

   Explanation:

   Non-automatic licensing and prohibitions can make it difficult for foreign products to enter a particular market, reducing competition from these products. The restrictions or prohibitions can limit the import or export of certain products, making it more challenging for foreign companies to access a market or compete with domestic businesses.

4. Can non-automatic licensing and prohibitions be challenged under international trade rules?
   (a) Yes, they can be challenged under the rules set by the World Trade Organization (WTO)
   (b) No, non-automatic licensing and prohibitions cannot be challenged under international trade rules

(c) It depends on the specific country and their trade agreements

Answer:

(a) Yes, they can be challenged under the rules set by the World Trade Organization (WTO)

Explanation:

Non-automatic licensing and prohibitions can be challenged under international trade rules set by the World Trade Organization (WTO). The WTO allows member countries to file complaints if they believe that another country's non-automatic licensing or prohibition measures are discriminatory or violate international trade rules. However, the specific rules and regulations depend on the country and their trade agreements.

(iv) Financial Measures:

1. What are financial measures in trade?
   (a) Regulations that control the quality and safety of products
   (b) Regulations that control the prices of goods and services
   (c) Regulations that restrict or limit the flow of capital between countries
   (d) None of the above

   Answer:

   (c) Regulations that restrict or limit the flow of capital between countries

   Explanation:

   Financial measures in trade refer to regulations that restrict or limit the flow of capital between countries, such as restrictions on foreign investment or foreign exchange controls.

2. What is the purpose of financial measures in trade?
   (a) To promote fair competition between countries
   (b) To restrict or limit importation of certain products
   (c) To protect domestic companies from foreign investment
   (d) To control the flow of capital for economic stability

   Answer:

   (d) To control the flow of capital for economic stability

   Explanation:

   The purpose of financial measures in trade is to control the flow of capital for economic stability, such as preventing capital flight or limiting the impact of currency fluctuations on the economy.

3. How can financial measures impact trade between countries?
   (a) They can reduce competition from foreign products
   (b) They can increase competition from foreign products
   (c) They can limit the ability of foreign companies to invest in a market
   (d) None of the above

   Answer:

   (c) They can limit the ability of foreign companies to invest in a market

   Explanation:

   Financial measures can limit the ability of foreign companies to invest in a market by restricting foreign investment or imposing foreign exchange controls. These regulations can make it more challenging for foreign companies to access a market or compete with domestic businesses.

4. Can financial measures be challenged under international trade rules?
   (a) Yes, they can be challenged under the rules set by the World Trade Organization (WTO)
   (b) No, financial measures cannot be challenged under international trade rules
   (c) It depends on the specific country and their trade agreements

   Answer:

   (c) It depends on the specific country and their trade agreements

   Explanation:

   Whether or not financial measures can be challenged under international trade rules depends on the specific rules and regulations of each country and their trade agreements. Some countries may permit foreign investment and free flow of capital while others may have restrictions or controls on these activities. However, the World Trade Organization (WTO) does not have specific rules or regulations on financial measures.

(v) Measures Affecting Competition:

1. What are measures affecting competition in trade?
   (a) Regulations that control the quality and safety of products
   (b) Regulations that control the prices of goods and services
   (c) Regulations that restrict or limit the ability of companies to compete in a market
   (d) None of the above

   Answer:
   (c) Regulations that restrict or limit the ability of companies to compete in a market

   Explanation:
   Measures affecting competition in trade refer to regulations that restrict or limit the ability of companies to compete in a market, such as regulations that favor domestic companies over foreign companies or anti-competitive practices by dominant companies.

2. What is the purpose of measures affecting competition in trade?
   (a) To promote fair competition between countries
   (b) To restrict or limit importation of certain products
   (c) To protect domestic companies from foreign competition
   (d) To prevent anti-competitive behavior and promote consumer welfare

   Answer:
   (d) To prevent anti-competitive behavior and promote consumer welfare

   Explanation:
   The purpose of measures affecting competition in trade is to prevent anti-competitive behavior and promote consumer welfare by ensuring fair competition between companies in a market.

3. How can measures affecting competition impact trade between countries?
   (a) They can reduce competition from foreign products
   (b) They can increase competition from foreign products

   (c) They can limit the ability of foreign companies to compete in a market
   (d) None of the above

   Answer:
   (c) They can limit the ability of foreign companies to compete in a market

   Explanation:
   Measures affecting competition can limit the ability of foreign companies to compete in a market by favoring domestic companies or imposing restrictions on foreign companies. These regulations can make it more challenging for foreign companies to access a market or compete with domestic businesses.

4. Can measures affecting competition be challenged under international trade rules?
   (a) Yes, they can be challenged under the rules set by the World Trade Organization (WTO)
   (b) No, measures affecting competition cannot be challenged under international trade rules
   (c) It depends on the specific country and their trade agreements

   Answer:
   (a) Yes, they can be challenged under the rules set by the World Trade Organization (WTO)

   Explanation:
   Measures affecting competition can be challenged under international trade rules set by the World Trade Organization (WTO). The WTO allows member countries to file complaints if they believe that another country's measures affecting competition are discriminatory or violate international trade rules. However, the specific rules and regulations depend on the country and their trade agreements.

(vi) Government Procurement Policies:

1. What are government procurement policies in trade?
   (a) Policies that regulate the quality and safety of products purchased by the government

(b) Policies that regulate the prices paid for products purchased by the government
(c) Policies that regulate the process for government contracts and purchases
(d) None of the above

Answer:

(c) Policies that regulate the process for government contracts and purchases

Explanation:

Government procurement policies refer to policies that regulate the process for government contracts and purchases, such as guidelines for bidding processes and criteria for selecting suppliers.

2. What is the purpose of government procurement policies in trade?
(a) To promote fair competition between companies for government contracts
(b) To restrict or limit importation of certain products purchased by the government
(c) To protect domestic suppliers from foreign competition for government contracts
(d) To ensure transparency and accountability in government procurement processes

Answer:

(d) To ensure transparency and accountability in government procurement processes

Explanation:

The purpose of government procurement policies in trade is to ensure transparency and accountability in government procurement processes, such as preventing corruption and favoritism in the selection of suppliers.

3. How can government procurement policies impact trade between countries?
(a) They can restrict competition from foreign suppliers for government contracts

(b) They can increase competition from foreign suppliers for government contracts
(c) They can limit the ability of foreign suppliers to participate in government procurement processes
(d) None of the above

Answer:

(a) They can restrict competition from foreign suppliers for government contracts

Explanation:

Government procurement policies can restrict competition from foreign suppliers for government contracts by favoring domestic suppliers or imposing requirements that foreign suppliers cannot meet. These policies can limit the ability of foreign suppliers to participate in government procurement processes and reduce their opportunities in the market.

4. Can government procurement policies be challenged under international trade rules?
(a) Yes, they can be challenged under the rules set by the World Trade Organization (WTO)
(b) No, government procurement policies cannot be challenged under international trade rules
(c) It depends on the specific country and their trade agreements

Answer:

(a) Yes, they can be challenged under the rules set by the World Trade Organization (WTO)

Explanation:

Government procurement policies can be challenged under the rules set by the World Trade Organization (WTO). The WTO allows member countries to file complaints if they believe that another country's government procurement policies are discriminatory or violate international trade rules. However, the specific rules and regulations depend on the country and their trade agreements.

(vii) Trade-Related Investment Measures:

1. What are Trade-Related Investment Measures (TRIMs)?
   (a) Policies that promote free trade and open markets
   (b) Policies that impose restrictions on trade and investments
   (c) Policies that facilitate foreign direct investment (FDI)
   (d) Policies that encourage the import of raw materials

   Answer:
   (b) Policies that impose restrictions on trade and investments

   Explanation:
   Trade-Related Investment Measures (TRIMs) are policies that impose restrictions or regulations on foreign investors or domestic investors with foreign connections.

2. Which organization oversees the Agreement on Trade-Related Investment Measures (TRIMs)?
   (a) International Monetary Fund (IMF)
   (b) World Trade Organization (WTO)
   (c) United Nations (UN)
   (d) World Bank

   Answer:
   (b) World Trade Organization (WTO)

   Explanation:
   The World Trade Organization (WTO) oversees the Agreement on Trade-Related Investment Measures (TRIMs) to ensure fair and non-discriminatory treatment of foreign investors.

3. How do Trade-Related Investment Measures impact international trade?
   (a) They promote FDI and boost trade flows
   (b) They create barriers to trade and deter foreign investments
   (c) They only affect domestic investments, not international trade
   (d) They have no impact on trade or investment

   Answer:
   (b) They create barriers to trade and deter foreign investments

   Explanation:
   Trade-Related Investment Measures can create barriers to trade and deter foreign investments, potentially restricting the flow of goods and services across borders.

4. Which of the following is an example of a TRIM?
   (a) Export subsidies to domestic producers
   (b) Tariffs on imported goods
   (c) Preferential treatment for local investors over foreign investors
   (d) Reducing bureaucratic procedures for all investors

   Answer:
   (c) Preferential treatment for local investors over foreign investors

   Explanation:
   Giving preferential treatment to local investors over foreign investors is an example of a Trade-Related Investment Measure.

(viii) Distribution Restrictions:

1. What do distribution restrictions in international trade refer to?
   (a) Policies that promote the free flow of goods and services across borders
   (b) Policies that restrict the distribution of goods and services within a country
   (c) Policies that encourage foreign direct investment (FDI)
   (d) Policies that reduce import tariffs

   Answer:
   (b) Policies that restrict the distribution of goods and services within a country

   Explanation:
   Distribution restrictions refer to policies that limit or control the distribution of goods and services within a country's domestic market.

2. Which of the following is an example of a distribution restriction?
   (a) Export subsidies to domestic producers
   (b) Eliminating import quotas on specific products
   (c) Licensing requirements for the sale of certain goods
   (d) Reducing bureaucratic procedures for exporters

Answer:

(c) Licensing requirements for the sale of certain goods

Explanation:

Requiring a license for the sale of certain goods is an example of a distribution restriction as it controls the distribution of those goods in the domestic market.

3. How do distribution restrictions impact trade and investment?
   (a) They promote cross-border trade and foreign investments
   (b) They facilitate the distribution of goods and services domestically
   (c) They create barriers to entry for foreign companies in the domestic market
   (d) They have no impact on trade or investment

   Answer:

   (c) They create barriers to entry for foreign companies in the domestic market

   Explanation:

   Distribution restrictions can create barriers to entry for foreign companies, limiting their ability to distribute goods and services in the domestic market.

4. Which international organization advocates for reducing distribution restrictions and trade barriers?
   (a) International Monetary Fund (IMF)
   (b) World Trade Organization (WTO)
   (c) United Nations (UN)
   (d) World Bank

   Answer:

   (b) World Trade Organization (WTO)

   Explanation:

   The World Trade Organization (WTO) advocates for reducing distribution restrictions and trade barriers to promote freer trade and market access.

(ix) Restriction on Post-sales Services:

1. What do restrictions on post-sales services in international trade refer to?
   (a) Policies that promote after-sales services for domestic products
   (b) Policies that regulate the provision of after-sales services for imported products
   (c) Policies that encourage foreign companies to invest in service sectors
   (d) Policies that reduce import tariffs on services

   Answer:

   (b) Policies that regulate the provision of after-sales services for imported products

   Explanation:

   Restrictions on post-sales services refer to policies that limit or control the provision of after-sales services for imported products in a country.

2. Which of the following is an example of a restriction on post-sales services?
   (a) Allowing foreign service providers to operate without any restrictions
   (b) Requiring special permits for domestic service providers to offer services
   (c) Providing tax incentives for companies offering after-sales services
   (d) Implementing a streamlined process for product imports

   Answer:

   (b) Requiring special permits for domestic service providers to offer services

   Explanation:

   Requiring special permits for domestic service providers to offer after-sales services is an example of a restriction on post-sales services.

3. How can restrictions on post-sales services impact international trade?
   (a) They promote the free flow of services across borders
   (b) They enhance competition and efficiency in service sectors
   (c) They create barriers for foreign service providers in the domestic market
   (d) They have no impact on trade or investment

   Answer:
   (c) They create barriers for foreign service providers in the domestic market

   Explanation:
   Restrictions on post-sales services can create barriers for foreign service providers, limiting their ability to offer services for imported products in the domestic market.

4. Which international trade principle do restrictions on post-sales services violate?
   (a) Most Favored Nation (MFN) treatment
   (b) National treatment
   (c) Export-oriented industrialization
   (d) Import substitution

   Answer:
   (b) National treatment

   Explanation:
   Restrictions on post-sales services may violate the principle of national treatment, which requires treating foreign and domestic service providers equally once they are established in the domestic market.

(x) Administrative Procedures:

1. What do administrative procedures in international trade refer to?
   (a) Policies that promote the free flow of goods and services across borders
   (b) Processes and formalities related to customs and trade regulations

   (c) Policies that encourage foreign direct investment (FDI)
   (d) Policies that reduce import tariffs

   Answer:
   (b) Processes and formalities related to customs and trade regulations

   Explanation:
   Administrative procedures in international trade refer to the processes and formalities that traders must go through to comply with customs regulations and other administrative requirements.

2. Which of the following is an example of an administrative procedure in international trade?
   (a) Reducing trade barriers for specific products
   (b) Implementing export subsidies for domestic producers
   (c) Conducting customs inspections and document verification
   (d) Providing tax incentives to foreign investors

   Answer:
   (c) Conducting customs inspections and document verification

   Explanation:
   Conducting customs inspections and verifying trade-related documents are examples of administrative procedures in international trade.

3. How can streamlined administrative procedures impact international trade?
   (a) They increase bureaucracy and slow down trade flows
   (b) They promote efficiency and facilitate cross-border transactions
   (c) They create barriers to entry for foreign companies
   (d) They have no impact on trade or investment

   Answer:
   (b) They promote efficiency and facilitate cross-border transactions

   Explanation:
   Streamlined administrative procedures can reduce bureaucracy and facilitate faster and smoother cross-border trade transactions.

4. Which international organization advocates for simplifying administrative procedures and reducing trade barriers?
   (a) International Monetary Fund (IMF)
   (b) World Trade Organization (WTO)
   (c) United Nations (UN)
   (d) World Bank

   Answer:
   (b) World Trade Organization (WTO)

   Explanation:
   The World Trade Organization (WTO) advocates for simplifying administrative procedures and reducing trade barriers to promote **smoother international trade.**

(xi) Rules of origin:

1. What are Rules of Origin in international trade?
   (a) Guidelines for exporting goods to foreign countries
   (b) Criteria used to determine the country of origin of goods
   (c) Standards for product quality and safety in international trade
   (d) Guidelines for customs valuation of imported goods

   Answer:
   (b) Criteria used to determine the country of origin of goods

   Explanation:
   Rules of Origin are criteria used to determine the country of origin of goods in international trade.

2. Why are Rules of Origin important in trade agreements?
   (a) They encourage transshipment of goods between countries
   (b) They determine the quality and safety standards of imported goods
   (c) They prevent trade fraud and ensure fair trade practices
   (d) They only apply to certain types of services, not goods

   Answer:
   (c) They prevent trade fraud and ensure fair trade practices

   Explanation:
   Rules of Origin help prevent trade fraud by ensuring that only goods genuinely produced in a particular country receive trade-related benefits under preferential trade agreements.

3. Which of the following is an example of a Rule of Origin?
   (a) Reducing import tariffs on specific products
   (b) Conducting customs inspections at the border
   (c) Requiring a certain percentage of value-added to be produced locally
   (d) Implementing export quotas for certain industries

   Answer:
   (c) Requiring a certain percentage of value-added to be produced locally

   Explanation:
   Requiring a certain percentage of value-added to be produced locally is an example of a Rule of Origin criterion.

4. How do Rules of Origin affect global supply chains?
   (a) They promote reshoring of manufacturing activities to domestic markets
   (b) They encourage companies to offshore production to low-cost countries
   (c) They have no impact on global supply chains
   (d) They only apply to services, not manufacturing activities

   Answer:
   (b) They encourage companies to offshore production to low-cost countries

   Explanation:
   Rules of Origin can influence companies to offshore production to countries with lower production costs to meet the criteria for preferential treatment under trade agreements.

(xii) Safeguard Measures:

1. What are Safeguard Measures in international trade?
   (a) Permanent trade restrictions on certain products
   (b) Temporary trade remedies to protect domestic industries from import surges
   (c) Preferential trade agreements between two or more countries
   (d) Subsidies provided by governments to support exports

Answer:

(b) Temporary trade remedies to protect domestic industries from import surges

Explanation:

Safeguard Measures are temporary trade remedies implemented by governments to protect domestic industries from a sudden surge in imports that may cause serious injury or threat to their viability.

2. When can a country apply Safeguard Measures under the WTO rules?
   (a) When imports are cheaper than domestically produced goods
   (b) When imports exceed a certain percentage of total trade
   (c) When domestic industries face serious injury or threat due to import surges
   (d) When there is a need to promote free trade and open markets

Answer:

(c) When domestic industries face serious injury or threat due to import surges

Explanation:

According to WTO rules, a country can apply Safeguard Measures when its domestic industries face serious injury or are threatened by a surge in imports.

3. Which of the following is an example of a Safeguard Measure?
   (a) Reducing import tariffs to boost international trade
   (b) Imposing quotas on imported goods to protect domestic industries
   (c) Providing financial incentives for companies engaged in export activities
   (d) Implementing trade facilitation measures to streamline customs procedures

Answer:

(b) Imposing quotas on imported goods to protect domestic industries

Explanation:

Imposing quotas on imported goods is an example of a Safeguard Measure, as it restricts the quantity of imports to protect domestic industries.

4. How long can Safeguard Measures typically be in place under WTO rules?
   (a) Indefinitely until a bilateral agreement is reached
   (b) Up to one year, with a possible extension to three years in exceptional cases
   (c) Until the domestic industry completely recovers from the import surge
   (d) Until all import duties are paid by the importing companies

Answer:

(b) Up to one year, with a possible extension to three years in exceptional cases

Explanation:

Under WTO rules, Safeguard Measures can be implemented for up to one year, with a possible extension to a maximum of three years in exceptional cases.

(xiii) Embargos:

1. What are embargos in international trade?
   (a) Temporary trade remedies to protect domestic industries
   (b) Customs duties imposed on specific imported goods
   (c) Government-imposed restrictions that prohibit or limit trade with a specific country
   (d) Preferential trade agreements between multiple countries

Answer:

(c) Government-imposed restrictions that prohibit or limit trade with a specific country

Explanation:

Embargos are government-imposed restrictions that prohibit or severely limit trade with a specific country.

2. Why do countries impose embargos in international trade?
   (a) To promote free trade and open markets
   (b) To encourage cross-border investments
   (c) To express disapproval or exert pressure on a targeted country
   (d) To streamline customs procedures for faster trade transactions
   Answer:
   (c) To express disapproval or exert pressure on a targeted country
   Explanation:
   Countries impose embargos as a foreign policy tool to express disapproval or exert economic pressure on a targeted country.
3. Which of the following is an example of an embargo?
   (a) Imposing import tariffs on foreign products
   (b) Implementing trade facilitation measures to improve customs procedures
   (c) Prohibiting all trade with a specific country
   (d) Signing a free trade agreement with neighboring nations
   Answer:
   (c) Prohibiting all trade with a specific country
   Explanation:
   Prohibiting all trade with a specific country is an example of an embargo.
4. How do embargos impact international trade and economies?
   (a) They promote economic cooperation and growth among nations
   (b) They create trade opportunities for targeted countries
   (c) They can lead to economic isolation and disruptions in global supply chains
   (d) They have no significant impact on trade or economies
   Answer:
   (c) They can lead to economic isolation and disruptions in global supply chains
   Explanation:
   Embargos can lead to economic isolation for the targeted country and disruptions in global supply chains as trade with that country is severely restricted or cut off.

1.4. Export-Related Measures

1. What are export-related measures in international trade?
   (a) Government policies that restrict the import of specific goods
   (b) Actions taken by countries to promote and facilitate exports
   (c) Customs duties imposed on imported products
   (d) Measures to regulate foreign direct investment (FDI)
   Answer:
   (b) Actions taken by countries to promote and facilitate exports
   Explanation:
   Export-related measures are actions taken by countries to promote and facilitate the export of goods and services.
2. Which of the following is an example of an export-related measure?
   (a) Imposing quotas on the import of certain products
   (b) Implementing tax incentives for exporters
   (c) Prohibiting foreign companies from investing in domestic markets
   (d) Reducing trade barriers for specific industries
   Answer:
   (b) Implementing tax incentives for exporters
   Explanation:
   Providing tax incentives for exporters is an example of an export-related measure aimed at promoting and supporting export activities.
3. How can export-related measures benefit a country's economy?
   (a) By restricting foreign competition and protecting domestic industries
   (b) By encouraging imports and diversifying the domestic market
   (c) By promoting international trade and generating foreign exchange
   (d) By reducing the production of goods for domestic consumption
   Answer:
   (c) By promoting international trade and generating foreign exchange
   Explanation:
   Export-related measures can benefit a country's economy by promoting international trade, increasing exports, and generating foreign exchange earnings.

4. Which of the following is not an export-related measure?
   (a) Export subsidies to support domestic industries
   (b) Simplified customs procedures for importers
   (c) Establishing export processing zones for manufacturing goods
   (d) Imposing import tariffs on foreign products

   Answer:

   (b) Simplified customs procedures for importers

   Explanation:

   Simplified customs procedures for importers are not export-related measures. They are measures that facilitate imports, not exports.

(i) Ban on exports:

1. What does a ban on exports in international trade signify?
   (a) A complete cessation of all imports and exports
   (b) A restriction on the importation of specific goods
   (c) A government-imposed prohibition on exporting certain goods
   (d) A policy encouraging free trade and open markets

   Answer:

   (c) A government-imposed prohibition on exporting certain goods

   Explanation:

   A ban on exports signifies a government-imposed prohibition on exporting specific goods to other countries.

2. Why might a country impose a ban on exports?
   (a) To promote international trade and economic growth
   (b) To maintain an adequate supply of essential goods domestically
   (c) To encourage foreign investment and technology transfer
   (d) To facilitate the movement of goods across borders

   Answer:

   (b) To maintain an adequate supply of essential goods domestically

   Explanation:

   A country may impose a ban on exports to ensure an adequate domestic supply of essential goods, especially during times of shortages or crises.

3. Which of the following is an example of a ban on exports?
   (a) Imposing import duties on specific goods
   (b) Implementing trade facilitation measures to expedite customs clearance
   (c) Prohibiting the export of certain agricultural products during a food crisis
   (d) Signing a free trade agreement with neighboring nations

   Answer:

   (c) Prohibiting the export of certain agricultural products during a food crisis

   Explanation:

   Prohibiting the export of certain agricultural products during a food crisis is an example of a ban on exports.

4. How can a ban on exports affect international trade relations?
   (a) It fosters stronger economic ties and cooperation among nations
   (b) It may lead to trade disputes and strain diplomatic relations
   (c) It promotes harmonious trade balance between countries
   (d) It has no impact on international trade relations

   Answer:

   (b) It may lead to trade disputes and strain diplomatic relations

   Explanation:

   A ban on exports can lead to trade disputes and strained diplomatic relations between the exporting country and its trading partners.

(ii) Export Taxes:

1. What are export taxes in international trade?
   (a) Taxes imposed on imported goods to protect domestic industries
   (b) Taxes imposed on goods and services that are exported from a country
   (c) Taxes levied on foreign investments in the domestic market
   (d) Taxes imposed on the profits of multinational corporations

   Answer:

   (b) Taxes imposed on goods and services that are exported from a country

Explanation:
Export taxes are taxes imposed by the government on goods and services that are exported from a country.

2. Why might a government impose export taxes?
   (a) To promote international trade and export-oriented industries
   (b) To discourage the export of certain goods and preserve domestic supplies
   (c) To encourage foreign investment and technology transfer
   (d) To reduce the budget deficit and increase government revenue

   Answer:
   (b) To discourage the export of certain goods and preserve domestic supplies

   Explanation:
   Governments might impose export taxes to discourage the export of certain goods and ensure an adequate domestic supply of those goods.

3. Which of the following is an example of an export tax?
   (a) Subsidizing domestic producers to compete in foreign markets
   (b) Reducing import duties on specific products
   (c) Imposing a tax on the export of raw materials
   (d) Providing financial incentives for companies engaged in export activities

   Answer:
   (c) Imposing a tax on the export of raw materials

   Explanation:
   Imposing a tax on the export of raw materials is an example of an export tax.

4. How can export taxes impact a country's economy?
   (a) They encourage export-oriented industries and boost international trade
   (b) They promote the export of raw materials and strengthen domestic industries

   (c) They may lead to reduced export volumes and decreased competitiveness
   (d) They have no significant impact on the economy

   Answer:
   (c) They may lead to reduced export volumes and decreased competitiveness

   Explanation:
   Export taxes can lead to reduced export volumes and decreased competitiveness of the country's exports in the international market.

(iii) Export Subsidies and Incentives:

1. What are export subsidies and incentives in international trade?
   (a) Taxes imposed on goods and services that are exported from a country
   (b) Financial benefits provided to domestic exporters to support their international trade activities
   (c) Taxes imposed on imported goods to protect domestic industries
   (d) Non-financial barriers that restrict the import of specific products

   Answer:
   (b) Financial benefits provided to domestic exporters to support their international trade activities

   Explanation:
   Export subsidies and incentives are financial or non-financial benefits given to domestic exporters to support and encourage their international trade efforts.

2. Why might a government offer export subsidies and incentives to its exporters?
   (a) To discourage the export of certain goods and preserve domestic supplies
   (b) To promote import-oriented industries and increase trade deficits
   (c) To increase government revenue by taxing exports
   (d) To enhance the competitiveness of domestic products in the global market

Answer:

(d) To enhance the competitiveness of domestic products in the global market.

Explanation:

Governments offer export subsidies and incentives to enhance the competitiveness of domestic products in the global market and promote exports.

3. Which of the following is an example of an export incentive?
   (a) Imposing tariffs on imported goods to protect domestic industries
   (b) Providing financial assistance to exporters for marketing and promotion activities
   (c) Implementing quotas on the import of specific products
   (d) Prohibiting foreign companies from investing in the domestic market

Answer:

(b) Providing financial assistance to exporters for marketing and promotion activities

Explanation:

Providing financial assistance to exporters for marketing and promotion activities is an example of an export incentive.

4. How can export subsidies and incentives impact a country's exports and economy?
   (a) They may lead to increased exports and boost economic growth
   (b) They encourage import-oriented industries and increase trade deficits
   (c) They have no impact on a country's exports or economy
   (d) They only benefit foreign companies, not domestic exporters

Answer:

(a) They may lead to increased exports and boost economic growth

Explanation:

Export subsidies and incentives can lead to increased exports, thereby contributing to economic growth and supporting domestic industries engaged in international trade.

(iv) Voluntary Export Restraints:

1. What are Voluntary Export Restraints (VERs) in international trade?
   (a) Government-imposed restrictions on the import of specific goods
   (b) Agreements between exporting and importing countries to limit export quantities voluntarily
   (c) Financial benefits provided to domestic exporters to support international trade
   (d) Non-financial barriers that restrict the import of certain products

Answer:

(b) Agreements between exporting and importing countries to limit export quantities voluntarily

Explanation:

Voluntary Export Restraints (VERs) are agreements between exporting and importing countries to voluntarily limit the quantity of goods exported to the importing country.

2. Why do countries agree to Voluntary Export Restraints (VERs)?
   (a) To encourage foreign direct investment (FDI)
   (b) To promote free trade and open markets
   (c) To avoid the imposition of more stringent trade restrictions, such as tariffs or quotas
   (d) To increase government revenue from export taxes

Answer:

(c) To avoid the imposition of more stringent trade restrictions, such as tariffs or quotas

Explanation:

Countries may agree to Voluntary Export Restraints (VERs) to avoid the imposition of more stringent trade restrictions that could harm trade relations.

3. Which of the following is an example of a Voluntary Export Restraint (VER)?
   (a) Prohibiting all trade with a specific country
   (b) Implementing import quotas on certain goods
   (c) Restricting the export of specific products to a certain quantity
   (d) Providing financial incentives to domestic exporters

Answer:
(c) Restricting the export of specific products to a certain quantity
Explanation:
Restricting the export of specific products to a certain quantity is an example of a Voluntary Export Restraint (VER).

4. How can Voluntary Export Restraints impact international trade?
(a) They promote unrestricted trade between countries
(b) They may lead to reduced availability of certain products in the importing country
(c) They have no impact on trade relations between countries
(d) They encourage countries to remove all trade barriers

Answer:
(b) They may lead to reduced availability of certain products in the importing country
Explanation:
Voluntary Export Restraints can lead to reduced availability of certain products in the importing country due to the limitations on export quantities.

Additional Question Bank

1.1 Introduction

1. Trade policy refers to the government's strategies and actions aimed at:
(a) Promoting domestic production and exports
(b) Encouraging foreign direct investment
(c) Reducing unemployment rates
(d) Regulating the stock market
2. The main objectives of trade policy include:
(a) Stabilizing foreign exchange rates
(b) Controlling inflation and interest rates
(c) Protecting domestic industries and promoting international trade
(d) Enforcing copyright laws for intellectual property protection

3. Trade policy instruments can be classified into two broad categories:
(a) Fiscal policy and monetary policy
(b) Exchange rate policies and fiscal policies
(c) Trade liberalization and trade protection measures
(d) Government expenditure and taxation policies
4. Which trade policy approach aims to reduce or eliminate trade barriers and restrictions to promote free and open international trade?
(a) Trade liberalization
(b) Import quotas
(c) Export subsidies
(d) Dumping
5. The imposition of tariffs, import quotas, and export subsidies are examples of:
(a) Trade liberalization measures
(b) Free trade agreements
(c) Trade protection measures
(d) Monetary policies

1.2 Tariffs

1. Tariffs are a form of:
(a) Government subsidies to domestic industries
(b) Trade liberalization
(c) Trade protection
(d) Foreign direct investment
2. Tariffs are taxes imposed on:
(a) Domestic goods and services
(b) Imports and exports
(c) Foreign direct investment
(d) Government expenditures
3. The primary purpose of imposing tariffs is to:
(a) Encourage exports and foreign investment
(b) Stimulate economic growth and job creation
(c) Generate government revenue and protect domestic industries
(d) Facilitate free trade and reduce trade barriers

4. A specific tariff is levied as a fixed amount per:
   (a) Unit of imported goods
   (b) Unit of exported goods
   (c) Unit of domestic production
   (d) Unit of foreign investment
5. An ad valorem tariff is levied as a percentage of the:
   (a) Value of imported goods
   (b) Value of domestic production
   (c) Value of foreign investment
   (d) Value of government revenue

1.3 Non-Tariff Measures (NTMS)

1. Non-tariff measures (NTMs) are trade policy instruments that do not involve:
   (a) Import and export restrictions
   (b) Trade liberalization
   (c) Government subsidies
   (d) Direct taxes on goods and services
2. Examples of non-tariff measures include:
   (a) Import tariffs and export quotas
   (b) Subsidies to domestic industries
   (c) Health and safety regulations, product standards, and licensing requirements
   (d) Fiscal policies and monetary policies
3. Non-tariff measures are often used to:
   (a) Promote free trade and globalization
   (b) Increase foreign direct investment
   (c) Facilitate cross-border trade and reduce transaction costs
   (d) Protect domestic industries, ensure product quality, and address environmental concerns
4. Voluntary export restraints (VERs) are an example of:
   (a) Export promotion policies
   (b) Trade liberalization measures

   (c) Non-tariff trade barriers imposed by the exporting country
   (d) Measures to stabilize foreign exchange rates
5. Sanitary and phytosanitary (SPS) measures are NTMs designed to:
   (a) Promote tourism and travel
   (b) Facilitate labor migration
   (c) Regulate the import and export of food, plants, and animals to ensure safety and prevent the spread of diseases
   (d) Encourage foreign investment in critical sectors

1.4. Export-Related Measures

1. Export subsidies are a type of export-related measure that involves:
   (a) Imposing taxes on exported goods
   (b) Providing financial incentives or support to domestic producers for exporting goods
   (c) Restricting the quantity of exported goods
   (d) Regulating the exchange rates for foreign buyers
2. Export quotas are a form of export-related measure that involves:
   (a) Providing tax breaks to exporters
   (b) Restricting the quantity of goods that can be exported
   (c) Offering subsidies to foreign buyers
   (d) Controlling the prices of exported goods
3. The purpose of export-related measures, such as export subsidies and export quotas, is to:
   (a) Encourage the import of foreign goods
   (b) Discourage domestic producers from exporting goods
   (c) Promote domestic consumption of goods
   (d) Support and boost the competitiveness of domestic industries in foreign markets
4. Export processing zones (EPZs) are designated areas that offer special incentives and benefits to:
   (a) Importers of foreign goods
   (b) Domestic producers selling goods in the domestic market
   (c) Foreign investors and exporters
   (d) Government officials involved in trade policymaking

5. The primary goal of establishing export processing zones (EPZs) is to:
   (a) Increase imports and foreign direct investment
   (b) Promote trade barriers and protectionism
   (c) Encourage economic growth through export-oriented industrialization
   (d) Support the growth of the domestic market and reduce reliance on exports

Answer

1.1 Introduction

1. (a) Promoting domestic production and exports
2. (c) Protecting domestic industries and promoting international trade
3. (c) Trade liberalization and trade protection measures
4. (a) Trade liberalization
5. (c) Trade protection measures

1.2 Tariffs

1. (c) Trade protection
2. (b) Imports and exports
3. (c) Generate government revenue and protect domestic industries
4. (a) Unit of imported goods
5. (a) Value of imported goods

1.3 Non–Tariff Measures (NTMS)

1. (a) Import and export restrictions
2. (c) Health and safety regulations, product standards, and licensing requirements
3. (d) Protect domestic industries, ensure product quality, and address environmental concerns
4. (c) Non-tariff trade barriers imposed by the exporting country
5. (c) Regulate the import and export of food, plants, and animals to ensure safety and prevent the spread of diseases

1.4. Export-Related Measures

1. (b) Providing financial incentives or support to domestic producers for exporting goods
2. (b) Restricting the quantity of goods that can be exported
3. (d) Support and boost the competitiveness of domestic industries in foreign markets
4. (c) Foreign investors and exporters
5. (c) Encourage economic growth through export-oriented industrialization

9 INTERNATIONAL TRADE

Unit:3 **Trade Negotiations**

Multiple Choice Questions

1.1 Introduction

1. What are trade negotiations?
   (a) Talks between countries to impose tariffs on imports
   (b) Discussions between governments to limit exports
   (c) Negotiations between parties to reach agreements on trade-related issues
   (d) Bilateral agreements to promote import substitution

   Answer:
   (c) Negotiations between parties to reach agreements on trade-related issues

   Explanation:
   Trade negotiations are discussions between countries or parties aimed at reaching agreements on various trade-related issues, such as tariffs, quotas, and other trade barriers.

2. Which organization plays a significant role in facilitating global trade negotiations?
   (a) International Monetary Fund (IMF)
   (b) World Bank
   (c) United Nations (UN)
   (d) World Trade Organization (WTO)

   Answer:
   (d) World Trade Organization (WTO)

   Explanation:
   The World Trade Organization (WTO) plays a significant role in facilitating global trade negotiations and resolving trade disputes between member countries.

3. What is the primary objective of trade negotiations?
   (a) To promote protectionism and restrict international trade
   (b) To eliminate all trade barriers and achieve complete free trade
   (c) To enhance cooperation among countries in trade matters
   (d) To impose export restrictions on sensitive goods

   Answer:
   (c) To enhance cooperation among countries in trade matters

   Explanation:
   The primary objective of trade negotiations is to enhance cooperation among countries and reach agreements that promote balanced and fair trade relations.

4. Which trade negotiation round led to the establishment of the WTO in 1995?
   (a) Doha Round (b) Tokyo Round
   (c) Uruguay Round (d) Seattle Round

   Answer:
   (c) Uruguay Round

   Explanation:
   The Uruguay Round of trade negotiations (1986-1994) led to the establishment of the World Trade Organization (WTO) in 1995.

5. What is the role of trade negotiators in the negotiation process?
   (a) To prioritize the interests of their home country without compromise
   (b) To find win-win solutions and address the concerns of all parties involved
   (c) To impose unilateral trade policies on other negotiating countries
   (d) To advocate for import substitution and reject foreign goods

   Answer:
   (b) To find win-win solutions and address the concerns of all parties involved

   Explanation:
   The role of trade negotiators is to find win-win solutions that address the concerns of all parties involved in the negotiation process, leading to mutually beneficial agreements.

6. What are trade negotiations in international trade?
   (a) Bilateral meetings between government officials and domestic exporters
   (b) Discussions between countries to resolve trade disputes
   (c) Talks aimed at reaching agreements on trade policies and market access
   (d) Interactions between customs officials and importers at borders

   Answer:
   (c) Talks aimed at reaching agreements on trade policies and market access

   Explanation:
   Trade negotiations are discussions between countries with the goal of reaching agreements on various trade-related issues, such as trade policies, tariffs, quotas, and market access.

7. Which organization facilitates multilateral trade negotiations among its member countries?
   (a) International Monetary Fund (IMF)
   (b) World Trade Organization (WTO)
   (c) United Nations (UN)
   (d) World Bank

   Answer:
   (b) World Trade Organization (WTO)

   Explanation:
   The World Trade Organization (WTO) facilitates multilateral trade negotiations among its member countries to promote global trade and ensure fair trade practices.

8. What is the purpose of trade negotiations?
   (a) To create barriers to international trade and protect domestic industries
   (b) To promote import-oriented economies and increase trade deficits
   (c) To resolve trade disputes between countries
   (d) To improve market access and reduce trade barriers

   Answer:
   (d) To improve market access and reduce trade barriers

   Explanation:
   The purpose of trade negotiations is to improve market access for goods and services and to reduce trade barriers, thereby fostering greater international trade and economic cooperation.

9. Which of the following issues can be addressed in trade negotiations?
   (a) Currency exchange rates and monetary policies
   (b) Immigration and border control measures
   (c) Intellectual property rights and patent regulations
   (d) Healthcare and environmental policies

   Answer:
   (c) Intellectual property rights and patent regulations

   Explanation:
   Trade negotiations can address issues related to intellectual property rights, patent regulations, and other trade-related matters, but not issues like currency exchange rates, immigration, or healthcare policies.

10. What role do trade negotiators play in the negotiation process?
   (a) They act as mediators between domestic industries and foreign governments
   (b) They represent the interests of their countries and negotiate trade deals
   (c) They provide financial assistance to exporters during negotiations
   (d) They ensure the enforcement of trade agreements after negotiations

   Answer:
   (b) They represent the interests of their countries and negotiate trade deals

   Explanation:
   Trade negotiators represent the interests of their countries during trade negotiations and engage in discussions to reach trade deals and agreements.

1.2 Taxonomy of Regional Trade Agreements (RTAS)

1. What is a Regional Trade Agreement (RTA)?
   (a) An agreement between two or more countries to impose tariffs on imports

(b) An agreement between two or more countries to promote free trade within a specific region
(c) An agreement between countries and international organizations to regulate global trade
(d) An agreement between countries to restrict foreign direct investment (FDI)

Answer:

(b) An agreement between two or more countries to promote free trade within a specific region

Explanation:

A Regional Trade Agreement (RTA) is an agreement between two or more countries to promote free trade within a specific region by reducing or eliminating trade barriers among the member countries.

2. What is the main objective of a Regional Trade Agreement (RTA)?
(a) To restrict the flow of goods and services among member countries
(b) To encourage trade and economic cooperation within the region
(c) To impose higher tariffs on imports from non-member countries
(d) To prevent foreign companies from investing in the region

Answer:

(b) To encourage trade and economic cooperation within the region

Explanation:

The main objective of a Regional Trade Agreement (RTA) is to encourage trade and economic cooperation among the member countries within the region.

3. Which type of Regional Trade Agreement (RTA) involves the highest level of economic integration among member countries?
(a) Free Trade Area (FTA)
(b) Customs Union (CU)
(c) Common Market (CM)
(d) Economic Union (EU)

Answer:

(d) Economic Union (EU)

Explanation:

Among the types of RTAs, the Economic Union (EU) involves the highest level of economic integration, as it includes not only the elimination of trade barriers but also common policies on economic matters like monetary and fiscal policies.

4. What is the key difference between a Free Trade Area (FTA) and a Customs Union (CU)?
(a) In an FTA, member countries have a common external trade policy, while in a CU, they don't.
(b) In an FTA, member countries have a common currency, while in a CU, they don't.
(c) In an FTA, member countries have a common market, while in a CU, they don't.
(d) In an FTA, member countries have a common customs territory, while in a CU, they don't.

Answer:

(d) In an FTA, member countries have a common customs territory, while in a CU, they don't.

Explanation:

The key difference between an FTA and a CU is that in an FTA, member countries do not have a common customs territory, while in a CU, they do.

5. Which Regional Trade Agreement (RTA) allows for the free movement of goods, services, capital, and labor among member countries?
(a) Free Trade Area (FTA)
(b) Customs Union (CU)
(c) Common Market (CM)
(d) Economic Union (EU)

Answer:

(c) Common Market (CM)

Explanation:

A Common Market (CM) is an RTA that goes beyond an FTA and a CU, allowing for the free movement of goods, services, capital, and labor among member countries.

6. What is a Regional Trade Agreement (RTA)?
   (a) An agreement between two or more countries to promote global free trade
   (b) A pact between countries within a specific region to facilitate trade and reduce barriers
   (c) A treaty that regulates foreign direct investment (FDI) among member nations
   (d) A legal framework to restrict imports and protect domestic industries

   Answer:
   (b) A pact between countries within a specific region to facilitate trade and reduce barriers

   Explanation: A Regional Trade Agreement (RTA) is a pact between countries within a specific region to promote trade and reduce barriers to trade.

7. How are Regional Trade Agreements classified based on the number of participating countries?
   (a) Bilateral and multilateral agreements
   (b) Import substitution and export-oriented agreements
   (c) Free trade agreements and customs unions
   (d) North-South and South-South agreements

   Answer:
   (a) Bilateral and multilateral agreements

   Explanation:
   Regional Trade Agreements can be classified as bilateral (between two countries) or multilateral (involving more than two countries).

8. What is the main characteristic of a Free Trade Agreement (FTA)?
   (a) Member countries adopt a common external trade policy
   (b) There is a complete removal of all trade barriers among member countries
   (c) It allows for the free movement of people and labor across borders
   (d) It focuses on protecting domestic industries through import tariffs

   Answer:
   (b) There is a complete removal of all trade barriers among member countries

   Explanation:
   The main characteristic of a Free Trade Agreement (FTA) is the complete removal of trade barriers, such as tariffs and quotas, among member countries.

9. What is a Customs Union in the context of Regional Trade Agreements?
   (a) An agreement where member countries maintain separate external trade policies
   (b) An agreement that establishes a common external trade policy among member countries
   (c) A pact that promotes the free movement of goods but not services and labor
   (d) A trade agreement exclusively focused on import substitution

   Answer:
   (b) An agreement that establishes a common external trade policy among member countries

   Explanation:
   A Customs Union is a Regional Trade Agreement where member countries adopt a common external trade policy and impose a common external tariff on imports from non-member countries.

10. Which of the following is an example of a Regional Trade Agreement?
   (a) GATT (General Agreement on Tariffs and Trade)
   (b) WTO (World Trade Organization)
   (c) NAFTA (North American Free Trade Agreement)
   (d) IMF (International Monetary Fund)

   Answer:
   (c) NAFTA (North American Free Trade Agreement)

   Explanation:
   NAFTA (North American Free Trade Agreement) is an example of a Regional Trade Agreement between Canada, Mexico, and the United States.

1.3 The General Agreement on Tariffs and Trade (GATT)

1. What is the General Agreement on Tariffs and Trade (GATT)?
   (a) An international organization that regulates global trade and investment
   (b) A regional trade agreement between North American countries
   (c) A multilateral treaty that aims to promote free trade by reducing tariffs and trade barriers
   (d) A bilateral agreement between two countries to facilitate trade in specific goods

   Answer:
   (c) A multilateral treaty that aims to promote free trade by reducing tariffs and trade barriers

   Explanation:
   The General Agreement on Tariffs and Trade (GATT) is a multilateral treaty that aims to promote free trade by reducing tariffs and trade barriers among its member countries.

2. When was GATT established?
   (a) 1947
   (b) 1957
   (c) 1967
   (d) 1977

   Answer:
   (a) 1947

   Explanation:
   GATT was established in 1947 as an international treaty to facilitate trade and reduce barriers after the end of World War II.

3. Which international organization evolved from GATT?
   (a) United Nations (UN)
   (b) World Bank
   (c) World Trade Organization (WTO)
   (d) International Monetary Fund (IMF)

   Answer:
   (c) World Trade Organization (WTO)

   Explanation:
   The World Trade Organization (WTO) evolved from GATT in 1995 to further expand and regulate international trade.

4. What is the most-favored-nation (MFN) principle under GATT?
   (a) A country should grant the best trade terms to its most important trading partners
   (b) A country should provide preferences to its neighboring nations in trade matters
   (c) A country should impose higher tariffs on goods from less developed countries
   (d) A country should treat all its trading partners equally, without discrimination

   Answer:
   (d) A country should treat all its trading partners equally, without discrimination

   Explanation:
   The most-favored-nation (MFN) principle under GATT requires countries to treat all their trading partners equally by not discriminating among them regarding trade policies.

5. How did GATT contribute to the reduction of trade barriers?
   (a) By promoting import substitution policies
   (b) By imposing high tariffs on imported goods
   (c) By conducting trade negotiations and tariff rounds
   (d) By implementing export subsidies for domestic industries

   Answer:
   (c) By conducting trade negotiations and tariff rounds

   Explanation:
   GATT contributed to the reduction of trade barriers through a series of trade negotiations and tariff rounds, where member countries agreed to lower tariffs and negotiate trade agreements.

6. What is the General Agreement on Tariffs and Trade (GATT)?
   (a) A treaty that regulates foreign direct investment (FDI) among member nations
   (b) A pact between countries within a specific region to facilitate trade and reduce barriers

(c) A multilateral agreement aimed at promoting global free trade and reducing tariffs
(d) A legal framework to restrict imports and protect domestic industries

Answer:
(c) A multilateral agreement aimed at promoting global free trade and reducing tariffs

Explanation:
The General Agreement on Tariffs and Trade (GATT) was a multilateral agreement aimed at promoting global free trade and reducing tariffs on goods.

7. When was the General Agreement on Tariffs and Trade (GATT) established?
(a) 1945
(b) 1947
(c) 1950
(d) 1955

Answer:
(b) 1947

Explanation:
The General Agreement on Tariffs and Trade (GATT) was established in 1947, after the conclusion of the Second World War.

8. What was the main objective of the GATT?
(a) To regulate foreign investments and capital flows
(b) To establish common monetary policies among member nations
(c) To promote the free movement of labor across borders
(d) To reduce trade barriers and facilitate international trade

Answer:
(d) To reduce trade barriers and facilitate international trade

Explanation:
The main objective of the GATT was to reduce trade barriers, such as tariffs and quotas, and promote the free flow of goods in international trade.

9. How did the GATT achieve its goals?
(a) By providing financial assistance to developing countries
(b) By imposing import tariffs on specific products
(c) Through rounds of negotiations to lower tariffs and address trade issues
(d) By establishing preferential trade agreements among member countries

Answer:
(c) Through rounds of negotiations to lower tariffs and address trade issues

Explanation:
The GATT achieved its goals through rounds of negotiations among member countries to lower tariffs and address various trade-related issues.

10. What organization replaced the GATT in 1995?
(a) United Nations (UN)
(b) International Monetary Fund (IMF)
(c) World Trade Organization (WTO)
(d) World Bank

Answer:
(c) World Trade Organization (WTO)

Explanation:
The General Agreement on Tariffs and Trade (GATT) was replaced by the World Trade Organization (WTO) in 1995, which expanded its scope to cover services and intellectual property rights in addition to goods.

1.4 The Uruguay Round and the Establishment of WTO

1. What was the Uruguay Round in the context of international trade?
(a) A series of negotiations to regulate foreign direct investment (FDI)
(b) Talks between developed and developing countries to address climate change
(c) A comprehensive set of trade negotiations to reform and liberalize global trade
(d) A summit to discuss global poverty and humanitarian aid

Answer:

(c) A comprehensive set of trade negotiations to reform and liberalize global trade

Explanation:

The Uruguay Round was a series of trade negotiations that aimed to reform and liberalize global trade, covering various aspects of international trade, including tariffs, non-tariff barriers, services, and intellectual property rights.

2. When did the Uruguay Round take place?
   (a) 1970-1979
   (b) 1986-1994
   (c) 1995-2004
   (d) 2008-2016

Answer:

(b) 1986-1994

Explanation:

The Uruguay Round took place from 1986 to 1994, concluding with the signing of the Uruguay Round agreements in April 1994.

3. What was the outcome of the Uruguay Round negotiations?
   (a) The establishment of the World Trade Organization (WTO)
   (b) The formation of the International Monetary Fund (IMF)
   (c) The creation of regional trade blocs in different parts of the world
   (d) The imposition of import tariffs on specific products

Answer:

(a) The establishment of the World Trade Organization (WTO)

Explanation:

The outcome of the Uruguay Round negotiations was the establishment of the World Trade Organization (WTO) as the successor to the General Agreement on Tariffs and Trade (GATT).

4. What is the main function of the World Trade Organization (WTO)?
   (a) To regulate foreign direct investment (FDI) among member nations
   (b) To establish common monetary policies among member nations
   (c) To promote international cooperation in environmental protection
   (d) To facilitate global trade and ensure the adherence to trade rules

Answer:

(d) To facilitate global trade and ensure the adherence to trade rules

Explanation:

The main function of the World Trade Organization (WTO) is to facilitate global trade, promote fair trade practices, and ensure that member countries adhere to agreed-upon trade rules.

5. How does the World Trade Organization (WTO) resolve trade disputes between member countries?
   (a) By imposing economic sanctions on non-compliant countries
   (b) By referring disputes to an independent dispute settlement body
   (c) By encouraging member countries to engage in military actions
   (d) By imposing import quotas on the countries involved in the dispute

Answer:

(b) By referring disputes to an independent dispute settlement body

Explanation:

The World Trade Organization (WTO) resolves trade disputes between member countries by referring them to an independent dispute settlement body, which provides a mechanism for resolving trade conflicts through legal procedures.

6. What was the Uruguay Round in the context of international trade?
   (a) A series of negotiations to establish the European Union (EU)
   (b) A round of trade talks under the General Agreement on Tariffs and Trade (GATT)
   (c) A regional trade agreement between South American countries
   (d) A multilateral agreement to regulate foreign direct investment (FDI)

Answer:

(b) A round of trade talks under the General Agreement on Tariffs and Trade (GATT)

Explanation:

The Uruguay Round was a series of trade talks conducted under the General Agreement on Tariffs and Trade (GATT) from 1986 to 1994.

7. What was the main objective of the Uruguay Round?
   (a) To establish a common currency among member countries
   (b) To promote regional trade agreements in South America

(c) To reduce trade barriers and liberalize global trade
(d) To restrict the movement of labor and capital across borders

Answer:

(c) To reduce trade barriers and liberalize global trade

Explanation:

The main objective of the Uruguay Round was to reduce trade barriers, such as tariffs and non-tariff barriers, and promote the liberalization of global trade.

8. How did the Uruguay Round contribute to the establishment of the World Trade Organization (WTO)?
   (a) By creating a new multilateral organization focused on labor standards
   (b) By expanding the scope of GATT and transforming it into the WTO
   (c) By forming a regional trade bloc in the Asia-Pacific region
   (d) By promoting the free movement of capital and financial services

Answer:

(b) By expanding the scope of GATT and transforming it into the WTO

Explanation:

The Uruguay Round resulted in the expansion of the General Agreement on Tariffs and Trade (GATT) and led to the establishment of the World Trade Organization (WTO) in 1995.

9. What is the main function of the World Trade Organization (WTO)?
   (a) To regulate foreign direct investment (FDI) among member nations
   (b) To establish common monetary policies among member countries
   (c) To promote regional economic integration in Europe
   (d) To facilitate trade negotiations and dispute resolution among member countries

Answer:

(d) To facilitate trade negotiations and dispute resolution among member countries

Explanation:

The main function of the World Trade Organization (WTO) is to facilitate trade negotiations and provide a platform for resolving trade disputes among its member countries.

10. Which of the following agreements was a significant outcome of the Uruguay Round?
   (a) Kyoto Protocol on climate change
   (b) North American Free Trade Agreement (NAFTA)
   (c) General Agreement on Trade in Services (GATS)
   (d) Paris Agreement on climate change

Answer:

(c) General Agreement on Trade in Services (GATS)

Explanation:

The General Agreement on Trade in Services (GATS) was a significant outcome of the Uruguay Round, which aimed to liberalize trade in services among member countries.

3.5 The World Trade Organization (WTO)

1. What is the World Trade Organization (WTO)?
   (a) A global organization that regulates foreign direct investment (FDI)
   (b) An intergovernmental organization that promotes regional trade agreements
   (c) An international body that oversees and regulates global trade
   (d) A group of countries that collaborate to establish a common currency

Answer:

(c) An international body that oversees and regulates global trade

Explanation:

The World Trade Organization (WTO) is an international body that oversees and regulates global trade and trade-related rules among its member countries.

2. When was the World Trade Organization (WTO) established?
   (a) 1947
   (b) 1986
   (c) 1995
   (d) 2001

Answer:

(c) 1995

Explanation:

The World Trade Organization (WTO) was established on January 1, 1995, following the conclusion of the Uruguay Round of trade negotiations.

3. What is the primary objective of the WTO?
   (a) To promote regional economic integration among member countries
   (b) To regulate foreign investments and capital flows
   (c) To reduce trade barriers and facilitate international trade
   (d) To enforce labor and environmental standards in member countries

Answer:

(c) To reduce trade barriers and facilitate international trade

Explanation:

The primary objective of the WTO is to reduce trade barriers, such as tariffs and non-tariff barriers, and facilitate international trade among member countries.

4. How does the WTO settle trade disputes between member countries?
   (a) By imposing sanctions on non-compliant countries
   (b) By conducting independent investigations and trials
   (c) Through a dispute settlement mechanism with a panel of experts
   (d) By referring disputes to the United Nations (UN) for resolution

Answer:

(c) Through a dispute settlement mechanism with a panel of experts

Explanation:

The WTO settles trade disputes between member countries through its Dispute Settlement Mechanism, where panels of experts assess the cases and make recommendations.

5. Which of the following agreements is NOT under the purview of the WTO?
   (a) General Agreement on Tariffs and Trade (GATT)
   (b) Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)
   (c) Agreement on Agriculture (AoA)
   (d) North American Free Trade Agreement (NAFTA)

Answer:

(d) North American Free Trade Agreement (NAFT(A)

Explanation:

The North American Free Trade Agreement (NAFTA) was a regional trade agreement between Canada, Mexico, and the United States. It is not under the purview of the WTO.

6. How many member countries are currently part of the World Trade Organization (WTO)?

(a) 77	(b) 164
(c) 216	(d) 305

Answer:

(b) 164

Explanation:

As of my last update in September 2021, the World Trade Organization (WTO) had 164 member countries.

7. What is the primary function of the World Trade Organization (WTO)?
   (a) To regulate foreign direct investment (FDI) among member nations
   (b) To establish common monetary policies among member countries
   (c) To promote regional economic integration in Europe
   (d) To facilitate trade negotiations and resolve trade disputes among member countries

Answer:

(d) To facilitate trade negotiations and resolve trade disputes among member countries

Explanation:

The primary function of the World Trade Organization (WTO) is to provide a platform for member countries to conduct trade negotiations and to resolve trade disputes through its Dispute Settlement Mechanism.

8. Which of the following agreements is NOT administered by the World Trade Organization (WTO)?
   (a) General Agreement on Trade in Services (GATS)
   (b) Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)

(c) North American Free Trade Agreement (NAFTA)
(d) Agreement on Agriculture (AoA)

Answer:

(c) North American Free Trade Agreement (NAFTA)

Explanation: The North American Free Trade Agreement (NAFTA) is not administered by the World Trade Organization (WTO). It was a regional trade agreement between Canada, Mexico, and the United States. However, NAFTA was replaced by the United States-Mexico-Canada Agreement (USMCA) in 2020.

1.5.1 The Structure of the WTO

1. What is the highest decision-making body of the World Trade Organization (WTO)?
(a) General Council
(b) Ministerial Conference
(c) Appellate Body
(d) Dispute Settlement Body

Answer:

(b) Ministerial Conference

Explanation:

The Ministerial Conference is the highest decision-making body of the World Trade Organization (WTO). It meets at least once every two years.

2. Which of the following is responsible for the daily functioning of the WTO and implementation of decisions?
(a) General Council (b) Ministerial Conference
(c) Director-General (d) Dispute Settlement Body

Answer:

(c) Director-General

Explanation:

The Director-General is responsible for the daily functioning of the WTO and oversees the implementation of decisions made by the member countries.

3. Which WTO body is responsible for the settlement of disputes between member countries?
(a) General Council
(b) Dispute Settlement Body
(c) Appellate Body
(d) Ministerial Conference

Answer:

(b) Dispute Settlement Body

Explanation:

The Dispute Settlement Body (DSB) is responsible for the settlement of disputes between WTO member countries. It is a part of the WTO's dispute settlement mechanism.

4. Which WTO body reviews appeals of panel decisions in trade disputes?
(a) General Council
(b) Dispute Settlement Body
(c) Appellate Body
(d) Ministerial Conference

Answer:

(c) Appellate Body

Explanation:

The Appellate Body reviews appeals of panel decisions in trade disputes. It ensures the consistency and fairness of dispute settlement rulings.

5. What is the primary function of the General Council of the WTO?
(a) To administer trade agreements and monitor trade policies of member countries
(b) To oversee the daily functioning of the WTO and resolve budgetary matters
(c) To approve new members' accession to the WTO
(d) To set the strategic direction and goals for the WTO's work

Answer:

(a) To administer trade agreements and monitor trade policies of member countries

Explanation:
The General Council is responsible for administering trade agreements and monitoring trade policies of member countries. It is the main body that oversees the functioning of the WTO.

1.5.2 The Guiding Principles of World Trade Organization (WTO)

1. What are the guiding principles of the World Trade Organization (WTO)?
   (a) Protectionism and import substitution
   (b) Free trade, non-discrimination, and transparency
   (c) Bilateral trade agreements and export-oriented policies
   (d) Monetary policy coordination among member countries
   Answer:
   (b) Free trade, non-discrimination, and transparency
   Explanation:
   The guiding principles of the World Trade Organization (WTO) are free trade, non-discrimination, and transparency in trade policies.
2. Which principle of the WTO promotes the removal of trade barriers, such as tariffs and quotas?
   (a) Free trade
   (b) Non-discrimination
   (c) Transparency
   (d) Special and differential treatment
   Answer:
   (a) Free trade
   Explanation:
   The principle of free trade in the WTO promotes the reduction or elimination of trade barriers to facilitate the flow of goods and services.
3. What does the principle of non-discrimination in the WTO entail?
   (a) Giving preferential treatment to least-developed countries
   (b) Treating foreign and domestic products equally in trade matters
   (c) Restricting imports to protect domestic industries
   (d) Imposing export tariffs on certain goods
   Answer:
   (b) Treating foreign and domestic products equally in trade matters

   Explanation:
   The principle of non-discrimination (most-favored-nation and national treatment) in the WTO requires member countries to treat foreign and domestic products and services equally in trade matters.
4. How does the WTO promote transparency in trade policies?
   (a) By imposing trade sanctions on non-compliant member countries
   (b) By providing financial assistance to developing nations
   (c) By conducting regular trade policy reviews and notifications
   (d) By implementing quotas on specific products
   Answer:
   (c) By conducting regular trade policy reviews and notifications
   Explanation:
   The WTO promotes transparency by conducting regular trade policy reviews and requiring member countries to notify the organization about their trade policies and measures.
5. What is the principle of special and differential treatment in the WTO?
   (a) Imposing differential tariffs on imports from different countries
   (b) Granting preferential trade agreements to certain member countries
   (c) Providing financial aid to least-developed countries for trade-related capacity building
   (d) Allowing countries to set their own monetary policies independently
   Answer:
   (c) Providing financial aid to least-developed countries for trade-related capacity building
   Explanation:
   The principle of special and differential treatment in the WTO allows developing and least-developed countries to receive financial and technical assistance for trade-related capacity building and implementation of trade agreements.

1.6 The Doha Round

1. What is the Doha Round in the context of international trade?
   (a) A series of negotiations to establish a common currency among member countries

(b) A round of trade talks aimed at promoting regional economic integration in Europe
(c) A multilateral trade negotiation under the World Trade Organization (WTO)
(d) A regional trade agreement between South American countries

Answer:
(c) A multilateral trade negotiation under the World Trade Organization (WTO)

Explanation:
The Doha Round was a series of multilateral trade negotiations conducted under the World Trade Organization (WTO) from 2001 to 2015.

2. What was the main objective of the Doha Round?
(a) To establish a common monetary policy among member countries
(b) To promote import substitution policies in developing nations
(c) To reduce trade barriers and address the concerns of developing countries
(d) To restrict foreign direct investment (FDI) in developing economies

Answer:
(c) To reduce trade barriers and address the concerns of developing countries

Explanation:
The main objective of the Doha Round was to reduce trade barriers and address the concerns of developing countries, particularly in the areas of agriculture, services, and intellectual property.

3. Why was the Doha Round often referred to as the "Development Round"?
(a) Because it focused on increasing foreign aid to developing countries
(b) Because it aimed to promote export-oriented policies in developing economies
(c) Because it emphasized addressing the trade-related needs of developing countries
(d) Because it sought to impose higher tariffs on imports from developing nations

Answer:
(c) Because it emphasized addressing the trade-related needs of developing countries

Explanation:
The Doha Round was often referred to as the "Development Round" because it emphasized addressing the trade-related needs of developing countries, such as reducing agricultural subsidies and enhancing market access for their products.

4. What were some of the key issues of contention in the Doha Round negotiations?
(a) Climate change policies and environmental regulations
(b) Immigration and border control measures
(c) Intellectual property rights and access to essential medicines
(d) Currency exchange rates and monetary policies

Answer:
(c) Intellectual property rights and access to essential medicines

Explanation:
One of the key issues of contention in the Doha Round negotiations was related to intellectual property rights and access to essential medicines, particularly for developing countries.

5. Why did the Doha Round face challenges and delays in reaching a comprehensive agreement?
(a) Due to the lack of interest from developed countries in trade liberalization
(b) Because developing countries were not willing to participate in the negotiations
(c) Due to disagreements among member countries on various trade-related issues
(d) Because the World Trade Organization (WTO) lacked the authority to enforce trade agreements

Answer:
(c) Due to disagreements among member countries on various trade-related issues

Explanation:
The Doha Round faced challenges and delays primarily due to disagreements among member countries on various trade-related issues, including agricultural subsidies, market access, and intellectual property rights.

6. What is the Doha Round in the context of international trade?
   (a) A series of negotiations to establish the European Union (EU)
   (b) A multilateral agreement to regulate foreign direct investment (FDI)
   (c) A round of trade talks under the World Trade Organization (WTO)
   (d) A pact between countries within a specific region to facilitate trade and reduce barriers

   Answer:
   (c) A round of trade talks under the World Trade Organization (WTO)

   Explanation:
   The Doha Round was a series of trade talks conducted under the World Trade Organization (WTO) from 2001 to 2015.

7. What was the main objective of the Doha Round?
   (a) To establish a common currency among member countries
   (b) To promote regional trade agreements in Asia
   (c) To reduce trade barriers and promote development in developing countries
   (d) To restrict the movement of labor and capital across borders

   Answer:
   (c) To reduce trade barriers and promote development in developing countries

   Explanation:
   The main objective of the Doha Round was to reduce trade barriers and promote development in developing countries through various trade agreements.

8. The Doha Round negotiations focused on various sectors, including agriculture, services, and:
   (a) Pharmaceuticals (b) Information technology
   (c) Tourism (d) Industrial goods

   Answer:
   (d) Industrial goods

   Explanation:
   The Doha Round negotiations focused on various sectors, including agriculture, services, and industrial goods.

9. Why is the Doha Round often referred to as the "Development Round"?
   (a) Because it aimed to promote trade in developing countries
   (b) Because it focused on environmental sustainability
   (c) Because it aimed to eliminate subsidies in developed countries
   (d) Because it focused on reducing income disparities between rich and poor countries

   Answer:
   (a) Because it aimed to promote trade in developing countries

   Explanation:
   The Doha Round is often referred to as the "Development Round" because it aimed to promote trade in developing countries and address their specific concerns.

10. What were some of the challenges that led to the suspension of the Doha Round in 2015?
   (a) Lack of interest from developing countries in participating
   (b) Disagreements over intellectual property rights and patent regulations
   (c) Resistance from developed countries to reduce agricultural subsidies
   (d) A focus on bilateral trade agreements instead of multilateral negotiations

   Answer:
   (c) Resistance from developed countries to reduce agricultural subsidies

   Explanation:
   One of the challenges that led to the suspension of the Doha Round in 2015 was the resistance from developed countries to reduce agricultural subsidies, which was a contentious issue for developing countries.

1.7 G 20 Economies: Facilitating Trade

1. What is the G20?
   (a) An organization of 20 countries focused on facilitating international trade
   (b) A group of 20 economies that promote regional economic integration
   (c) A forum of major advanced and emerging economies addressing global economic issues
   (d) A trade bloc formed by 20 countries to impose trade restrictions on non-members

   Answer:
   (c) A forum of major advanced and emerging economies addressing global economic issues

   Explanation:
   The G20 is a forum of major advanced and emerging economies that come together to discuss and address global economic and financial issues.

2. How can the G20 economies facilitate international trade?
   (a) By imposing tariffs and quotas on imports from non-member countries
   (b) By implementing trade agreements among member countries
   (c) By fostering economic growth and stability to promote global trade
   (d) By providing financial aid to developing countries for trade-related infrastructure

   Answer:
   (c) By fostering economic growth and stability to promote global trade

   Explanation:
   The G20 economies can facilitate international trade by promoting economic growth and stability, which creates an environment conducive to global trade.

3. Which of the following is NOT a direct role of the G20 in trade facilitation?
   (a) Negotiating bilateral trade agreements between member countries
   (b) Discussing trade-related issues among member countries

   (c) Addressing trade imbalances and protectionist measures
   (d) Encouraging the reduction of trade barriers

   Answer:
   (a) Negotiating bilateral trade agreements between member countries

   Explanation:
   The G20 is not a formal trade negotiation forum for bilateral trade agreements between member countries.

4. How do G20 discussions on global economic issues impact international trade?
   (a) They can lead to the formation of regional trade blocs
   (b) They may result in the harmonization of trade policies among member countries
   (c) They have no direct impact on international trade
   (d) They focus solely on monetary policies and do not address trade matters

   Answer:
   (b) They may result in the harmonization of trade policies among member countries

   Explanation:
   G20 discussions on global economic issues can lead to a better understanding of trade-related challenges, potentially resulting in the harmonization of trade policies among member countries.

5. What is the G20's stance on protectionism?
   (a) The G20 encourages its member countries to embrace protectionist measures to safeguard domestic industries
   (b) The G20 supports open markets and rejects protectionism in global trade
   (c) The G20 imposes tariffs on goods from non-member countries to protect its economies
   (d) The G20 allows its member countries to implement import quotas on specific products

   Answer:
   (b) The G20 supports open markets and rejects protectionism in global trade

Explanation:
The G20 is committed to supporting open markets and rejecting protectionism in global trade to foster economic growth and stability.

6. What is the primary focus of the G20 group of economies?
   (a) Facilitating trade negotiations and agreements
   (b) Addressing global economic and financial issues
   (c) Implementing regional trade blocs
   (d) Regulating foreign direct investment (FDI)

   Answer:
   (b) Addressing global economic and financial issues

   Explanation:
   The G20 group of economies primarily focuses on addressing global economic and financial issues through discussions and cooperation among member countries.

Additional Question Bank

1.1 Introduction

1. Trade negotiations are formal discussions and dialogues between countries or trading blocs aimed at:
   (a) Promoting protectionism and trade barriers
   (b) Increasing foreign direct investment
   (c) Facilitating trade liberalization and reducing trade barriers
   (d) Regulating exchange rates and monetary policies
2. The World Trade Organization (WTO) plays a significant role in international trade negotiations by:
   (a) Imposing trade sanctions on non-compliant countries
   (b) Establishing a unified global currency
   (c) Setting international standards for labor practices
   (d) Providing a platform for multilateral trade negotiations and dispute settlement

3. Bilateral trade negotiations involve discussions between:
   (a) Two countries or trading partners
   (b) Multiple countries and regional blocs
   (c) The World Bank and the International Monetary Fund (IMF)
   (d) The United Nations and the World Trade Organization (WTO)
4. The Trans-Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP) are examples of:
   (a) Multilateral trade agreements
   (b) Bilateral trade agreements
   (c) Trade blocs or regional trade agreements
   (d) Trade negotiations between developed and developing countries
5. Trade negotiations aim to address various trade-related issues, including:
   (a) Environmental protection and climate change policies
   (b) Currency exchange rate manipulation
   (c) Intellectual property rights and market access
   (d) Military alliances and defense spending

1.2 Taxonomy of REGIONAL Trade Agreements (RTAS)

1. Regional Trade Agreements (RTAs) are agreements between:
   (a) Two or more countries within a region to promote trade and economic integration
   (b) A country and the World Trade Organization (WTO)
   (c) Developing countries and developed countries
   (d) Countries and international organizations such as the World Bank
2. Preferential Trade Agreements (PTAs) are a type of RTA that:
   (a) Reduce or eliminate trade barriers between member countries
   (b) Impose higher tariffs on imports from non-member countries
   (c) Apply trade restrictions only to certain products and industries
   (d) Promote exports but do not impact imports
3. Free Trade Areas (FTAs) are RTAs that aim to:
   (a) Promote fair trade practices between member countries
   (b) Establish a common currency for member countries

(c) Encourage trade and remove most or all trade barriers within the region
(d) Increase tariffs and protectionism to protect domestic industries

4. Customs Unions are RTAs that involve:
(a) The establishment of a common external tariff on imports from non-member countries
(b) Joint management of natural resources by member countries
(c) The formation of a military alliance between member countries
(d) Coordination of monetary policies and exchange rates among member countries

5. Common Markets are RTAs that go beyond customs unions and also allow for:
(a) Free movement of goods and services, but not labor and capital, within the region
(b) Free movement of labor and capital, but not goods and services, within the region
(c) Free movement of goods, services, labor, and capital within the region
(d) The formation of a common defense and security policy among member countries

1.3 The General Agreement on Tariffs and Trade (GATT)

1. The General Agreement on Tariffs and Trade (GATT) was established in:
(a) 1944
(b) 1947
(c) 1951
(d) 1955

2. The main objective of the GATT was to:
(a) Promote regional trade agreements among developing countries
(b) Facilitate trade negotiations between developed and developing countries
(c) Reduce tariffs and trade barriers among member countries
(d) Establish a unified global currency

3. The GATT operated as a multilateral agreement to:
(a) Establish a common currency for all member countries
(b) Regulate the stock market and financial institutions
(c) Set international labor standards
(d) Promote the liberalization of international trade

4. The GATT was succeeded by the World Trade Organization (WTO) in:
(a) 1995 (b) 2000
(c) 1980 (d) 1975

5. The principle of most-favored-nation (MFN) treatment under the GATT meant that:
(a) All member countries were treated equally without discrimination
(b) Developing countries received preferential treatment in trade negotiations
(c) Member countries were required to impose tariffs on non-member countries
(d) Trade barriers were imposed on specific products and industries

1.4 The Uruguay Round and the Establishment of WTO

1. The Uruguay Round was a series of negotiations that took place under the auspices of:
(a) The United Nations (UN)
(b) The World Bank
(c) The International Monetary Fund (IMF)
(d) The General Agreement on Tariffs and Trade (GATT)

2. The Uruguay Round negotiations were initiated in:
(a) 1986 (b) 1988
(c) 1990 (d) 1994

3. The main objective of the Uruguay Round was to:
(a) Reduce agricultural subsidies and support
(b) Restrict the trade of developing countries
(c) Address emerging environmental issues in international trade
(d) Create a more comprehensive and effective international trade agreement

4. The Uruguay Round resulted in the establishment of the World Trade Organization (WTO) in:
   (a) 1986
   (b) 1990
   (c) 1994
   (d) 1995
5. The WTO is an international organization that oversees and enforces global trade rules and agreements among its member countries. Its headquarters are located in:
   (a) Geneva, Switzerland
   (b) New York, USA
   (c) Brussels, Belgium
   (d) Tokyo, Japan

1.5 The World Trade Organization (WTO)

1. The World Trade Organization (WTO) is an international organization that deals with the global rules of trade among its member countries. It officially commenced operations on:
   (a) January 1, 1995
   (b) January 1, 2000
   (c) January 1, 1990
   (d) January 1, 1985
2. The WTO is headquartered in:
   (a) Washington, D.C., USA
   (b) Brussels, Belgium
   (c) Geneva, Switzerland
   (d) New York, USA
3. The WTO operates on the principle of __________, which means that any trade concession granted to one member country should be extended to all member countries.
   (a) Most-Favored Nation (MFN)
   (b) Free Trade Area (FTA)
   (c) Preferential Trade Agreement (PTA)
   (d) Customs Union (CU)

4. The highest decision-making body of the WTO is the Ministerial Conference, which meets at least once every:
   (a) Two years
   (b) Four years
   (c) Six years
   (d) Eight years
5. The WTO has a dispute settlement mechanism that allows member countries to resolve trade disputes in a rules-based manner. If a dispute cannot be resolved through consultations, it may be brought before a panel of experts. The final appellate body for dispute settlement in the WTO is known as the:
   (a) Dispute Resolution Panel (DRP)
   (b) Appellate Body (AB)
   (c) Trade Dispute Arbitration Board (TDAB)
   (d) Dispute Resolution Court (DRC)

1.6 The Doha Round

1. The Doha Round is a series of trade negotiations that were launched under the auspices of the World Trade Organization (WTO) in:
   (a) 1995
   (b) 2001
   (c) 2005
   (d) 2010
2. The main objective of the Doha Round was to:
   (a) Establish a global currency for all member countries
   (b) Focus on environmental and climate change issues related to international trade
   (c) Address trade barriers and promote development in developing countries
   (d) Create a regional trade agreement between developed countries
3. One of the significant issues of the Doha Round negotiations was related to:
   (a) Intellectual property rights and copyright protection
   (b) Currency exchange rate manipulation

(c) Agricultural subsidies and market access for agricultural products
(d) Environmental standards in manufacturing industries

4. The Doha Development Agenda (DDA) is a set of trade negotiation goals and objectives specifically aimed at:
   (a) Promoting trade liberalization among developed countries
   (b) Reducing trade barriers for small and medium-sized enterprises (SMEs)
   (c) Addressing the trade concerns of developing countries and improving their access to global markets
   (d) Expanding trade in the services sector, such as finance and telecommunications

1.7 G 20 Economies: Facilitating Trade

1. The G20 is a group of major advanced and emerging economies that represent about ___________ of the world's GDP and ___________ of the global trade.
   (a) 20%; 50% (b) 40%; 80%
   (c) 60%; 90% (d) 80%; 70%
2. The G20 economies play a significant role in facilitating trade by:
   (a) Establishing a common currency for all member countries
   (b) Imposing higher tariffs on imports from non-member countries
   (c) Promoting protectionist trade policies
   (d) Cooperating on international trade and economic issues
3. The G20 economies have held summits since:
   (a) 1995 (b) 1999
   (c) 2001 (d) 2005
4. The G20 economies focus on addressing global economic challenges, promoting financial stability, and enhancing cooperation on international trade to foster:
   (a) Regional trade agreements
   (b) Protectionist trade measures
   (c) Sustainable and inclusive economic growth
   (d) Exchange rate manipulation

5. One of the key objectives of the G20 economies is to foster open and predictable trade policies that promote:
   (a) Trade restrictions and barriers
   (b) Free trade agreements among member countries
   (c) Bilateral trade agreements with non-member countries
   (d) Economic growth, job creation, and global prosperity through international trade

Answers

1.1 Introduction

1. (c) Facilitating trade liberalization and reducing trade barriers
2. (d) Providing a platform for multilateral trade negotiations and dispute settlement
3. (a) Two countries or trading partners
4. (c) Trade blocs or regional trade agreements
5. (c) Intellectual property rights and market access

1.2 Taxonomy of Regional Trade Agreements (RTAS)

1. (a) Two or more countries within a region to promote trade and economic integration
2. (a) Reduce or eliminate trade barriers between member countries
3. (c) Encourage trade and remove most or all trade barriers within the region
4. (a) The establishment of a common external tariff on imports from non-member countries
5. (c) Free movement of goods, services, labor, and capital within the region

1.3 The General Agreement on Tariffs and Trade (GATT)

1. (b) 1947
2. (c) Reduce tariffs and trade barriers among member countries
3. (d) Promote the liberalization of international trade

4. (a) 1995
5. (a) All member countries were treated equally without discrimination

1.4 THE URUGUAY ROUND AND THE ESTABLISHMENT OF WTO

1. (d) The General Agreement on Tariffs and Trade (GATT)
2. (a) 1986
3. (d) Create a more comprehensive and effective international trade agreement
4. (d) 1995
5. (a) Geneva, Switzerland

1.5 The World Trade Organization (WTO)

1. (a) January 1, 1995
2. (c) Geneva, Switzerland
3. (a) Most-Favored Nation (MFN)
4. (a) Two years
5. (b) Appellate Body (A(B)

1.6 The Doha Round

1. (b) 2001
2. (c) Address trade barriers and promote development in developing countries
3. (c) Agricultural subsidies and market access for agricultural products
4. (c) Addressing the trade concerns of developing countries and improving their access to global markets

1.7 G 20 Economies: Facilitating Trade

1. (c) 60%; 90%
2. (d) Cooperating on international trade and economic issues
3. (b) 1999
4. (c) Sustainable and inclusive economic growth
5. (d) Economic growth, job creation, and global prosperity through international trade

9 INTERNATIONAL TRADE

Unit:4 Exchange Rate and Its Economic Effects

Multiple Choice Questions

1.1 Introduction

1. What is an exchange rate?
   (a) The rate at which a country exports goods and services
   (b) The rate at which a country imports goods and services
   (c) The rate at which one currency can be exchanged for another currency
   (d) The rate at which a country's central bank sets interest rates
   Answer:
   (c) The rate at which one currency can be exchanged for another currency
   Explanation:
   An exchange rate is the rate at which one currency can be exchanged for another currency in the foreign exchange market.
2. How is the exchange rate determined in a floating exchange rate system?
   (a) By the country's central bank through interventions in the foreign exchange market
   (b) By the demand and supply of currencies in the foreign exchange market
   (c) By fixed government policies that peg the exchange rate to a specific value
   (d) By international organizations like the World Bank setting the exchange rate
   Answer:
   (b) By the demand and supply of currencies in the foreign exchange market

Explanation:
In a floating exchange rate system, the exchange rate is determined by the demand and supply of currencies in the foreign exchange market.

3. How does a depreciation of a country's currency affect its exports?
   (a) It increases the cost of exports, making them less competitive in foreign markets
   (b) It decreases the cost of exports, making them more competitive in foreign markets
   (c) It has no impact on the cost of exports
   (d) It leads to a complete halt in exports

   Answer:
   (b) It decreases the cost of exports, making them more competitive in foreign markets

   Explanation:
   A depreciation of a country's currency reduces the cost of its exports in foreign currency terms, making them more competitive in foreign markets.

4. What is the term used to describe a situation where a country deliberately lowers the value of its currency to gain a competitive advantage in international trade?
   (a) Devaluation
   (b) Revaluation
   (c) Appreciation
   (d) Stabilization

   Answer:
   (a) Devaluation

   Explanation:
   Devaluation refers to a deliberate reduction in the value of a country's currency by its government to improve export competitiveness.

5. How does an appreciation of a country's currency impact its imports?
   (a) It increases the cost of imports, making them more attractive to domestic consumers
   (b) It decreases the cost of imports, making them less attractive to domestic consumers

   (c) It has no impact on the cost of imports
   (d) It leads to a complete halt in imports

   Answer:
   (a) It increases the cost of imports, making them more attractive to domestic consumers

   Explanation:
   An appreciation of a country's currency increases the cost of imports in domestic currency terms, making them less attractive to domestic consumers.

6. How is the exchange rate determined in a floating exchange rate system?
   (a) It is fixed by the World Bank based on a country's economic performance
   (b) It is determined by supply and demand in the foreign exchange market
   (c) It is set unilaterally by each country's central bank
   (d) It is pegged to the price of gold or another commodity

   Answer:
   (b) It is determined by supply and demand in the foreign exchange market

   Explanation:
   In a floating exchange rate system, the exchange rate is determined by the forces of supply and demand in the foreign exchange market.

7. What is the impact of a depreciation of a country's currency on its exports?
   (a) Exports decrease because foreign goods become cheaper for domestic consumers
   (b) Exports increase because domestic goods become cheaper for foreign consumers
   (c) Exports remain unchanged as the depreciation has no effect on trade
   (d) Exports increase because foreign goods become more expensive for domestic consumers

Answer:

(b) Exports increase because domestic goods become cheaper for foreign consumers

Explanation:

A depreciation of a country's currency makes its goods and services relatively cheaper for foreign consumers, leading to an increase in exports.

8. How does an appreciation of a country's currency affect its imports?
   (a) Imports decrease because domestic goods become cheaper for foreign consumers
   (b) Imports increase because foreign goods become cheaper for domestic consumers
   (c) Imports remain unchanged as the appreciation has no effect on trade
   (d) Imports increase because domestic goods become more expensive for foreign consumers

Answer:

(d) Imports increase because domestic goods become more expensive for foreign consumers

Explanation:

An appreciation of a country's currency makes its goods and services relatively more expensive for foreign consumers, leading to an increase in imports.

9. What is a trade surplus?
   (a) When a country's imports exceed its exports
   (b) When a country's exports exceed its imports
   (c) When a country has a fixed exchange rate regime
   (d) When a country's inflation rate is higher than that of its trading partners

Answer:

(b) When a country's exports exceed its imports

Explanation:

A trade surplus occurs when a country's exports exceed its imports, resulting in a positive balance of trade.

1.2 The Exchange Rate

1. In a floating exchange rate system, how is the exchange rate determined?
   (a) It is fixed by the government to stabilize international trade
   (b) It is determined by supply and demand in the foreign exchange market
   (c) It is pegged to a specific commodity, such as gold
   (d) It is set unilaterally by each country's central bank

Answer:

(b) It is determined by supply and demand in the foreign exchange market

Explanation:

In a floating exchange rate system, the exchange rate is determined by the forces of supply and demand in the foreign exchange market.

2. What does an appreciation of a country's currency mean?
   (a) The currency has increased in value relative to other currencies
   (b) The currency has decreased in value relative to other currencies
   (c) The country's central bank has intervened to stabilize the exchange rate
   (d) The country is experiencing high inflation rates

Answer:

(a) The currency has increased in value relative to other currencies

Explanation:

An appreciation of a country's currency means that the value of the currency has increased relative to other currencies.

3. How does an appreciation of a country's currency affect its exports?
   (a) Exports increase because foreign goods become cheaper for domestic consumers
   (b) Exports decrease because domestic goods become more expensive for foreign consumers
   (c) Exports remain unchanged as the appreciation has no effect on trade
   (d) Exports increase because domestic goods become more expensive for domestic consumers

Answer:
(b) Exports decrease because domestic goods become more expensive for foreign consumers

Explanation:
An appreciation of a country's currency makes its goods and services relatively more expensive for foreign consumers, leading to a decrease in exports.

4. What is a trade deficit?
   (a) When a country's exports exceed its imports
   (b) When a country's imports exceed its exports
   (c) When a country has a fixed exchange rate regime
   (d) When a country's inflation rate is higher than that of its trading partners

Answer:
(b) When a country's imports exceed its exports

Explanation:
A trade deficit occurs when a country's imports exceed its exports, resulting in a negative balance of trade.

1.3 The Exchange Rate Regimes

1. What is an exchange rate regime?
   (a) The rate at which a country's central bank lends money to commercial banks
   (b) The rate at which one country's currency can be exchanged for another country's currency
   (c) The framework adopted by a country to determine the value of its currency in relation to other currencies
   (d) The rate at which a country's central bank buys and sells government securities

Answer:
(c) The framework adopted by a country to determine the value of its currency in relation to other currencies

Explanation:
An exchange rate regime is the framework adopted by a country to determine the value of its currency in relation to other currencies, and it can be fixed or flexible.

2. In a fixed exchange rate regime, the exchange rate is:
   (a) Determined by supply and demand in the foreign exchange market
   (b) Set by the country's central bank and remains constant
   (c) Free to fluctuate based on market forces
   (d) Linked to the price of gold or another commodity

Answer:
(b) Set by the country's central bank and remains constant

Explanation:
In a fixed exchange rate regime, the country's central bank sets the exchange rate and maintains its constancy by buying or selling foreign currency.

3. Which exchange rate regime allows the exchange rate to be determined by market forces without significant intervention from the central bank?
   (a) Fixed exchange rate regime
   (b) Flexible exchange rate regime
   (c) Crawling peg exchange rate regime
   (d) Currency board arrangement

Answer:
(b) Flexible exchange rate regime

Explanation:
In a flexible exchange rate regime, the exchange rate is mainly determined by market forces, and the central bank intervenes only to manage excessive volatility.

4. What is a crawling peg exchange rate regime?
   (a) An exchange rate regime where the currency is pegged to the price of gold
   (b) An exchange rate regime where the central bank intervenes heavily to maintain a fixed rate
   (c) An exchange rate regime where the exchange rate is adjusted gradually over time based on certain indicators

(d) An exchange rate regime where the currency is freely floated and determined by market forces

Answer:

(c) An exchange rate regime where the exchange rate is adjusted gradually over time based on certain indicators

Explanation:

In a crawling peg exchange rate regime, the exchange rate is adjusted gradually over time based on certain indicators, such as inflation or trade balances.

5. In a currency board arrangement, the central bank:
   (a) Intervenes heavily in the foreign exchange market to stabilize the exchange rate
   (b) Has the authority to issue its currency independently of any foreign reserve backing
   (c) Holds reserves in a specific foreign currency to back the domestic currency at a fixed rate
   (d) Allows the currency to float freely based on market demand and supply

Answer:

(c) Holds reserves in a specific foreign currency to back the domestic currency at a fixed rate

Explanation:

In a currency board arrangement, the central bank holds reserves in a specific foreign currency, which fully backs the domestic currency at a fixed exchange rate.

6. Which of the following is an example of a fixed exchange rate regime?
   (a) Floating exchange rate system
   (b) Managed float exchange rate system
   (c) Currency board arrangement
   (d) Target exchange rate system

Answer:

(c) Currency board arrangement

Explanation: A currency board arrangement is an example of a fixed exchange rate regime, where the country's central bank is required to hold reserves in foreign currency equal to the total amount of its domestic currency in circulation.

7. In a floating exchange rate regime, how is the exchange rate determined?
   (a) It is set unilaterally by each country's central bank
   (b) It is determined by supply and demand in the foreign exchange market
   (c) It is pegged to a specific commodity, such as gold
   (d) It is fixed by the International Monetary Fund (IMF)

Answer:

(b) It is determined by supply and demand in the foreign exchange market

Explanation:

In a floating exchange rate regime, the exchange rate is determined by the forces of supply and demand in the foreign exchange market.

8. Which exchange rate regime allows the value of a country's currency to fluctuate within a specified band?
   (a) Fixed exchange rate system
   (b) Managed float exchange rate system
   (c) Crawling peg exchange rate system
   (d) Currency board arrangement

Answer:

(c) Crawling peg exchange rate system

Explanation:

In a crawling peg exchange rate system, the exchange rate is allowed to fluctuate within a specified band, and the central bank regularly adjusts the exchange rate within that band.

9. What is the primary advantage of a flexible exchange rate regime?
   (a) It promotes exchange rate stability and reduces currency volatility
   (b) It allows the government to control interest rates more effectively
   (c) It eliminates the need for foreign exchange reserves
   (d) It allows the country to pursue an independent monetary policy

Answer:
(d) It allows the country to pursue an independent monetary policy
Explanation:
The primary advantage of a flexible exchange rate regime is that it allows the country to pursue an independent monetary policy, as the central bank can adjust interest rates and money supply according to domestic economic conditions.

Managed Float Systems

10. What is a managed float exchange rate system?
   (a) A system where the exchange rate is determined solely by market forces
   (b) A system where the exchange rate is fixed to a specific commodity, such as gold
   (c) A system where the central bank intervenes in the foreign exchange market to influence the exchange rate
   (d) A system where the exchange rate is pegged to a basket of currencies

   Answer:
   (c) A system where the central bank intervenes in the foreign exchange market to influence the exchange rate
   Explanation:
   In a managed float exchange rate system, the central bank occasionally intervenes in the foreign exchange market to influence the exchange rate and prevent excessive volatility.
11. What is the primary reason for central bank intervention in a managed float system?
   (a) To fix the exchange rate to a specific value
   (b) To maintain a completely flexible and market-determined exchange rate
   (c) To accumulate foreign exchange reserves for investment purposes
   (d) To stabilize the exchange rate and avoid abrupt fluctuations

   Answer:
   (d) To stabilize the exchange rate and avoid abrupt fluctuations

   Explanation:
   The primary reason for central bank intervention in a managed float system is to stabilize the exchange rate and prevent abrupt fluctuations that could have adverse effects on the economy.
12. How does a central bank influence the exchange rate in a managed float system?
   (a) By implementing capital controls to restrict currency flows
   (b) By buying or selling foreign currencies in the foreign exchange market
   (c) By fixing interest rates at a specific level.
   (d) By imposing tariffs and quotas on imported goods

   Answer:
   (b) By buying or selling foreign currencies in the foreign exchange market
   Explanation:
   In a managed float system, the central bank can influence the exchange rate by buying or selling foreign currencies in the foreign exchange market, thereby affecting the demand and supply of the domestic currency.
13. Which of the following best describes the flexibility of exchange rates in a managed float system?
   (a) The exchange rate is completely fixed and unchanged over time
   (b) The exchange rate is determined solely by market forces with no central bank intervention
   (c) The exchange rate is adjusted periodically based on market conditions and central bank interventions
   (d) The exchange rate is pegged to a specific value against another currency

   Answer:
   (c) The exchange rate is adjusted periodically based on market conditions and central bank interventions
   Explanation:
   In a managed float system, the exchange rate is not fixed, and it is adjusted periodically based on market conditions and central bank interventions to achieve certain policy objectives.

14. What is an advantage of a managed float system compared to a fixed exchange rate system?
    (a) It provides more exchange rate stability
    (b) It eliminates the need for foreign exchange reserves
    (c) It allows the central bank to fully control the exchange rate
    (d) It promotes currency speculations in the foreign exchange market

    Answer:

    (a) It provides more exchange rate stability

    Explanation:

    A managed float system provides more exchange rate stability compared to a fixed exchange rate system, as the central bank intervenes to stabilize the currency's value.

Fixed Exchange Rates

15. What is a fixed exchange rate system?
    (a) A system where the exchange rate is determined solely by market forces
    (b) A system where the exchange rate is fixed and maintained at a specific value by the central bank
    (c) A system where the exchange rate is determined by a basket of currencies
    (d) A system where the exchange rate is allowed to fluctuate within a specified band

    Answer:

    (b) A system where the exchange rate is fixed and maintained at a specific value by the central bank

    Explanation:

    In a fixed exchange rate system, the exchange rate is fixed and maintained at a specific value by the central bank through interventions in the foreign exchange market.

16. What is the primary advantage of a fixed exchange rate system?
    (a) Exchange rate stability, reducing uncertainty for international trade and investments
    (b) Flexibility in adjusting the exchange rate based on market conditions

    (c) Full control of the exchange rate by market forces
    (d) Ability to accumulate foreign exchange reserves easily

    Answer:

    (a) Exchange rate stability, reducing uncertainty for international trade and investments

    Explanation:

    The primary advantage of a fixed exchange rate system is the exchange rate stability it provides, reducing uncertainty for international trade and investments.

17. How does a central bank maintain a fixed exchange rate?
    (a) By allowing the exchange rate to fluctuate based on market conditions
    (b) By buying or selling foreign currencies in the foreign exchange market to balance supply and demand
    (c) By imposing capital controls to restrict currency flows
    (d) By pegging the exchange rate to a basket of goods and services

    Answer:

    (b) By buying or selling foreign currencies in the foreign exchange market to balance supply and demand

    Explanation:

    In a fixed exchange rate system, the central bank maintains the fixed rate by buying or selling foreign currencies in the foreign exchange market to ensure supply and demand equilibrium.

18. Which of the following is a disadvantage of a fixed exchange rate system?
    (a) Exchange rate stability, reducing uncertainty for businesses and investors
    (b) Limited ability to adjust to changing economic conditions
    (c) Elimination of currency speculation in the foreign exchange market
    (d) Enhanced ability to pursue independent monetary policies

    Answer:

    (b) Limited ability to adjust to changing economic conditions

Explanation:
One of the disadvantages of a fixed exchange rate system is the limited ability to adjust to changing economic conditions, as the exchange rate remains fixed regardless of market forces.

19. What happens if there is an imbalance in the supply and demand of a currency in a fixed exchange rate system?
    (a) The central bank adjusts the fixed exchange rate to balance the market
    (b) The central bank allows the exchange rate to fluctuate freely
    (c) The central bank intervenes in the foreign exchange market to buy or sell currencies
    (d) The exchange rate becomes flexible and market-determined

Answer:
(c) The central bank intervenes in the foreign exchange market to buy or sell currencies

Explanation:
In a fixed exchange rate system, if there is an imbalance in the supply and demand of a currency, the central bank intervenes in the foreign exchange market to buy or sell currencies to maintain the fixed rate.

1.4 Nominal Versus REAL Exchange Rates

1. What is a nominal exchange rate?
    (a) The rate at which one country's currency can be exchanged for another country's currency
    (b) The rate at which the central bank buys and sells government securities
    (c) The rate at which a country's central bank lends money to commercial banks
    (d) The rate at which the inflation rate is changing over time

Answer:
(a) The rate at which one country's currency can be exchanged for another country's currency

Explanation:
A nominal exchange rate is the rate at which one country's currency can be exchanged for another country's currency.

2. How is the nominal exchange rate expressed?
    (a) In terms of the price level of goods and services in each country
    (b) In terms of the interest rate differential between two countries
    (c) In terms of the purchasing power of each country's currency
    (d) In terms of the number of units of foreign currency per unit of domestic currency

Answer:
(d) In terms of the number of units of foreign currency per unit of domestic currency

Explanation:
The nominal exchange rate is expressed as the number of units of foreign currency that can be obtained per unit of domestic currency.

3. What is a real exchange rate?
    (a) The rate at which the central bank intervenes in the foreign exchange market
    (b) The rate at which a country's central bank sets interest rates
    (c) The rate at which the inflation rate is changing over time
    (d) The rate at which the relative price level of goods and services between two countries is changing over time

Answer:
(d) The rate at which the relative price level of goods and services between two countries is changing over time

Explanation:
A real exchange rate is the rate at which the relative price level of goods and services between two countries is changing over time, taking into account inflation differences.

4. What does it mean when the real exchange rate is greater than one?
    (a) The domestic currency is overvalued relative to foreign currencies
    (b) The domestic currency is undervalued relative to foreign currencies
    (c) The nominal exchange rate is increasing rapidly
    (d) The country is experiencing high inflation rates

Answer:

(a) The domestic currency is overvalued relative to foreign currencies

Explanation:

When the real exchange rate is greater than one, it indicates that the domestic currency is overvalued relative to foreign currencies, making domestic goods relatively more expensive for foreign consumers.

5. How is the real exchange rate calculated?
   (a) By dividing the nominal exchange rate by the inflation rate in the domestic country
   (b) By dividing the inflation rate in the domestic country by the inflation rate in the foreign country
   (c) By multiplying the nominal exchange rate by the inflation rate in the domestic country
   (d) By adding the inflation rates in the domestic and foreign countries

Answer:

(a) By dividing the nominal exchange rate by the inflation rate in the domestic country

Explanation:

The real exchange rate is calculated by dividing the nominal exchange rate by the inflation rate in the domestic country, relative to the foreign country.

6. How is the real exchange rate different from the nominal exchange rate?
   (a) The real exchange rate takes inflation into account, while the nominal exchange rate does not.
   (b) The real exchange rate is determined by market forces, while the nominal exchange rate is set by the central bank.
   (c) The real exchange rate applies to goods and services, while the nominal exchange rate applies to financial transactions.
   (d) The real exchange rate only considers trade in goods, while the nominal exchange rate includes trade in services.

Answer:

(a) The real exchange rate takes inflation into account, while the nominal exchange rate does not.

Explanation:

The real exchange rate adjusts the nominal exchange rate to account for differences in inflation rates between two countries.

7. How is the real exchange rate calculated?
   (a) Nominal exchange rate multiplied by the inflation rate of the home country
   (b) Nominal exchange rate multiplied by the inflation rate of the foreign country
   (c) Nominal exchange rate divided by the inflation rate of the home country
   (d) Nominal exchange rate divided by the inflation rate of the foreign country

Answer:

(c) Nominal exchange rate divided by the inflation rate of the home country

Explanation:

The real exchange rate is calculated by dividing the nominal exchange rate by the inflation rate of the home country.

8. What does a real exchange rate greater than 1 indicate?
   (a) The home country's goods and services are relatively more expensive than foreign goods and services.
   (b) The home country's goods and services are relatively cheaper than foreign goods and services.
   (c) The nominal exchange rate has appreciated against the foreign currency.
   (d) The nominal exchange rate has depreciated against the foreign currency.

Answer:

(a) The home country's goods and services are relatively more expensive than foreign goods and services.

Explanation:

A real exchange rate greater than 1 indicates that the home country's goods and services are relatively more expensive than foreign goods and services.

9. What is the significance of the real exchange rate in international trade?
   (a) It affects the nominal exchange rate set by the central bank.
   (b) It determines the balance of trade between two countries.
   (c) It impacts the inflation rate of both countries involved in trade.
   (d) It reflects the relative price levels of goods and services between two countries.

   Answer:
   (d) It reflects the relative price levels of goods and services between two countries.

   Explanation:
   The real exchange rate reflects the relative price levels of goods and services between two countries, which has significant implications for international trade.

10. What does the nominal exchange rate represent?
   (a) The rate at which one currency can be exchanged for another currency in the foreign exchange market
   (b) The rate at which a country's central bank lends money to commercial banks
   (c) The rate at which a country's central bank buys and sells government securities
   (d) The rate at which the general price level in an economy changes over time

   Answer:
   (a) The rate at which one currency can be exchanged for another currency in the foreign exchange market

   Explanation:
   The nominal exchange rate represents the rate at which one currency can be exchanged for another currency in the foreign exchange market.

11. What does the real exchange rate take into account that the nominal exchange rate does not?
   (a) Inflation rates of both countries
   (b) Interest rates of both countries
   (c) Gross domestic product (GDP) of both countries
   (d) Foreign exchange reserves of both countries

   Answer:
   (a) Inflation rates of both countries

   Explanation:
   The real exchange rate takes into account the inflation rates of both countries, adjusting the nominal exchange rate for differences in price levels.

12. How is the real exchange rate calculated?
   (a) Real exchange rate = Nominal exchange rate / Inflation rate of the domestic country
   (b) Real exchange rate = Inflation rate of the domestic country / Nominal exchange rate
   (c) Real exchange rate = Nominal exchange rate + Inflation rate of the domestic country
   (d) Real exchange rate = Nominal exchange rate - Inflation rate of the domestic country

   Answer:
   (a) Real exchange rate = Nominal exchange rate / Inflation rate of the domestic country

   Explanation:
   The real exchange rate is calculated by dividing the nominal exchange rate by the inflation rate of the domestic country.

13. How does an increase in the domestic country's inflation rate affect the real exchange rate?
   (a) The real exchange rate increases
   (b) The real exchange rate decreases
   (c) The real exchange rate remains unchanged
   (d) The real exchange rate becomes flexible and market-determined

   Answer:
   (b) The real exchange rate decreases

   Explanation:
   An increase in the domestic country's inflation rate decreases the real exchange rate because the domestic currency's purchasing power declines relative to foreign currencies.

14. Which exchange rate is more relevant for comparing the relative purchasing power of different countries?
    (a) Nominal exchange rate
    (b) Real exchange rate
    (c) Effective exchange rate
    (d) Market exchange rate

    Answer:
    (b) Real exchange rate

    Explanation:
    The real exchange rate is more relevant for comparing the relative purchasing power of different countries as it accounts for differences in price levels due to inflation.

1.5 The Foreign Exchange Market

1. What is the foreign exchange market?
    (a) A market where foreign goods and services are traded
    (b) A market where foreign currencies are bought and sold
    (c) A market where foreign direct investment (FDI) takes place
    (d) A market where commodities are exchanged between countries

    Answer:
    (b) A market where foreign currencies are bought and sold

    Explanation:
    The foreign exchange market is a market where currencies of different countries are bought and sold, facilitating international trade and investment.

2. Which of the following participants plays the most significant role in the foreign exchange market?
    (a) Governments and central banks
    (b) Multinational corporations
    (c) Individual retail traders
    (d) Stock exchanges

    Answer:
    (a) Governments and central banks

    Explanation:
    Governments and central banks play a crucial role in the foreign exchange market, as they can intervene to stabilize exchange rates and influence currency movements.

3. What is the primary purpose of the foreign exchange market?
    (a) To facilitate international trade and investment
    (b) To determine interest rates in the domestic economy
    (c) To control inflation rates in the domestic economy
    (d) To regulate capital flows between countries

    Answer:
    (a) To facilitate international trade and investment

    Explanation:
    The primary purpose of the foreign exchange market is to facilitate the exchange of currencies to support international trade and investment.

4. Which of the following is NOT a major financial center for the foreign exchange market?
    (a) New York
    (b) London
    (c) Tokyo
    (d) Sydney

    Answer:
    (d) Sydney

    Explanation:
    While Sydney is an important financial center, it is not among the major financial centers for the foreign exchange market. New York, London, and Tokyo are among the key centers.

5. How is the foreign exchange rate determined in the foreign exchange market?
    (a) It is fixed by the International Monetary Fund (IMF)
    (b) It is determined by supply and demand for currencies in the market
    (c) It is set by a group of leading central banks
    (d) It is determined based on the gold standard

    Answer:
    (b) It is determined by supply and demand for currencies in the market

Explanation:

The foreign exchange rate is determined by the forces of supply and demand for currencies in the foreign exchange market.

6. Who are the primary participants in the foreign exchange market?
   (a) Governments and central banks
   (b) Domestic and foreign banks
   (c) Foreign investors only
   (d) Exporters and importers

   Answer:

   (b) Domestic and foreign banks

   Explanation:

   Domestic and foreign banks are the primary participants in the foreign exchange market, serving as intermediaries for currency transactions.

7. Which of the following is NOT a function of the foreign exchange market?
   (a) Facilitating currency conversion for international trade and travel
   (b) Providing a platform for governments to borrow foreign currencies
   (c) Setting interest rates for domestic currencies
   (d) Speculating on currency price movements

   Answer:

   (c) Setting interest rates for domestic currencies

   Explanation:

   Setting interest rates for domestic currencies is not a direct function of the foreign exchange market. Interest rates are determined by central banks and monetary policies.

8. What is a spot exchange rate in the foreign exchange market?
   (a) The rate at which foreign currencies are bought or sold for future delivery
   (b) The rate at which foreign currencies are bought or sold for immediate delivery
   (c) The rate at which foreign currencies are bought or sold in the black market
   (d) The rate at which foreign currencies are bought or sold by governments only

   Answer:

   (b) The rate at which foreign currencies are bought or sold for immediate delivery

   Explanation:

   A spot exchange rate is the rate at which foreign currencies are bought or sold for immediate delivery, typically within two business days.

9. What is a forward exchange rate in the foreign exchange market?
   (a) The rate at which foreign currencies are bought or sold for immediate delivery
   (b) The rate at which foreign currencies are bought or sold in the black market
   (c) The rate at which foreign currencies are bought or sold for future delivery
   (d) The rate at which foreign currencies are bought or sold by governments only

   Answer:

   (c) The rate at which foreign currencies are bought or sold for future delivery

   Explanation:

   A forward exchange rate is the rate at which foreign currencies are bought or sold for future delivery, typically at a specified date beyond the spot date.

1.6 Determination of Nominal Exchange Rate

Certainly! Here are some multiple-choice questions (MCQs) related to the determination of the nominal exchange rate along with their solutions:

1. What is the nominal exchange rate?
   (a) The rate at which goods and services are traded between two countries
   (b) The rate at which one currency can be exchanged for another currency in the foreign exchange market
   (c) The rate at which a country's central bank sets interest rates
   (d) The rate at which a country's central bank lends money to commercial banks

Answer:

(b) The rate at which one currency can be exchanged for another currency in the foreign exchange market

Explanation:

The nominal exchange rate represents the rate at which one currency can be exchanged for another currency in the foreign exchange market.

2. Which of the following factors can influence the nominal exchange rate in the short term?
   (a) Relative inflation rates between two countries
   (b) Relative interest rates between two countries
   (c) Trade balances between two countries
   (d) All of the above

Answer:

(d) All of the above

Explanation:

All of the listed factors, including relative inflation rates, relative interest rates, and trade balances between two countries, can influence the nominal exchange rate in the short term.

3. According to the purchasing power parity (PPP) theory, what will happen to the nominal exchange rate if the inflation rate is higher in one country compared to another?
   (a) The nominal exchange rate will appreciate in the country with higher inflation
   (b) The nominal exchange rate will depreciate in the country with higher inflation
   (c) The nominal exchange rate will remain unchanged
   (d) The nominal exchange rate will be determined by relative interest rates instead

Answer:

(b) The nominal exchange rate will depreciate in the country with higher inflation

Explanation:

According to the PPP theory, if the inflation rate is higher in one country compared to another, the nominal exchange rate of the currency of the country with higher inflation will depreciate.

4. What role do central banks play in influencing the nominal exchange rate?
   (a) Central banks do not have any influence over the nominal exchange rate
   (b) Central banks can directly set the nominal exchange rate
   (c) Central banks can intervene in the foreign exchange market to influence the nominal exchange rate
   (d) Central banks can only influence the real exchange rate, not the nominal exchange rate

Answer:

(c) Central banks can intervene in the foreign exchange market to influence the nominal exchange rate

Explanation:

Central banks can intervene in the foreign exchange market by buying or selling foreign currencies to influence the nominal exchange rate and stabilize their domestic currency.

5. What is the primary factor that determines the long-term trend of the nominal exchange rate?
   (a) Relative interest rates between two countries
   (b) Relative inflation rates between two countries
   (c) Trade balances between two countries
   (d) Market speculation and investor sentiment

Answer:

(b) Relative inflation rates between two countries

Explanation:

The long-term trend of the nominal exchange rate is primarily determined by relative inflation rates between two countries, according to the purchasing power parity (PPP) theory.

6. Which of the following factors affects the nominal exchange rate in a floating exchange rate system?
   (a) Inflation rates of both countries
   (b) Interest rates of both countries
   (c) Gross domestic product (GDP) of both countries
   (d) Exchange rate regime chosen by the countries

Answer:
(a) Inflation rates of both countries
Explanation:
In a floating exchange rate system, the nominal exchange rate is influenced by the inflation rates of both countries. Higher inflation in one country relative to the other can lead to a depreciation of its currency.

7. According to the purchasing power parity (PPP) theory, what will happen to the nominal exchange rate if the inflation rate is higher in one country than in another?
   (a) The nominal exchange rate will remain unchanged
   (b) The nominal exchange rate will appreciate for the high inflation country
   (c) The nominal exchange rate will appreciate for the low inflation country
   (d) The nominal exchange rate will depreciate for the high inflation country

   Answer:
   (d) The nominal exchange rate will depreciate for the high inflation country
   Explanation:
   According to the PPP theory, if the inflation rate is higher in one country than in another, the currency of the high inflation country is expected to depreciate to maintain purchasing power parity.

8. How does a trade deficit or surplus impact the nominal exchange rate?
   (a) A trade deficit leads to a depreciation of the domestic currency
   (b) A trade surplus leads to an appreciation of the domestic currency
   (c) A trade deficit leads to an appreciation of the domestic currency
   (d) A trade surplus leads to a depreciation of the domestic currency

   Answer:
   (a) A trade deficit leads to a depreciation of the domestic currency
   Explanation:
   A trade deficit (where imports exceed exports) can lead to a depreciation of the domestic currency, making exports relatively cheaper and imports more expensive.

9. What is the role of market participants in determining the nominal exchange rate in a floating exchange rate system?
   (a) Market participants have no influence on the nominal exchange rate
   (b) Market participants set the nominal exchange rate unilaterally
   (c) Market participants engage in buying and selling currencies, influencing demand and supply
   (d) Market participants determine the nominal exchange rate based on interest rate differentials

   Answer:
   (c) Market participants engage in buying and selling currencies, influencing demand and supply
   Explanation:
   In a floating exchange rate system, market participants play a significant role by engaging in buying and selling currencies, which affects the demand and supply and, in turn, influences the nominal exchange rate.

1.7 Changes in Exchange Rates

1. What causes changes in exchange rates in a floating exchange rate system?
   (a) Changes in interest rates only
   (b) Changes in inflation rates only
   (c) Changes in demand and supply of currencies
   (d) Changes in government regulations on trade

   Answer:
   (c) Changes in demand and supply of currencies
   Explanation:
   In a floating exchange rate system, changes in the demand and supply of currencies in the foreign exchange market lead to changes in exchange rates.

2. How does an increase in demand for a currency affect its exchange rate?
   (a) The exchange rate depreciates
   (b) The exchange rate appreciates

(c) The exchange rate remains unchanged
(d) The exchange rate fluctuates wildly

Answer:

(b) The exchange rate appreciates

Explanation:

An increase in demand for a currency causes its value to rise, leading to an appreciation of the exchange rate.

3. If the U.S. dollar depreciates against the euro, how will this impact U.S. exports to the Eurozone?
   (a) U.S. exports will increase as they become cheaper for Eurozone consumers
   (b) U.S. exports will decrease as they become more expensive for Eurozone consumers
   (c) U.S. exports will remain unchanged as exchange rate changes have no effect on trade
   (d) U.S. exports will decrease due to higher inflation in the Eurozone

Answer:

(a) U.S. exports will increase as they become cheaper for Eurozone consumers

Explanation:

A depreciation of the U.S. dollar against the euro makes U.S. goods and services relatively cheaper for Eurozone consumers, leading to an increase in U.S. exports.

4. What is the impact of an increase in interest rates in a country on its exchange rate?
   (a) The exchange rate appreciates
   (b) The exchange rate depreciates
   (c) The exchange rate remains unchanged
   (d) The impact on the exchange rate cannot be determined from the information given

Answer:

(a) The exchange rate appreciates

Explanation:

An increase in interest rates in a country attracts foreign investment, leading to an increase in demand for its currency and causing the exchange rate to appreciate.

5. How does political stability in a country affect its exchange rate?
   (a) Political stability has no impact on the exchange rate
   (b) Political stability leads to a depreciation of the domestic currency
   (c) Political stability leads to an appreciation of the domestic currency
   (d) Political stability leads to fluctuations in the exchange rate

Answer:

(c) Political stability leads to an appreciation of the domestic currency

Explanation:

Political stability in a country is viewed positively by investors, leading to increased confidence in the domestic economy and a higher demand for its currency, causing it to appreciate.

6. If the demand for a country's currency increases in the foreign exchange market, what is the likely effect on its exchange rate?
   (a) The exchange rate will appreciate
   (b) The exchange rate will depreciate
   (c) The exchange rate will remain unchanged
   (d) The exchange rate will fluctuate randomly

Answer:

(a) The exchange rate will appreciate

Explanation:

An increase in demand for a country's currency in the foreign exchange market will lead to an appreciation of its exchange rate.

7. How do changes in interest rates affect exchange rates?
   (a) Higher interest rates lead to currency appreciation
   (b) Higher interest rates lead to currency depreciation
   (c) Interest rates have no impact on exchange rates
   (d) Interest rates cause fluctuations in exchange rates but do not affect the overall trend

Answer:

(a) Higher interest rates lead to currency appreciation

Explanation:
Higher interest rates generally attract foreign investors, leading to an increase in demand for a country's currency and, consequently, currency appreciation.

8. What is a speculative attack on a currency?
   (a) A sudden incréase in the value of a currency due to speculative trading
   (b) A sudden decrease in the value of a currency due to speculative trading
   (c) A coordinated effort by governments to manipulate a currency's value
   (d) A change in exchange rate regime from fixed to floating

   Answer:
   (b) A sudden decrease in the value of a currency due to speculative trading

   Explanation:
   A speculative attack on a currency occurs when speculators sell a country's currency in large volumes, causing its value to rapidly decrease in the foreign exchange market.

9. How do geopolitical events and economic indicators impact exchange rates?
   (a) They have no impact on exchange rates
   (b) They cause temporary fluctuations, but the overall trend remains unaffected
   (c) They can cause significant and lasting changes in exchange rates
   (d) They only impact exchange rates in fixed exchange rate systems

   Answer:
   (c) They can cause significant and lasting changes in exchange rates

   Explanation:
   Geopolitical events and economic indicators can have a significant impact on investor confidence and sentiment, leading to lasting changes in exchange rates, especially in floating exchange rate systems.

1.8 Devaluation (Revaluation) Vs Depreciation (Appreciation)

1. What is devaluation of a currency?
   (a) A decrease in the value of a currency relative to other currencies under a fixed exchange rate system
   (b) An increase in the value of a currency relative to other currencies under a floating exchange rate system
   (c) A decrease in the value of a currency relative to other currencies under a floating exchange rate system
   (d) An increase in the value of a currency relative to other currencies under a fixed exchange rate system

   Answer:
   (a) A decrease in the value of a currency relative to other currencies under a fixed exchange rate system

   Explanation:
   Devaluation refers to a deliberate decrease in the value of a currency relative to other currencies, typically carried out by the government under a fixed exchange rate system.

2. What is revaluation of a currency?
   (a) A decrease in the value of a currency relative to other currencies under a floating exchange rate system
   (b) An increase in the value of a currency relative to other currencies under a fixed exchange rate system
   (c) An increase in the value of a currency relative to other currencies under a floating exchange rate system
   (d) A decrease in the value of a currency relative to other currencies under a fixed exchange rate system

   Answer:
   (b) An increase in the value of a currency relative to other currencies under a fixed exchange rate system

   Explanation:
   Revaluation refers to a deliberate increase in the value of a currency relative to other currencies, typically carried out by the government under a fixed exchange rate system.

3. What is depreciation of a currency?
   (a) A decrease in the value of a currency relative to other currencies under a fixed exchange rate system
   (b) An increase in the value of a currency relative to other currencies under a floating exchange rate system
   (c) A decrease in the value of a currency relative to other currencies under a floating exchange rate system
   (d) An increase in the value of a currency relative to other currencies under a fixed exchange rate system

Answer:
(c) A decrease in the value of a currency relative to other currencies under a floating exchange rate system

Explanation:
Depreciation refers to a decrease in the value of a currency relative to other currencies in a floating exchange rate system.

4. What is appreciation of a currency?
   (a) A decrease in the value of a currency relative to other currencies under a floating exchange rate system
   (b) An increase in the value of a currency relative to other currencies under a fixed exchange rate system
   (c) An increase in the value of a currency relative to other currencies under a floating exchange rate system
   (d) A decrease in the value of a currency relative to other currencies under a fixed exchange rate system

Answer:
(c) An increase in the value of a currency relative to other currencies under a floating exchange rate system

Explanation:
Appreciation refers to an increase in the value of a currency relative to other currencies in a floating exchange rate system.

5. Which of the following is typically used as a policy measure to devalue or revalue a currency?
   (a) Changing interest rates
   (b) Buying or selling foreign currencies in the foreign exchange market

   (c) Implementing capital controls
   (d) Imposing tariffs on imports

Answer:
(b) Buying or selling foreign currencies in the foreign exchange market

Explanation:
Governments can devalue or revalue a currency by buying or selling foreign currencies in the foreign exchange market to influence the exchange rate.

6. What is revaluation of a currency?
   (a) A decrease in the value of a country's currency relative to other currencies due to market forces
   (b) An increase in the value of a country's currency relative to other currencies due to market forces
   (c) A decrease in the value of a country's currency relative to other currencies deliberately set by the government
   (d) An increase in the value of a country's currency relative to other currencies deliberately set by the government

Answer:
(d) An increase in the value of a country's currency relative to other currencies deliberately set by the government

Explanation:
Revaluation is the deliberate increase in the value of a country's currency relative to other currencies by the government or central bank.

7. What is depreciation of a currency?
   (a) A decrease in the value of a country's currency relative to other currencies due to market forces
   (b) An increase in the value of a country's currency relative to other currencies due to market forces
   (c) A decrease in the value of a country's currency relative to other currencies deliberately set by the government
   (d) An increase in the value of a country's currency relative to other currencies deliberately set by the government

Answer:
(a) A decrease in the value of a country's currency relative to other currencies due to market forces

Explanation:
Depreciation is the decrease in the value of a country's currency relative to other currencies due to market forces such as supply and demand in the foreign exchange market.

8. What is appreciation of a currency?
(a) A decrease in the value of a country's currency relative to other currencies due to market forces
(b) An increase in the value of a country's currency relative to other currencies due to market forces
(c) A decrease in the value of a country's currency relative to other currencies deliberately set by the government
(d) An increase in the value of a country's currency relative to other currencies deliberately set by the government

Answer:
(b) An increase in the value of a country's currency relative to other currencies due to market forces

Explanation:
Appreciation is the increase in the value of a country's currency relative to other currencies due to market forces such as increased demand in the foreign exchange market.

9. Which of the following is an example of a government policy that can lead to devaluation?
(a) Lowering interest rates
(b) Implementing fiscal austerity measures
(c) Introducing capital controls
(d) Selling foreign exchange reserves

Answer:
(d) Selling foreign exchange reserves

Explanation:
A government can devalue its currency by deliberately selling its foreign exchange reserves in the foreign exchange market to increase the supply of its currency and lower its value.

1.9 Impacts of Exchange Rate Fluctuations on Domestic Economy

1. How does currency depreciation impact a country's exports?
(a) It makes exports more expensive for foreign buyers, reducing export competitiveness
(b) It makes exports cheaper for foreign buyers, increasing export competitiveness
(c) It has no impact on exports
(d) It only impacts the quantity of exports, not the price

Answer:
(b) It makes exports cheaper for foreign buyers, increasing export competitiveness

Explanation:
Currency depreciation makes a country's exports cheaper in foreign markets, which can increase export competitiveness and potentially lead to higher export volumes.

2. What effect does currency appreciation have on a country's imports?
(a) It makes imports more expensive, reducing import volumes
(b) It makes imports cheaper, increasing import volumes
(c) It has no impact on imports
(d) It only impacts the quantity of imports, not the price

Answer:
(a) It makes imports more expensive, reducing import volumes

Explanation:
Currency appreciation makes foreign imports more expensive in the domestic market, leading to a potential reduction in import volumes.

3. How does a weaker domestic currency (depreciation) affect inflation in the country?
(a) It leads to higher inflation due to increased import costs
(b) It leads to lower inflation due to reduced import costs
(c) It has no impact on inflation
(d) It only impacts inflation in the long term, not the short term

Answer:
(a) It leads to higher inflation due to increased import costs

Explanation:
Currency depreciation leads to higher inflation as the cost of imports increases, and these higher costs are often passed on to consumers in the form of higher prices for imported goods.

4. How does exchange rate volatility impact foreign direct investment (FDI)?
(a) It encourages FDI by reducing uncertainty for investors
(b) It discourages FDI due to increased risk and uncertainty
(c) It has no impact on FDI
(d) It only affects FDI from certain countries, not all investors

Answer:
(b) It discourages FDI due to increased risk and uncertainty

Explanation:
Exchange rate volatility can create uncertainty for investors, making them hesitant to invest in a country with an unstable currency value.

5. What is the impact of exchange rate fluctuations on a country's balance of trade (trade balance)?
(a) It has no impact on the trade balance
(b) It always leads to a trade surplus
(c) It always leads to a trade deficit
(d) It can lead to either a trade surplus or a trade deficit depending on other factors

Answer:
(d) It can lead to either a trade surplus or a trade deficit depending on other factors

Explanation:
Exchange rate fluctuations can impact the trade balance in either direction. Currency depreciation may lead to a trade surplus by increasing export competitiveness, while currency appreciation may lead to a trade deficit by making imports cheaper.

6. How does currency depreciation impact a country's imports?
(a) Imports increase as foreign goods become cheaper for domestic buyers
(b) Imports decrease as foreign goods become more expensive for domestic buyers

(c) Imports remain unchanged as foreign goods maintain the same price for domestic buyers
(d) Imports are not affected by exchange rate fluctuations

Answer:
(b) Imports decrease as foreign goods become more expensive for domestic buyers

Explanation:
Currency depreciation makes foreign goods more expensive for domestic buyers, leading to a decrease in imports as domestic consumers may reduce purchases of costly foreign goods.

7. What is the impact of currency appreciation on a country's inflation rate?
(a) Inflation rate increases as imported goods become cheaper
(b) Inflation rate decreases as imported goods become cheaper
(c) Inflation rate remains unchanged as imported goods maintain the same price
(d) Inflation rate is not affected by exchange rate fluctuations

Answer:
(a) Inflation rate increases as imported goods become cheaper

Explanation:
Currency appreciation makes imported goods cheaper for domestic buyers, leading to a decrease in the prices of imported goods and potentially increasing overall domestic consumption and inflation.

8. How do exchange rate fluctuations affect the tourism industry?
(a) Exchange rate fluctuations have no impact on the tourism industry
(b) Depreciation of the domestic currency attracts more foreign tourists
(c) Appreciation of the domestic currency attracts more foreign tourists
(d) Exchange rate fluctuations only affect business travel, not tourism

Answer:
(b) Depreciation of the domestic currency attracts more foreign tourists

Explanation:
Depreciation of the domestic currency makes the country's tourism offerings more affordable for foreign tourists, leading to an increase in inbound tourism.

9. What is the impact of exchange rate volatility on foreign direct investments (FDI)?
   (a) Exchange rate volatility has no impact on FDI
   (b) FDI increases as investors seek to benefit from exchange rate fluctuations
   (c) FDI decreases as investors perceive higher risks due to exchange rate uncertainty
   (d) Exchange rate volatility only affects portfolio investments, not FDI

   Answer:

   (c) FDI decreases as investors perceive higher risks due to exchange rate uncertainty

   Explanation:

   Exchange rate volatility can create uncertainty for investors, leading to reduced foreign direct investments as investors may be hesitant to commit capital in an uncertain exchange rate environment.

Additional Question Bank

1.1 Introduction

1. The exchange rate is the:
   (a) Rate at which one currency can be exchanged for another currency
   (b) Rate at which a country's central bank lends money to commercial banks
   (c) Rate at which a country's government borrows money from foreign lenders
   (d) Rate at which a country's inflation is calculated
2. An appreciation of a country's currency means that:
   (a) Its exchange rate has decreased, making its exports more expensive
   (b) Its exchange rate has increased, making its exports more expensive
   (c) Its exchange rate has decreased, making its exports more competitive
   (d) Its exchange rate has increased, making its exports more competitive

3. A depreciation of a country's currency means that:
   (a) Its exchange rate has decreased, making its imports more expensive
   (b) Its exchange rate has increased, making its imports more expensive
   (c) Its exchange rate has decreased, making its imports more affordable
   (d) Its exchange rate has increased, making its imports more affordable
4. The impact of a currency appreciation on a country's economy includes:
   (a) Increased export competitiveness and lower import costs
   (b) Reduced export competitiveness and higher import costs
   (c) Increased inflation and higher interest rates
   (d) Decreased inflation and lower interest rates
5. A flexible exchange rate system is one in which:
   (a) The exchange rate is fixed and controlled by the central bank
   (b) The exchange rate is determined by market forces of supply and demand
   (c) The exchange rate is pegged to a specific commodity such as gold
   (d) The exchange rate is determined by a committee of international economists

1.2 The Exchange Rate

1. The exchange rate is the price of one currency expressed in terms of another currency. It tells us:
   (a) The inflation rate of a country
   (b) The interest rate set by the central bank
   (c) The rate at which goods are exchanged in international trade
   (d) The rate at which one currency can be exchanged for another currency
2. A fixed exchange rate system is one in which:
   (a) The exchange rate fluctuates freely based on market forces
   (b) The exchange rate is determined by a committee of international economists
   (c) The exchange rate is pegged or fixed relative to a specific currency or a basket of currencies
   (d) The exchange rate is set by the World Trade Organization (WTO)

3. In a floating exchange rate system:
   (a) The exchange rate is fixed and does not change over time
   (b) The exchange rate is determined by supply and demand in the foreign exchange market
   (c) The exchange rate is determined by government authorities and central banks
   (d) The exchange rate is the same for all countries
4. The exchange rate between two currencies can be influenced by factors such as:
   (a) The weather conditions in each country
   (b) The political stability of the countries
   (c) The population size of each country
   (d) The interest rate differentials and economic performance of the countries
5. If the exchange rate between the US dollar (USD) and the Euro (EUR) is 1 USD = 0.85 EUR, how many Euros would you get for 100 US dollars?
   (a) 85 EUR
   (b) 115 EUR
   (c) 100 EUR
   (d) 120 EUR

1.3 The Exchange Rate Regimes

1. An exchange rate regime refers to:
   (a) The rate at which one currency can be exchanged for another currency
   (b) The system or framework used by a country to determine its exchange rate policy
   (c) The process of converting one currency into another for international trade
   (d) The rate at which a country's central bank lends money to commercial banks

2. In a fixed exchange rate regime, the exchange rate is:
   (a) Determined by market forces of supply and demand
   (b) Allowed to fluctuate freely without intervention
   (c) Pegged or fixed relative to a specific currency or a basket of currencies
   (d) Determined by a committee of international economists
3. Under a floating exchange rate regime, the exchange rate is primarily determined by:
   (a) Market forces of supply and demand in the foreign exchange market
   (b) Government authorities and central banks
   (c) The World Trade Organization (WTO)
   (d) A fixed formula set by the International Monetary Fund (IMF)
4. A managed or dirty float exchange rate regime is characterized by:
   (a) Frequent and significant fluctuations in the exchange rate
   (b) A completely fixed exchange rate that does not change over time
   (c) Minimal government intervention in the foreign exchange market
   (d) Frequent government intervention to influence the exchange rate without fully fixing it
5. A currency board system is a type of exchange rate regime where:
   (a) The central bank completely controls and manages the exchange rate
   (b) The exchange rate is determined by a committee of international economists
   (c) The central bank pegs the domestic currency to a foreign currency at a fixed rate
   (d) The exchange rate is allowed to fluctuate freely based on market forces

1.4 Nominal Versus Real Exchange Rates

1 The nominal exchange rate is the:
   (a) Rate at which one currency can be exchanged for another currency in the foreign exchange market
   (b) Rate at which a country's central bank lends money to commercial banks

(c) Rate at which a country's inflation is calculated
(d) Rate at which goods are exchanged in international trade

2. The real exchange rate is the nominal exchange rate adjusted for:
(a) Interest rate differentials between countries
(b) Inflation differentials between countries
(c) Differences in the GDP of countries
(d) Differences in the unemployment rates of countries

3. The real exchange rate reflects the relative purchasing power of currencies and provides information about:
(a) The interest rate set by the central bank
(b) The GDP growth rate of a country
(c) The rate of inflation in a country
(d) The relative price levels between countries

4. If the nominal exchange rate between the US dollar (US(D) and the Euro (EUR) is 1 USD = 0.85 EUR, and the inflation rate in the US is 2% while the inflation rate in the Eurozone is 1%, which of the following represents the real exchange rate between USD and EUR?
(a) 0.85 EUR
(b) 0.8345 EUR
(c) 0.8685 EUR
(d) 0.87 EUR

5. An increase in a country's inflation rate compared to its trading partners will likely lead to:
(a) An appreciation of its nominal exchange rate
(b) A depreciation of its nominal exchange rate
(c) No change in its nominal exchange rate
(d) A fixed exchange rate with no fluctuations

1.5 The Foreign Exchange Market

1. The foreign exchange market is a decentralized global market where currencies are traded. Which of the following participants is the most active in the foreign exchange market?
(a) Governments and central banks
(b) Commercial banks

(c) Multinational corporations
(d) Individual retail traders

2. The foreign exchange market operates 24 hours a day, five days a week, due to:
(a) The need for constant access to currency conversion services for travelers
(b) The continuous trading sessions in different time zones around the world
(c) The influence of international organizations like the World Bank
(d) Government regulations that require round-the-clock trading

3. The primary financial centers for foreign exchange trading include all of the following cities except:
(a) New York (b) London
(c) Tokyo (d) Paris

4. The most commonly traded currency pair in the foreign exchange market is:
(a) USD/EUR (US Dollar/Euro)
(b) USD/JPY (US Dollar/Japanese Yen)
(c) GBP/USD (British Pound/US Dollar)
(d) EUR/JPY (Euro/Japanese Yen)

5. The foreign exchange market facilitates currency trading for various purposes, including:
(a) Speculation on short-term price movements
(b) Foreign direct investment (FDI)
(c) Trading of commodities like gold and silver
(d) International monetary policy coordination

1.6 Determination of Nominal Exchange Rate

1. The nominal exchange rate is determined in the foreign exchange market by the interaction of:
(a) Central banks and governments of different countries
(b) Commercial banks and multinational corporations
(c) Supply and demand for currencies
(d) The World Trade Organization (WTO) and the International Monetary Fund (IMF)

2. An increase in the demand for a country's currency in the foreign exchange market will likely lead to:
   (a) A depreciation of its currency's exchange rate
   (b) An appreciation of its currency's exchange rate
   (c) No change in its currency's exchange rate
   (d) A fixed exchange rate with no fluctuations
3. Factors that can influence the demand for a currency in the foreign exchange market include:
   (a) Interest rate differentials between countries
   (b) Differences in GDP growth rates between countries
   (c) Political stability and economic performance of countries
   (d) All of the above
4. In a flexible exchange rate system, if a country experiences an increase in its trade deficit, the likely impact on its currency's exchange rate will be:
   (a) An appreciation of the currency
   (b) A depreciation of the currency
   (c) No change in the currency's exchange rate
   (d) A fixed exchange rate with no fluctuations
5. The nominal exchange rate can be influenced by various speculative activities in the foreign exchange market. This type of trading is often driven by expectations of:
   (a) Central bank interventions
   (b) Future inflation rates in the country
   (c) Political events and economic indicators
   (d) A fixed exchange rate system

1.7 Changes in Exchange Rates

1. A currency's exchange rate can change due to various factors. Which of the following is NOT a factor that can influence changes in exchange rates?
   (a) Interest rate differentials between countries
   (b) Political stability and economic performance of countries
   (c) The World Trade Organization (WTO) regulations
   (d) Speculative activities in the foreign exchange market

2. In a flexible exchange rate system, an increase in the demand for a country's goods and services in international markets is likely to result in:
   (a) An appreciation of the country's currency
   (b) A depreciation of the country's currency
   (c) No change in the country's currency value
   (d) A fixed exchange rate with no fluctuations
3. Changes in exchange rates can have various effects on a country's economy. An appreciation of the domestic currency can benefit the economy by:
   (a) Making imports cheaper and boosting domestic consumption
   (b) Making exports more expensive and reducing trade competitiveness
   (c) Encouraging foreign direct investment (FDI) from other countries
   (d) Reducing interest rates and stimulating investment and borrowing
4. If a country's currency depreciates significantly, it may lead to a potential risk of:
   (a) Lower inflation and increased purchasing power for consumers
   (b) Capital flight and loss of foreign investor confidence
   (c) Trade surplus and increased exports
   (d) Lower interest rates and increased investment
5. A sudden and significant change in exchange rates caused by unexpected economic or political events is known as:
   (a) A currency board system
   (b) Exchange rate volatility
   (c) A fixed exchange rate regime
   (d) Purchasing power parity (PPP)

1.8 Devaluation (Revaluation) Vs Depreciation (Appreciation)

1. Devaluation and revaluation refer to changes in the exchange rate set by:
   (a) Commercial banks in the foreign exchange market
   (b) Market forces of supply and demand
   (c) Government authorities and central banks
   (d) The International Monetary Fund (IMF)

2. Devaluation of a currency is a deliberate decision by a country's central bank to:
   (a) Increase the value of its currency in the foreign exchange market
   (b) Lower the value of its currency in the foreign exchange market
   (c) Peg its currency to a foreign currency at a fixed rate
   (d) Allow its currency to float freely without intervention
3. Revaluation of a currency is a deliberate decision by a country's central bank to:
   (a) Increase the value of its currency in the foreign exchange market
   (b) Lower the value of its currency in the foreign exchange market
   (c) Peg its currency to a foreign currency at a fixed rate
   (d) Allow its currency to float freely without intervention
4. Depreciation of a currency is a change in the exchange rate that occurs due to:
   (a) Market forces of supply and demand in the foreign exchange market
   (b) Frequent government interventions in the foreign exchange market
   (c) Fixed exchange rate systems implemented by central banks
   (d) The World Trade Organization (WTO) regulations
5. Appreciation of a currency is a change in the exchange rate that occurs due to:
   (a) Market forces of supply and demand in the foreign exchange market
   (b) Frequent government interventions in the foreign exchange market
   (c) Fixed exchange rate systems implemented by central banks
   (d) The World Trade Organization (WTO) regulations

1.9 Impacts of Exchange Rate Fluctuations on Domestic Economy

1. A depreciation of the domestic currency can have a positive impact on the domestic economy by:
   (a) Making imports cheaper and stimulating domestic consumption
   (b) Making exports more expensive and reducing trade competitiveness
   (c) Encouraging foreign direct investment (FDI) from other countries
   (d) Reducing interest rates and stimulating investment and borrowing

2. An appreciation of the domestic currency can negatively affect the domestic economy by:
   (a) Making imports more expensive and reducing domestic consumption
   (b) Making exports cheaper and boosting trade competitiveness
   (c) Attracting more foreign direct investment (FDI) to the country
   (d) Increasing interest rates and reducing investment and borrowing
3. Exchange rate fluctuations can impact inflation in the domestic economy. A depreciation of the domestic currency is likely to result in:
   (a) Higher inflation, as imported goods become more expensive
   (b) Lower inflation, as imported goods become more affordable
   (c) No impact on inflation, as exchange rates do not affect prices
   (d) A fixed exchange rate with no fluctuations
4. A depreciation of the domestic currency can benefit domestic producers by:
   (a) Increasing the cost of imported raw materials and inputs
   (b) Making domestic goods more expensive for foreign buyers
   (c) Reducing the competitiveness of domestic goods in foreign markets
   (d) Encouraging imports and discouraging domestic production
5. The impact of exchange rate fluctuations on the domestic economy can vary depending on the country's level of economic openness. In a highly open economy, exchange rate fluctuations are likely to have a more significant impact on:
   (a) Government spending and fiscal policy
   (b) Unemployment and labor market conditions
   (c) International trade and export-import dynamics
   (d) Interest rates and monetary policy decisions

Answers

1.1 Introduction

1. (a) Rate at which one currency can be exchanged for another currency
2. (d) Its exchange rate has increased, making its exports more expensive
3. (c) Its exchange rate has decreased, making its imports more affordable

4. (b) Reduced export competitiveness and higher import costs
5. (b) The exchange rate is determined by market forces of supply and demand

1.2 The Exchange Rate

1. (d) The rate at which one currency can be exchanged for another currency
2. (c) The exchange rate is pegged or fixed relative to a specific currency or a basket of currencies
3. (b) The exchange rate is determined by supply and demand in the foreign exchange market
4. (d) The interest rate differentials and economic performance of the countries
5. (b) 115 EUR

1.3 The Exchange Rate Regimes

1. (b) The system or framework used by a country to determine its exchange rate policy
2. (c) Pegged or fixed relative to a specific currency or a basket of currencies
3. (a) Market forces of supply and demand in the foreign exchange market
4. (d) Frequent government intervention to influence the exchange rate without fully fixing it
5. (c) The central bank pegs the domestic currency to a foreign currency at a fixed rate

1.4 Nominal Versus Real Exchange Rates

1. (a) Rate at which one currency can be exchanged for another currency in the foreign exchange market
2. (b) Inflation differentials between countries
3. (d) The relative price levels between countries
4. (c) 0.8685 EUR
5. (b) A depreciation of its nominal exchange rate

1.5 The Foreign Exchange Market

1. (b) Commercial banks
2. (b) The continuous trading sessions in different time zones around the world
3. (d) Paris
4. (b) USD/JPY (US Dollar/Japanese Yen)
5. (a) Speculation on short-term price movements

1.6 Determination of Nominal Exchange Rate

1. (c) Supply and demand for currencies
2. (b) An appreciation of its currency's exchange rate
3. (d) All of the above
4. (b) A depreciation of the currency
5. (c) Political events and economic indicators

1.7 Changes in Exchange Rates

1. (c) The World Trade Organization (WTO) regulations
2. (a) An appreciation of the country's currency
3. (b) Making exports more expensive and reducing trade competitiveness
4. (b) Capital flight and loss of foreign investor confidence
5. (b) Exchange rate volatility

1.8 Devaluation (Revaluation) Vs Depreciation (Appreciation)

1. (c) Government authorities and central banks
2. (b) Lower the value of its currency in the foreign exchange market
3. (a) Increase the value of its currency in the foreign exchange market
4. (a) Market forces of supply and demand in the foreign exchange market
5. (a) Market forces of supply and demand in the foreign exchange market

1.9 Impacts of Exchange Rate Fluctuations on Domestic Economy

1. (a) Making imports cheaper and stimulating domestic consumption
2. (a) Making imports more expensive and reducing domestic consumption
3. (a) Higher inflation, as imported goods become more expensive
4. (b) Making domestic goods more expensive for foreign buyers
5. (c) International trade and export-import dynamics

9 INTERNATIONAL TRADE

Unit:5 **International Capital Movements**

Multiple Choice Questions

1.1 Introduction

1. What are international capital movements?
   (a) Movements of goods and services between countries
   (b) Movements of people between countries for employment purposes
   (c) Movements of financial assets and liabilities between countries
   (d) Movements of foreign aid and grants between countries
   Answer:
   (c) Movements of financial assets and liabilities between countries
   Explanation:
   International capital movements refer to the flow of financial assets (e.g., stocks, bonds, currencies) and liabilities (e.g., loans, debts) between countries.
2. Which of the following is an example of a capital inflow?
   (a) A country exporting goods to another country
   (b) A country receiving foreign direct investments (FDI) from abroad
   (c) A country borrowing money from an international organization
   (d) A country granting foreign aid to another country
   Answer:
   (b) A country receiving foreign direct investments (FDI) from abroad
   Explanation:
   A capital inflow occurs when a country receives foreign funds, such as foreign direct investments (FDI), from other countries.
3. What is the primary motivation behind international capital movements?
   (a) To promote international trade and exchange of goods
   (b) To facilitate foreign aid and humanitarian assistance

   (c) To earn profits and achieve higher returns on investments
   (d) To strengthen diplomatic relations between countries
   Answer:
   (c) To earn profits and achieve higher returns on investments
   Explanation:
   The primary motivation behind international capital movements is to seek opportunities for higher returns on investments and to earn profits in foreign markets.
4. How do capital movements impact exchange rates?
   (a) Capital movements have no impact on exchange rates
   (b) Capital inflows lead to currency appreciation, and capital outflows lead to currency depreciation
   (c) Capital inflows lead to currency depreciation, and capital outflows lead to currency appreciation
   (d) Capital movements cause exchange rates to fluctuate randomly
   Answer:
   (b) Capital inflows lead to currency appreciation, and capital outflows lead to currency depreciation
   Explanation:
   Capital inflows increase the demand for the domestic currency, leading to currency appreciation. Conversely, capital outflows increase the supply of the domestic currency, leading to currency depreciation.
5. What is the role of capital controls in managing international capital movements?
   (a) Capital controls encourage free and unrestricted capital movements between countries
   (b) Capital controls limit the flow of financial assets between countries
   (c) Capital controls only apply to foreign direct investments (FDI) and not to portfolio investments
   (d) Capital controls are only implemented during financial crises
   Answer:
   (b) Capital controls limit the flow of financial assets between countries

Explanation:

Capital controls are measures implemented by governments to limit the flow of financial assets (such as investments and loans) between countries, especially during times of economic instability or to regulate foreign exchange rates.

6. What are international capital movements?
   (a) The movement of goods and services across borders
   (b) The flow of money and financial assets between countries
   (c) The exchange of currencies in the foreign exchange market
   (d) The movement of labor across borders

   Answer:

   (b) The flow of money and financial assets between countries

   Explanation:

   International capital movements refer to the movement of money, financial assets, and investments between countries, including foreign direct investments, portfolio investments, and loans.

7. Which of the following is an example of foreign direct investment (FDI)?
   (a) A foreign company purchasing goods from a domestic company
   (b) A domestic investor buying shares of a foreign company's stock
   (c) A domestic company setting up a subsidiary in a foreign country
   (d) A foreign country imposing tariffs on imported goods

   Answer:

   (c) A domestic company setting up a subsidiary in a foreign country

   Explanation:

   Foreign direct investment (FDI) occurs when a domestic company establishes a subsidiary or acquires significant ownership in a foreign company.

8. What is portfolio investment in the context of international capital movements?
   (a) Investment in physical assets like real estate in foreign countries
   (b) Investment in a diversified portfolio of stocks and bonds in foreign markets
   (c) Investment in infrastructure projects in foreign countries
   (d) Investment in foreign companies' manufacturing plants

   Answer:

   (b) Investment in a diversified portfolio of stocks and bonds in foreign markets

   Explanation:

   Portfolio investment involves investing in a diverse set of financial assets such as stocks and bonds in foreign markets, often through mutual funds or exchange-traded funds (ETFs).

9. How do international capital movements impact domestic economies?
   (a) They have no impact on domestic economies
   (b) They lead to higher inflation rates in domestic economies
   (c) They can contribute to economic growth and development
   (d) They lead to a decrease in foreign exchange reserves

   Answer:

   (c) They can contribute to economic growth and development

   Explanation:

   International capital movements can contribute positively to domestic economies by attracting foreign investments, promoting economic growth, and financing infrastructure and development projects.

10. What is capital flight?
    (a) The movement of foreign capital into a domestic economy
    (b) The movement of domestic capital into a foreign economy
    (c) The rapid increase in foreign direct investments
    (d) The rapid increase in exports of a country

    Answer:

    (b) The movement of domestic capital into a foreign economy

    Explanation:

    Capital flight refers to the movement of domestic capital out of a country into foreign markets, often driven by economic instability or concerns about the domestic economy's future prospects.

    Please note that the above MCQs are provided for illustrative purposes and may not represent actual questions from any specific exam. For accurate and relevant MCQs with their solutions, it's essential to refer to the material provided by your instructor or educational resources.

1.2 Types of Foreign Capital

1. What is Foreign Direct Investment (FDI)?
   (a) Investment in foreign financial markets by domestic investors
   (b) Investment in domestic financial markets by foreign investors
   (c) Investment in a foreign company to gain significant ownership and control
   (d) Investment in foreign currencies for speculative purposes

   Answer:
   (c) Investment in a foreign company to gain significant ownership and control

   Explanation:
   Foreign Direct Investment (FDI) involves investing in a foreign company to acquire a substantial ownership stake, giving the investor control over the company's operations and management.

2. What is Portfolio Investment?
   (a) Investment in a foreign company to gain significant ownership and control
   (b) Investment in foreign financial markets by domestic investors
   (c) Investment in domestic financial markets by foreign investors
   (d) Investment in foreign currencies for speculative purposes

   Answer:
   (b) Investment in foreign financial markets by domestic investors

   Explanation:
   Portfolio Investment involves investing in financial assets such as stocks and bonds in foreign markets, often through mutual funds or exchange-traded funds (ETFs).

3. What is Foreign Institutional Investment (FII)?
   (a) Investment by domestic institutions in foreign companies
   (b) Investment by foreign institutions in domestic companies
   (c) Investment in a foreign company to gain significant ownership and control
   (d) Investment in foreign currencies for speculative purposes

   Answer:
   (b) Investment by foreign institutions in domestic companies

   Explanation:
   Foreign Institutional Investment (FII) refers to investments made by foreign institutions (such as mutual funds, pension funds, or hedge funds) in the domestic capital markets.

4. What is Foreign Portfolio Investment (FPI)?
   (a) Investment in foreign financial markets by domestic investors
   (b) Investment by domestic institutions in foreign companies
   (c) Investment in a foreign company to gain significant ownership and control
   (d) Investment in foreign currencies for speculative purposes

   Answer:
   (a) Investment in foreign financial markets by domestic investors

   Explanation:
   Foreign Portfolio Investment (FPI) involves domestic investors investing in foreign financial assets, such as stocks and bonds, to diversify their investment portfolio.

5. What is Foreign Aid?
   (a) Investment in foreign financial markets by domestic investors
   (b) Investment by foreign institutions in domestic companies
   (c) Financial assistance provided by one country to another for development projects
   (d) Investment in foreign currencies for speculative purposes

   Answer:
   (c) Financial assistance provided by one country to another for development projects

   Explanation:
   Foreign Aid refers to financial assistance provided by one country (or international organizations) to another country for developmental projects, infrastructure, and humanitarian purposes.

6. What is Foreign Direct Investment (FDI)?
   (a) Investment in a diverse portfolio of stocks and bonds in foreign markets
   (b) Investment in physical assets like real estate in foreign countries

(c) Investment in short-term money market instruments in foreign markets
(d) Investment in a foreign company's manufacturing plants and operations

Answer:

(d) Investment in a foreign company's manufacturing plants and operations

Explanation:

Foreign Direct Investment (FDI) involves the investment by a company in a foreign country to establish or acquire significant ownership in businesses or manufacturing plants.

7. What is Foreign Portfolio Investment (FPI)?
(a) Investment in a diverse portfolio of stocks and bonds in foreign markets
(b) Investment in physical assets like real estate in foreign countries
(c) Investment in short-term money market instruments in foreign markets
(d) Investment in a foreign company's manufacturing plants and operations

Answer:

(a) Investment in a diverse portfolio of stocks and bonds in foreign markets

Explanation:

Foreign Portfolio Investment (FPI) refers to investments made by individuals or institutions in foreign financial assets such as stocks and bonds.

8. What is Foreign Institutional Investment (FII)?
(a) Investment in a diverse portfolio of stocks and bonds in foreign markets
(b) Investment in physical assets like real estate in foreign countries
(c) Investment in short-term money market instruments in foreign markets
(d) Investment made by foreign institutions in the domestic market

Answer:

(d) Investment made by foreign institutions in the domestic market

Explanation:

Foreign Institutional Investment (FII) is the investment made by foreign institutional investors in the domestic financial market of a country.

9. What is Foreign Aid?
(a) Investment in a diverse portfolio of stocks and bonds in foreign markets
(b) Financial assistance provided by one country to another for development projects
(c) Investment in short-term money market instruments in foreign markets
(d) Investment made by foreign institutions in the domestic market

Answer:

(b) Financial assistance provided by one country to another for development projects

Explanation:

Foreign Aid refers to financial assistance or grants provided by one country to another for various purposes, such as development projects, humanitarian aid, or economic support.

10. What is Foreign Debt?
(a) Investment in a diverse portfolio of stocks and bonds in foreign markets
(b) Financial assistance provided by one country to another for development projects
(c) Debt owed by a country to foreign lenders or governments
(d) Investment made by foreign institutions in the domestic market

Answer:

(c) Debt owed by a country to foreign lenders or governments

Explanation:

Foreign Debt refers to the debt that a country owes to foreign lenders or governments, which could be in the form of loans or bonds issued in the international market.

1.3 Foreign Direct Investment (FDI)

1. What is Foreign Direct Investment (FDI)?
   (a) Investment made by foreign individuals in the domestic stock market
   (b) Investment in foreign stocks and bonds through mutual funds
   (c) Investment in a foreign country to establish or acquire businesses or assets
   (d) Investment in short-term money market instruments in foreign markets

   Answer:
   (c) Investment in a foreign country to establish or acquire businesses or assets

   Explanation:
   Foreign Direct Investment (FDI) refers to the investment made by a company or individual from one country into businesses or assets located in another country, with the intention of having lasting interest and control in the foreign operations.

2. What distinguishes Foreign Direct Investment (FDI) from Foreign Portfolio Investment (FPI)?
   (a) FDI involves investing in a diverse portfolio of foreign stocks and bonds.
   (b) FDI involves short-term investments in foreign money market instruments.
   (c) FDI involves acquiring significant ownership in foreign companies or assets.
   (d) FDI involves lending money to foreign governments.

   Answer:
   (c) FDI involves acquiring significant ownership in foreign companies or assets.

   Explanation:
   The key distinction between FDI and FPI is that FDI involves acquiring substantial ownership and control in foreign businesses or assets, while FPI involves investing in financial assets such as stocks and bonds without taking ownership control.

3. Which of the following is an example of Foreign Direct Investment (FDI)?
   (a) A foreign investor purchasing shares of a domestic company in the stock market.
   (b) A domestic company setting up a subsidiary in a foreign country to produce goods.
   (c) A domestic investor buying foreign stocks through an exchange-traded fund (ETF).
   (d) A foreign company acquiring foreign government bonds.

   Answer:
   (b) A domestic company setting up a subsidiary in a foreign country to produce goods.

   Explanation:
   Setting up a subsidiary in a foreign country to produce goods or conduct business is an example of FDI.

4. What motivates companies to engage in Foreign Direct Investment (FDI)?
   (a) Short-term financial gains through speculative trading.
   (b) Access to new markets, resources, and technologies.
   (c) Hedging against currency fluctuations in the foreign exchange market.
   (d) Speculating on changes in interest rates in foreign markets.

   Answer:
   (b) Access to new markets, resources, and technologies.

   Explanation:
   Companies engage in FDI to access new markets, resources, and technologies that may not be readily available in their home country.

5. Which of the following is a potential benefit of Foreign Direct Investment (FDI) for the host country?
   (a) Increased exposure to foreign exchange rate fluctuations.
   (b) Decreased job opportunities due to competition from foreign investors.
   (c) Technology transfer and knowledge spillovers.
   (d) Limited access to global markets for local businesses.

Answer:
(c) Technology transfer and knowledge spillovers.
Explanation:
FDI can bring technology transfer and knowledge spillovers to the host country, which can enhance local industries' capabilities and stimulate economic development.

6. What is Foreign Direct Investment (FDI)?
   (a) Investment in a diverse portfolio of stocks and bonds in foreign markets
   (b) Investment in physical assets like real estate in foreign countries
   (c) Investment in short-term money market instruments in foreign markets
   (d) Investment made by foreign institutions in the domestic market

   Answer:
   (b) Investment in physical assets like real estate in foreign countries
   Explanation:
   Foreign Direct Investment (FDI) refers to the investment made by a company or individual in a foreign country to establish or acquire significant ownership in businesses, manufacturing plants, real estate, or other physical assets.

7. Which of the following is an example of FDI?
   (a) A foreign investor buying shares of a foreign company's stock
   (b) A domestic company setting up a subsidiary in a foreign country
   (c) A foreign company purchasing goods from a domestic company
   (d) A domestic investor investing in foreign government bonds

   Answer:
   (b) A domestic company setting up a subsidiary in a foreign country
   Explanation:
   Setting up a subsidiary in a foreign country is an example of Foreign Direct Investment (FDI) as it involves the establishment of a physical presence in the foreign country.

8. What distinguishes FDI from other types of foreign capital flows?
   (a) FDI involves short-term investments in financial assets
   (b) FDI involves investments in a diverse portfolio of stocks and bonds

   (c) FDI involves long-term investments in physical assets and businesses
   (d) FDI involves providing financial aid to foreign countries

   Answer:
   (c) FDI involves long-term investments in physical assets and businesses
   Explanation:
   FDI is characterized by long-term investments in physical assets and businesses, which differentiates it from other types of foreign capital flows such as Foreign Portfolio Investment (FPI) and Foreign Aid.

9. How does FDI contribute to economic development in host countries?
   (a) FDI leads to increased trade deficits in host countries
   (b) FDI has no impact on the host country's economy
   (c) FDI creates job opportunities and boosts infrastructure development
   (d) FDI increases the cost of living for local residents

   Answer:
   (c) FDI creates job opportunities and boosts infrastructure development
   Explanation:
   FDI can contribute positively to economic development in host countries by creating job opportunities, transferring technology and skills, and promoting infrastructure development.

10. What are the potential risks of FDI for host countries?
    (a) Increased employment opportunities for local residents
    (b) Dependence on foreign investors for economic growth
    (c) Decreased technology transfer to the host country
    (d) Improved competitiveness of local industries

    Answer:
    (b) Dependence on foreign investors for economic growth
    Explanation:
    One potential risk of FDI for host countries is the dependence on foreign investors, which may affect the host country's economic policies and development priorities.

1.4 Foreign Portfolio Investment (FPI)

1. What is Foreign Portfolio Investment (FPI)?
   (a) Investment in a diverse portfolio of stocks and bonds in foreign markets
   (b) Investment in physical assets like real estate in foreign countries
   (c) Investment in short-term money market instruments in foreign markets
   (d) Investment made by foreign institutions in the domestic market

   Answer:
   (a) Investment in a diverse portfolio of stocks and bonds in foreign markets

   Explanation:
   Foreign Portfolio Investment (FPI) refers to investments made by individuals or institutions in a diverse set of financial assets such as stocks, bonds, and money market instruments in foreign markets.

2. Which of the following is an example of FPI?
   (a) A foreign company setting up a subsidiary in a domestic country
   (b) A domestic investor buying shares of a domestic company's stock
   (c) A domestic company purchasing real estate in a foreign country
   (d) A foreign institutional investor buying shares of a foreign company's stock

   Answer:
   (d) A foreign institutional investor buying shares of a foreign company's stock

   Explanation:
   A foreign institutional investor buying shares of a foreign company's stock represents Foreign Portfolio Investment (FPI) as it involves investing in financial assets in foreign markets.

3. What is the primary objective of FPI?
   (a) Long-term ownership and control of foreign businesses
   (b) Capital appreciation and short-term profits
   (c) Investment in physical assets for industrial purposes
   (d) Providing financial aid to foreign countries

   Answer:
   (b) Capital appreciation and short-term profits

   Explanation:
   The primary objective of Foreign Portfolio Investment (FPI) is to seek capital appreciation and short-term profits by investing in financial assets that have the potential to increase in value.

4. How does FPI differ from Foreign Direct Investment (FDI)?
   (a) FPI involves investments in physical assets and businesses
   (b) FPI involves long-term ownership and control of foreign businesses
   (c) FPI involves short-term investments in financial assets
   (d) FPI involves providing financial aid to foreign countries

   Answer:
   (c) FPI involves short-term investments in financial assets

   Explanation:
   FPI is characterized by short-term investments in financial assets such as stocks and bonds, while Foreign Direct Investment (FDI) involves long-term investments in physical assets and businesses.

5. How can FPI affect the volatility of financial markets in host countries?
   (a) FPI has no impact on the volatility of financial markets
   (b) FPI reduces the volatility of financial markets by diversifying investments
   (c) FPI can increase the volatility of financial markets due to capital flows
   (d) FPI only affects the volatility of foreign financial markets

   Answer:
   (c) FPI can increase the volatility of financial markets due to capital flows

   Explanation:
   FPI can lead to increased volatility in financial markets of host countries due to the flow of capital in and out of the market, especially during periods of uncertainty or changes in market sentiment.

6. How is FPI different from Foreign Direct Investment (FDI)?
   (a) FPI involves long-term investments in physical assets, while FDI involves short-term investments in financial assets.

(b) FPI involves investments in a diverse portfolio of stocks and bonds, while FDI involves investment in a foreign company's manufacturing plants and operations.
(c) FPI involves investments in infrastructure projects in foreign countries, while FDI involves providing financial aid to foreign countries.
(d) FPI involves investment in the domestic market by foreign institutions, while FDI involves investment by domestic companies in foreign countries.

Answer:

(b) FPI involves investments in a diverse portfolio of stocks and bonds, while FDI involves investment in a foreign company's manufacturing plants and operations.

Explanation:

FPI involves investments in financial assets, such as stocks and bonds, in foreign markets, while FDI involves direct investments in physical assets and businesses in foreign countries.

7. Which of the following is an example of Foreign Portfolio Investment (FPI)?
(a) A foreign company setting up a subsidiary in a foreign country
(b) A domestic investor buying shares of a foreign company's stock
(c) A foreign company purchasing goods from a domestic company
(d) A domestic company investing in foreign real estate

Answer:

(b) A domestic investor buying shares of a foreign company's stock

Explanation:

A domestic investor buying shares of a foreign company's stock is an example of Foreign Portfolio Investment (FPI) as it involves investing in a financial asset (stock) in a foreign market.

8. What is the primary objective of investors engaging in FPI?
(a) To gain control and ownership in foreign businesses
(b) To acquire physical assets in foreign countries
(c) To maximize short-term profits from currency fluctuations
(d) To diversify their investment portfolio and earn returns

Answer:

(d) To diversify their investment portfolio and earn returns

Explanation:

The primary objective of investors engaging in FPI is to diversify their investment portfolio, reduce risk, and earn returns from the investment in foreign financial assets.

9. How does FPI impact the foreign exchange market?
(a) FPI has no impact on the foreign exchange market
(b) FPI leads to increased exchange rate volatility
(c) FPI affects the demand and supply of foreign currencies
(d) FPI only impacts the stock market, not the foreign exchange market

Answer:

(c) FPI affects the demand and supply of foreign currencies

Explanation:

FPI impacts the foreign exchange market by influencing the demand and supply of foreign currencies. Large FPI flows can impact exchange rates in the short term.

1.5 Reasons for Foreign Direct Investment

1. Which of the following is a primary reason for Foreign Direct Investment (FDI)?
(a) To diversify investment portfolios
(b) To gain short-term profits from currency fluctuations
(c) To establish a physical presence in a foreign market
(d) To provide financial aid to foreign countries

Answer:

(c) To establish a physical presence in a foreign market

Explanation:

One of the primary reasons for Foreign Direct Investment (FDI) is to establish a physical presence in a foreign market, either by setting up a subsidiary or acquiring ownership in existing businesses.

2. How does FDI contribute to market expansion for multinational corporations?
(a) FDI leads to market contraction as companies focus on domestic operations

(b) FDI allows companies to serve only domestic markets
(c) FDI provides access to new foreign markets and customers
(d) FDI limits companies to specific industries and sectors

Answer:
(c) FDI provides access to new foreign markets and customers

Explanation:
FDI allows multinational corporations to expand their operations and access new foreign markets, thereby reaching a broader customer base.

3. Why do companies engage in FDI for resource acquisition?
(a) To increase competition in the domestic market
(b) To access foreign markets with cheaper resources
(c) To reduce dependence on foreign suppliers
(d) To discourage international trade

Answer:
(b) To access foreign markets with cheaper resources

Explanation:
Companies may engage in FDI to access foreign markets with cheaper resources, such as raw materials or labor, which can enhance their competitiveness.

4. What role does FDI play in technology transfer?
(a) FDI restricts technology transfer between countries
(b) FDI does not impact technology transfer
(c) FDI encourages the transfer of technology to host countries
(d) FDI is limited to specific technology-based industries

Answer:
(c) FDI encourages the transfer of technology to host countries

Explanation:
FDI can facilitate the transfer of technology and know-how from investing companies to host countries, contributing to technological advancement in the host economies.

5. How does FDI contribute to employment generation?
(a) FDI leads to job losses as domestic companies face increased competition
(b) FDI has no impact on employment in host countries

(c) FDI creates job opportunities through new business establishments
(d) FDI focuses only on expatriate hiring, neglecting local workforce

Answer:
(c) FDI creates job opportunities through new business establishments

Explanation:
FDI can lead to employment generation in host countries as new business establishments and operations require a workforce, creating job opportunities for the local population.

6. What are the primary reasons for Foreign Direct Investment (FDI)?
(a) To provide financial aid to foreign countries
(b) To diversify investment portfolios and reduce risk
(c) To gain control and ownership in foreign businesses
(d) To invest in a diverse portfolio of stocks and bonds

Answer:
(c) To gain control and ownership in foreign businesses

Explanation:
One of the primary reasons for Foreign Direct Investment (FDI) is to gain control and ownership in foreign businesses or acquire significant ownership stakes in overseas enterprises.

7. How does FDI contribute to technology transfer?
(a) FDI reduces technology transfer as companies prefer to retain technology within their home country
(b) FDI has no impact on technology transfer between countries
(c) FDI encourages technology transfer as companies bring advanced technologies to host countries
(d) FDI limits technology transfer due to intellectual property protection concerns

Answer:
(c) FDI encourages technology transfer as companies bring advanced technologies to host countries

Explanation: FDI can facilitate technology transfer as multinational companies often bring advanced technologies, knowledge, and managerial expertise to the host countries where they invest.

8. What role does FDI play in stimulating economic growth in host countries?
   (a) FDI has no impact on economic growth in host countries
   (b) FDI stimulates economic growth by promoting competition and efficiency
   (c) FDI only leads to economic growth in the home country of the investing company
   (d) FDI stimulates economic growth by increasing the trade deficit in host countries

   Answer:

   (b) FDI stimulates economic growth by promoting competition and efficiency

   Explanation:

   FDI can stimulate economic growth in host countries by promoting competition, bringing in new technologies, generating employment, and enhancing overall efficiency in the economy.

9. How does FDI contribute to job creation in host countries?
   (a) FDI does not contribute to job creation in host countries
   (b) FDI creates jobs only in the primary sector, such as agriculture
   (c) FDI creates jobs in the primary, secondary, and tertiary sectors of the economy
   (d) FDI creates jobs in the host country's government sector only

   Answer:

   (c) FDI creates jobs in the primary, secondary, and tertiary sectors of the economy

   Explanation:

   FDI can create jobs across various sectors of the host country's economy, including primary (agriculture), secondary (manufacturing), and tertiary (services) sectors.

10. What is the relationship between FDI and infrastructure development in host countries?
   (a) FDI has no impact on infrastructure development in host countries
   (b) FDI leads to infrastructure development only in the home country of the investing company

   (c) FDI can contribute to infrastructure development in host countries through investments in key sectors
   (d) FDI leads to a decline in infrastructure quality in host countries

   Answer:

   (c) FDI can contribute to infrastructure development in host countries through investments in key sectors

   Explanation:

   FDI can contribute to infrastructure development in host countries by investing in key sectors such as transportation, communication, and utilities.

1.6 Modes of Foreign Direct Investment (FDI)

1. What are the different modes of Foreign Direct Investment (FDI)?
   (a) Outward FDI and Inward FDI
   (b) Horizontal FDI and Vertical FDI
   (c) Greenfield investment and Cross-border Mergers and Acquisitions (M&(a)
   (d) Portfolio Investment and Direct Investment

   Answer:

   (c) Greenfield investment and Cross-border Mergers and Acquisitions (M&(a)

   Explanation:

   The different modes of FDI include Greenfield investment, which involves setting up new businesses or facilities in a foreign country, and Cross-border Mergers and Acquisitions (M&(a), which involve acquiring existing foreign businesses.

2. What is Greenfield investment in the context of FDI?
   (a) Acquisition of an existing foreign company
   (b) Investment in a diverse portfolio of stocks and bonds in foreign markets
   (c) Setting up new businesses or facilities in a foreign country
   (d) Providing financial aid to foreign countries

   Answer:

   (c) Setting up new businesses or facilities in a foreign country

Explanation:
Greenfield investment involves establishing new businesses or facilities in a foreign country from the ground up, rather than acquiring existing ones.

3. What is Cross-border Mergers and Acquisitions (M&(a) as a mode of FDI?
   (a) Investment in a diverse portfolio of stocks and bonds in foreign markets
   (b) Acquisition of an existing foreign company
   (c) Setting up new businesses or facilities in a foreign country
   (d) Providing financial aid to foreign countries

   Answer:
   (b) Acquisition of an existing foreign company

   Explanation:
   Cross-border Mergers and Acquisitions (M&(a) as a mode of FDI involves the acquisition of an existing foreign company or its assets by a foreign investor.

4. How does Horizontal FDI differ from Vertical FDI?
   (a) Horizontal FDI involves investment in unrelated industries, while Vertical FDI involves investment in related industries.
   (b) Horizontal FDI involves investment in the same industry in different countries, while Vertical FDI involves investment in different industries in the same country.
   (c) Horizontal FDI involves investment in foreign stocks and bonds, while Vertical FDI involves investment in physical assets.
   (d) Horizontal FDI and Vertical FDI are the same; they refer to different terms for the same investment mode.

   Answer:
   (b) Horizontal FDI involves investment in the same industry in different countries, while Vertical FDI involves investment in different industries in the same country.

   Explanation:
   Horizontal FDI occurs when a company invests in the same industry in different countries, while Vertical FDI occurs when a company invests in different industries, usually along the production chain, in the same country.

5. What is the difference between Outward FDI and Inward FDI?
   (a) Outward FDI refers to FDI flows out of a country, while Inward FDI refers to FDI flows into a country.
   (b) Outward FDI involves Greenfield investment, while Inward FDI involves Cross-border Mergers and Acquisitions (M&(a).
   (c) Outward FDI is carried out by domestic companies, while Inward FDI is carried out by foreign companies.
   (d) Outward FDI has no impact on the home country's economy, while Inward FDI has no impact on the host country's economy.

   Answer:
   (a) Outward FDI refers to FDI flows out of a country, while Inward FDI refers to FDI flows into a country.

   Explanation:
   Outward FDI refers to investments made by domestic companies in foreign countries, while Inward FDI refers to investments made by foreign companies in the domestic country.

6. What is Greenfield FDI?
   (a) FDI that involves acquiring existing companies in a foreign country
   (b) FDI that involves setting up new businesses or facilities in a foreign country
   (c) FDI that involves portfolio investments in foreign stocks and bonds
   (d) FDI that involves short-term investments in financial assets

   Answer:
   (b) FDI that involves setting up new businesses or facilities in a foreign country

   Explanation:
   Greenfield FDI refers to the mode of FDI where a company sets up new businesses, manufacturing plants, or facilities in a foreign country from the ground up.

7. What is Brownfield FDI?
   (a) FDI that involves acquiring existing companies in a foreign country
   (b) FDI that involves setting up new businesses or facilities in a foreign country
   (c) FDI that involves portfolio investments in foreign stocks and bonds
   (d) FDI that involves short-term investments in financial assets

   Answer:
   (a) FDI that involves acquiring existing companies in a foreign country

   Explanation:
   Brownfield FDI refers to the mode of FDI where a company acquires or invests in existing companies, plants, or facilities in a foreign country.

8. What is the key difference between Greenfield FDI and Brownfield FDI?
   (a) The level of risk involved in the investment
   (b) The source country of the FDI
   (c) The type of industry involved in the investment
   (d) The stage of development of the host country's economy

   Answer:
   (a) The level of risk involved in the investment

   Explanation:
   The key difference between Greenfield FDI and Brownfield FDI is the level of risk involved. Greenfield FDI carries higher risks as it involves starting a new venture from scratch, while Brownfield FDI involves investing in an existing business with a known track record.

9. What is Cross-Border Mergers and Acquisitions (M&(a) FDI?
   (a) FDI that involves acquiring existing companies in the home country
   (b) FDI that involves setting up new businesses or facilities in a foreign country
   (c) FDI that involves acquiring or merging with foreign companies
   (d) FDI that involves investments in a diverse portfolio of foreign stocks and bonds

   Answer:
   (c) FDI that involves acquiring or merging with foreign companies

   Explanation:
   Cross-Border Mergers and Acquisitions (M&(a) FDI refers to the mode of FDI where a company from one country acquires or merges with a foreign company.

10. What is Vertical FDI?
   (a) FDI that involves acquiring existing companies in a foreign country
   (b) FDI that involves setting up new businesses or facilities in a foreign country
   (c) FDI that involves investments in companies operating in the same industry
   (d) FDI that involves investments in companies at different stages of the production process

   Answer:
   (d) FDI that involves investments in companies at different stages of the production process

   Explanation:
   Vertical FDI refers to the mode of FDI where a company invests in or acquires businesses that are at different stages of the production process, either upstream or downstream in the supply chain.

1.7 Benefits of Foreign Direct Investment

1. How does Foreign Direct Investment (FDI) contribute to job creation in host countries?
   (a) FDI does not contribute to job creation in host countries
   (b) FDI creates jobs only in the primary sector, such as agriculture
   (c) FDI creates jobs in the primary, secondary, and tertiary sectors of the economy
   (d) FDI creates jobs in the host country's government sector only

   Answer:
   (c) FDI creates jobs in the primary, secondary, and tertiary sectors of the economy

   Explanation:
   FDI can create jobs in various sectors of the host country's economy, including primary (agriculture), secondary (manufacturing), and tertiary (services) sectors.

2. How does FDI impact technology transfer in host countries?
   (a) FDI reduces technology transfer as companies prefer to retain technology within their home country
   (b) FDI has no impact on technology transfer between countries
   (c) FDI encourages technology transfer as companies bring advanced technologies to host countries
   (d) FDI limits technology transfer due to intellectual property protection concerns

   Answer:
   (c) FDI encourages technology transfer as companies bring advanced technologies to host countries

   Explanation:
   FDI can facilitate technology transfer as multinational companies often bring advanced technologies, knowledge, and managerial expertise to the host countries where they invest.

3. What role does FDI play in stimulating economic growth in host countries?
   (a) FDI has no impact on economic growth in host countries
   (b) FDI stimulates economic growth by promoting competition and efficiency
   (c) FDI only leads to economic growth in the home country of the investing company
   (d) FDI stimulates economic growth by increasing the trade deficit in host countries

   Answer:
   (b) FDI stimulates economic growth by promoting competition and efficiency

   Explanation:
   FDI can stimulate economic growth in host countries by promoting competition, bringing in new technologies, generating employment, and enhancing overall efficiency in the economy.

4. How does FDI contribute to infrastructure development in host countries?
   (a) FDI has no impact on infrastructure development in host countries
   (b) FDI leads to infrastructure development only in the home country of the investing company
   (c) FDI can contribute to infrastructure development in host countries through investments in key sectors
   (d) FDI leads to a decline in infrastructure quality in host countries

   Answer:
   (c) FDI can contribute to infrastructure development in host countries through investments in key sectors

   Explanation:
   FDI can contribute to infrastructure development in host countries by investing in key sectors such as transportation, communication, and utilities.

5. What is the relationship between FDI and export promotion in host countries?
   (a) FDI has no impact on export promotion in host countries
   (b) FDI leads to decreased exports in host countries
   (c) FDI can lead to export promotion as companies use host countries as a base for exporting goods and services
   (d) FDI only impacts the import sector of host countries

   Answer:
   (c) FDI can lead to export promotion as companies use host countries as a base for exporting goods and services

   Explanation: FDI can promote exports in host countries as foreign companies may use the host country as a base to manufacture goods and services for export to other markets.

6. What are the potential benefits of Foreign Direct Investment (FDI) for host countries?
   (a) Increased trade deficits and currency devaluation
   (b) Loss of domestic ownership and control over industries
   (c) Technology transfer, job creation, and economic growth
   (d) Dependency on foreign investors for economic policies

Answer:

(c) Technology transfer, job creation, and economic growth

Explanation:

FDI can bring technology transfer, create job opportunities, and stimulate economic growth in host countries.

7. How does FDI contribute to technology transfer in host countries?
   (a) FDI has no impact on technology transfer in host countries
   (b) FDI restricts technology transfer to protect intellectual property rights
   (c) FDI promotes technology transfer as multinational companies bring advanced technologies
   (d) FDI only transfers outdated technologies to host countries

Answer:

(c) FDI promotes technology transfer as multinational companies bring advanced technologies

Explanation:

FDI can facilitate technology transfer in host countries as multinational companies often bring advanced technologies and know-how.

8. What is the role of FDI in creating job opportunities in host countries?
   (a) FDI has no impact on job creation in host countries
   (b) FDI creates jobs only in the primary sector, such as agriculture
   (c) FDI creates jobs in the primary, secondary, and tertiary sectors of the economy
   (d) FDI only creates jobs for foreign workers, not for local residents

Answer:

(c) FDI creates jobs in the primary, secondary, and tertiary sectors of the economy

Explanation:

FDI can create jobs across various sectors of the host country's economy, including primary (agriculture), secondary (manufacturing), and tertiary (services) sectors.

9. How does FDI contribute to economic growth in host countries?
   (a) FDI has no impact on economic growth in host countries
   (b) FDI leads to increased trade deficits and reduces economic growth

   (c) FDI stimulates economic growth by promoting competition and efficiency
   (d) FDI only benefits the investing company's home country, not the host country

Answer:

(c) FDI stimulates economic growth by promoting competition and efficiency

Explanation:

FDI can stimulate economic growth in host countries by promoting competition, introducing new technologies, generating employment, and improving overall efficiency in the economy.

10. What is the relationship between FDI and infrastructure development in host countries?
   (a) FDI has no impact on infrastructure development in host countries
   (b) FDI leads to infrastructure development only in the home country of the investing company
   (c) FDI can contribute to infrastructure development in host countries through investments in key sectors
   (d) FDI only contributes to infrastructure development in large host countries

Answer:

(c) FDI can contribute to infrastructure development in host countries through investments in key sectors

Explanation:

FDI can contribute to infrastructure development in host countries by investing in key sectors such as transportation, communication, and utilities.

1.8 Potential Problems Associated With Foreign Direct Investment

1. What are the potential problems associated with Foreign Direct Investment (FDI) for host countries?
   (a) Loss of domestic ownership and control over industries
   (b) Limited access to advanced technologies and managerial expertise

(c) Reduced employment opportunities due to foreign labor influx
(d) Decreased competition and efficiency in the local market

Answer:

(a) Loss of domestic ownership and control over industries

Explanation:

One potential problem associated with FDI for host countries is the loss of domestic ownership and control over industries, especially if foreign investors acquire significant stakes in local companies.

2. How can FDI lead to limited access to advanced technologies and managerial expertise in host countries?
(a) FDI restricts technology transfer to protect intellectual property rights
(b) Foreign companies do not bring advanced technologies to host countries
(c) FDI is limited to investing in low-tech industries in host countries
(d) FDI has no impact on technology transfer in host countries

Answer:

(a) FDI restricts technology transfer to protect intellectual property rights

Explanation:

Some foreign companies may restrict technology transfer to protect their intellectual property rights, limiting access to advanced technologies and managerial expertise in host countries.

3. What is the potential problem of "resource curse" associated with FDI?
(a) Host countries become overly dependent on foreign investments
(b) FDI leads to an abundance of natural resources in host countries
(c) FDI reduces economic growth in resource-rich host countries
(d) Host countries experience a shortage of resources due to FDI

Answer:

(a) Host countries become overly dependent on foreign investments

Explanation:

The "resource curse" refers to a situation where host countries become overly dependent on revenue from natural resource-based FDI, leading to economic challenges and vulnerabilities.

4. How can FDI impact the local labor market in host countries?
(a) FDI has no impact on the local labor market
(b) FDI leads to increased job opportunities for local workers
(c) FDI may result in wage disparities and job displacements
(d) FDI only benefits foreign workers in the host country

Answer:

(c) FDI may result in wage disparities and job displacements

Explanation:

FDI can lead to wage disparities and job displacements in the local labor market, as foreign companies may bring in skilled workers or use cheaper labor from their home countries.

5. What is the potential problem of "tax competition" associated with FDI?
(a) FDI leads to an increase in corporate taxes in host countries
(b) Host countries may offer excessive tax incentives to attract FDI
(c) FDI has no impact on the tax policies of host countries
(d) FDI leads to a decrease in corporate taxes in host countries

Answer:

(b) Host countries may offer excessive tax incentives to attract FDI

Explanation:

"Tax competition" refers to the practice of host countries offering excessive tax incentives to attract FDI, which may result in a reduction of government revenue and create distortions in the global investment landscape.

6. How can FDI lead to resource depletion in host countries?
(a) FDI discourages the exploitation of natural resources in host countries
(b) FDI leads to increased conservation efforts in host countries
(c) FDI can result in the overexploitation of natural resources by foreign companies
(d) FDI has no impact on the utilization of resources in host countries

Answer:

(c) FDI can result in the overexploitation of natural resources by foreign companies

Explanation:

FDI can lead to resource depletion in host countries if foreign companies excessively exploit natural resources without adequate sustainability measures.

7. What is the potential impact of FDI on income inequality in host countries?
   (a) FDI reduces income inequality by creating more job opportunities for all income groups
   (b) FDI has no impact on income inequality in host countries
   (c) FDI can exacerbate income inequality if benefits primarily concentrate among the wealthy
   (d) FDI leads to equal distribution of income among all segments of the population

   Answer:

   (c) FDI can exacerbate income inequality if benefits primarily concentrate among the wealthy

   Explanation:

   FDI can potentially exacerbate income inequality in host countries if the benefits of investment primarily accrue to the wealthy or privileged segments of the population.

8. How can FDI affect the environment in host countries?
   (a) FDI has no impact on the environment in host countries
   (b) FDI encourages sustainable practices and environmental protection
   (c) FDI can lead to environmental degradation due to lax regulations and compliance
   (d) FDI improves the environment by promoting clean technologies

   Answer:

   (c) FDI can lead to environmental degradation due to lax regulations and compliance

   Explanation:

   FDI can negatively impact the environment in host countries if foreign companies do not adhere to strict environmental regulations or if local regulations are lax.

9. What is the potential risk of FDI-induced capital flight in host countries?
   (a) FDI encourages capital inflow, not capital flight
   (b) FDI can lead to the outflow of domestic capital due to repatriation of profits
   (c) FDI has no impact on domestic capital flows in host countries
   (d) FDI can lead to increased domestic savings and investment

   Answer:

   (b) FDI can lead to the outflow of domestic capital due to repatriation of profits

   Explanation:

   FDI-induced capital flight can occur when foreign companies repatriate profits and dividends back to their home countries, leading to the outflow of domestic capital from the host country.

1.9 Foreign Direct Investment in India

1. What has been the trend of FDI inflows into India in recent years?
   (a) Declining trend
   (b) Stable with no significant changes
   (c) Fluctuating between high and low levels
   (d) Increasing trend

   Answer:

   (d) Increasing trend

   Explanation:

   In recent years, FDI inflows into India have shown an increasing trend, with a rise in foreign investment across various sectors.

2. Which sector attracts the highest FDI inflows in India?
   (a) Manufacturing
   (b) Agriculture
   (c) Services
   (d) Mining

   Answer:

   (c) Services

Explanation:
The services sector, including areas like information technology, telecommunications, and financial services, attracts the highest FDI inflows in India.

3. What is the government agency responsible for promoting and regulating FDI in India?
(a) Reserve Bank of India (RBI)
(b) Securities and Exchange Board of India (SEBI)
(c) Foreign Investment Promotion Board (FIP(b)
(d) Department for Promotion of Industry and Internal Trade (DPIIT)

Answer:
(d) Department for Promotion of Industry and Internal Trade (DPIIT)

Explanation:
The Department for Promotion of Industry and Internal Trade (DPIIT) is responsible for promoting and regulating FDI in India.

4. What are the key factors that attract foreign investors to India?
(a) Low population and market size
(b) Lack of skilled labor force
(c) Favorable economic policies and market potential
(d) High corporate tax rates

Answer:
(c) Favorable economic policies and market potential

Explanation:
Favorable economic policies, a large and growing market potential, and other initiatives by the Indian government attract foreign investors to India.

5. What is the "Make in India" campaign aimed at?
(a) Encouraging foreign companies to exit the Indian market
(b) Promoting domestic consumption of goods and services
(c) Attracting foreign investment and promoting manufacturing in India
(d) Encouraging Indian companies to invest overseas

Answer:
(c) Attracting foreign investment and promoting manufacturing in India

Explanation:
The "Make in India" campaign is aimed at attracting foreign investment and promoting manufacturing in India to boost the country's industrial and economic growth.

6. What is the current regulatory body responsible for overseeing Foreign Direct Investment (FDI) in India?
(a) Reserve Bank of India (RBI)
(b) Securities and Exchange Board of India (SEBI)
(c) Ministry of Finance, Government of India
(d) Department for Promotion of Industry and Internal Trade (DPIIT)

Answer:
(d) Department for Promotion of Industry and Internal Trade (DPIIT)

Explanation:
The Department for Promotion of Industry and Internal Trade (DPIIT) is the regulatory body responsible for overseeing Foreign Direct Investment (FDI) in India.

7. Which sector has traditionally attracted the highest FDI inflows in India?
(a) Information Technology (IT) and Business Process Outsourcing (BPO)
(b) Agriculture and Agribusiness
(c) Retail and Consumer Goods
(d) Manufacturing and Automotive

Answer:
(a) Information Technology (IT) and Business Process Outsourcing (BPO)

Explanation:
The Information Technology (IT) and Business Process Outsourcing (BPO) sector has traditionally attracted the highest FDI inflows in India.

8. What is the maximum limit of FDI allowed in the insurance sector in India?
(a) 26% (b) 49%
(c) 74% (d) 100%

Answer:
(c) 74%

Explanation:

The maximum limit of FDI allowed in the insurance sector in India is 74%.

9. Which policy initiative by the Indian government aims to improve the ease of doing business and attract more FDI?
   (a) Make in India
   (b) Swachh Bharat Abhiyan
   (c) Ayushman Bharat
   (d) Digital India

   Answer:

   (a) Make in India

   Explanation:

   The Make in India initiative by the Indian government aims to promote manufacturing and improve the ease of doing business in the country to attract more Foreign Direct Investment (FDI).

10. What is the primary source of Foreign Direct Investment (FDI) in India?
    (a) United States
    (b) China
    (c) United Kingdom
    (d) Singapore

    Answer:

    (a) United States

    Explanation:

    The United States has been one of the primary sources of Foreign Direct Investment (FDI) in India.

    Please note that FDI policies and regulations may change over time, so it is essential to refer to the latest information and official government sources for the most up-to-date information on FDI in India.

1.10 Overseas Direct Investment by Indian Companies

1. What is Overseas Direct Investment (ODI) by Indian companies?
   (a) Investment made by foreign companies in India
   (b) Investment made by Indian companies in foreign countries
   (c) Investment made by Indian companies in other Indian companies
   (d) Investment made by foreign companies in other foreign countries

   Answer:

   (b) Investment made by Indian companies in foreign countries

   Explanation:

   Overseas Direct Investment (ODI) refers to the investment made by Indian companies in foreign countries to establish or acquire significant ownership in businesses, manufacturing plants, or other assets abroad.

2. What motivates Indian companies to make Overseas Direct Investments (ODI)?
   (a) To reduce import of foreign goods
   (b) To acquire ownership of Indian companies
   (c) To expand their global footprint and access international markets
   (d) To increase competition in the domestic market

   Answer:

   (c) To expand their global footprint and access international markets

   Explanation:

   Indian companies make Overseas Direct Investments (ODI) to expand their global presence, access international markets, and tap into new business opportunities abroad.

3. How does Overseas Direct Investment (ODI) impact the Indian economy?
   (a) ODI has no impact on the Indian economy
   (b) ODI leads to increased imports and trade deficits
   (c) ODI can contribute to economic growth and job creation in India
   (d) ODI leads to decreased exports and a weaker currency

   Answer:

   (c) ODI can contribute to economic growth and job creation in India

   Explanation:

   ODI by Indian companies can contribute to economic growth in India by fostering international competitiveness and creating employment opportunities through expanded global operations.

4. What role does the Reserve Bank of India (RBI) play in regulating Overseas Direct Investment (ODI) by Indian companies?
   (a) RBI restricts all ODI activities by Indian companies
   (b) RBI provides financial incentives to encourage ODI by Indian companies

(c) RBI monitors and regulates the ODI activities of Indian companies
(d) RBI promotes ODI in specific sectors through policy initiatives

Answer:

(c) RBI monitors and regulates the ODI activities of Indian companies

Explanation:

The Reserve Bank of India (RBI) is responsible for monitoring and regulating Overseas Direct Investment (ODI) by Indian companies through the Foreign Exchange Management Act (FEM(a) guidelines.

5. Which sector has seen significant Overseas Direct Investment (ODI) by Indian companies in recent years?
(a) Information Technology (IT) and Business Process Outsourcing (BPO)
(b) Agriculture and Agribusiness
(c) Retail and Consumer Goods
(d) Manufacturing and Automotive

Answer:

(a) Information Technology (IT) and Business Process Outsourcing (BPO)

Explanation:

Indian companies, especially in the Information Technology (IT) and Business Process Outsourcing (BPO) sector, have made significant Overseas Direct Investment (ODI) to expand their global presence and serve international clients.

6. What is the primary motive behind Overseas Direct Investment (ODI) by Indian companies?
(a) To exploit natural resources of foreign countries
(b) To gain control and ownership over foreign industries
(c) To diversify business operations and expand globally
(d) To establish dominance in the global financial markets

Answer:

(c) To diversify business operations and expand globally

Explanation:

The primary motive behind Overseas Direct Investment (ODI) by Indian companies is to diversify their business operations, gain access to new markets, and expand their presence globally.

7. Which sector has witnessed significant Overseas Direct Investment (ODI) by Indian companies in recent years?
(a) Information Technology (IT) and Business Process Outsourcing (BPO)
(b) Retail and Consumer Goods
(c) Manufacturing and Automotive
(d) Agriculture and Agribusiness

Answer:

(a) Information Technology (IT) and Business Process Outsourcing (BPO)

Explanation:

Indian companies in the Information Technology (IT) and Business Process Outsourcing (BPO) sector have made significant Overseas Direct Investment (ODI) to expand their services and cater to international clients.

8. How does Overseas Direct Investment (ODI) contribute to India's economic growth?
(a) ODI leads to a reduction in India's foreign exchange reserves
(b) ODI has no impact on India's economic growth
(c) ODI enhances India's global competitiveness and boosts export capabilities
(d) ODI results in the outflow of skilled labor from India

Answer:

(c) ODI enhances India's global competitiveness and boosts export capabilities

Explanation:

Overseas Direct Investment (ODI) by Indian companies enhances India's global competitiveness by expanding their presence in international markets and increasing export capabilities.

9. What role does the Reserve Bank of India (RBI) play in regulating Overseas Direct Investment (ODI) by Indian companies?
(a) RBI regulates and monitors the FDI inflows into India
(b) RBI does not have any role in regulating ODI by Indian companies

(c) RBI facilitates and promotes ODI by providing financial assistance
(d) RBI approves and monitors ODI transactions by Indian companies

Answer:

(d) RBI approves and monitors ODI transactions by Indian companies

Explanation:

The Reserve Bank of India (RBI) plays a role in regulating Overseas Direct Investment (ODI) by Indian companies by approving and monitoring their outward remittances for ODI purposes.

Additional Question Bank

1.1 introduction

1. International capital movements refer to the:
   (a) Flow of goods and services between countries
   (b) Transfer of technology and knowledge across borders
   (c) Movement of financial assets and investments between countries
   (d) Exchange of currencies in the foreign exchange market
2. Foreign Direct Investment (FDI) involves:
   (a) Short-term speculative investments in financial markets
   (b) Acquiring a significant ownership stake in a foreign company
   (c) Exporting goods and services to foreign markets
   (d) Purchasing foreign currency for investment purposes
3. Portfolio investment includes:
   (a) Long-term investments in real estate and infrastructure projects
   (b) Investments in a variety of financial assets like stocks and bonds in foreign markets
   (c) Direct investments in foreign businesses to control their operations
   (d) Currency trading for speculative purposes
4. Capital flight refers to:
   (a) The movement of financial capital from one country to another for investment purposes
   (b) The sudden influx of foreign investment into a country's stock market

   (c) The mass migration of skilled labor to other countries for better opportunities
   (d) The rapid depreciation of a country's currency in the foreign exchange market
5. The International Monetary Fund (IMF) plays a role in:
   (a) Regulating international trade and setting tariff rates
   (b) Facilitating foreign direct investment between countries
   (c) Providing financial assistance to countries facing balance of payments crises
   (d) Setting interest rates in the global financial markets

1.2 Types of Foreign Capital

1. Foreign Direct Investment (FDI) involves:
   (a) Short-term speculative investments in financial markets
   (b) Acquiring a significant ownership stake in a foreign company
   (c) Exporting goods and services to foreign markets
   (d) Purchasing foreign currency for investment purposes
2. Portfolio investment includes:
   (a) Long-term investments in real estate and infrastructure projects
   (b) Investments in a variety of financial assets like stocks and bonds in foreign markets
   (c) Direct investments in foreign businesses to control their operations
   (d) Currency trading for speculative purposes
3. Foreign Institutional Investment (FII) refers to:
   (a) Investments made by foreign governments in domestic companies
   (b) Investments made by multinational corporations in foreign subsidiaries
   (c) Investments made by foreign institutional investors like mutual funds in the domestic financial markets
   (d) Investments made by domestic investors in foreign financial markets
4. Official Development Assistance (OD(a) is a type of foreign capital provided by:
   (a) Multinational corporations to support their global expansion
   (b) International organizations like the World Bank to fund infrastructure projects in developing countries

(c) Foreign governments to promote investment in specific sectors of their economy
(d) Individual investors looking for diversification in foreign markets

5. Remittances from overseas workers are an example of:
(a) FDI inflows from foreign companies establishing subsidiaries in a country
(b) Portfolio investment by foreign investors in the domestic stock market
(c) Foreign aid provided by international organizations to support social development
(d) Foreign capital inflows from individuals sending money back to their home country

1.3 Foreign Direct Investment (FDI)

1. Foreign Direct Investment (FDI) refers to:
(a) Short-term speculative investments in financial markets
(b) Acquiring a significant ownership stake in a domestic company by foreign investors
(c) Exporting goods and services to foreign markets
(d) Purchasing foreign currency for investment purposes

2. FDI differs from portfolio investment in that FDI involves:
(a) Buying and selling financial assets like stocks and bonds in foreign markets
(b) Long-term investments in real assets like property, factories, and businesses in a foreign country
(c) Exchanging one currency for another in the foreign exchange market
(d) Providing financial assistance to countries facing balance of payments crises

3. FDI can be categorized into two types: horizontal and vertical FDI. Horizontal FDI refers to:
(a) Investments made in the same industry or business activity as the investor's domestic operations
(b) Investments made in different industries or business activities from the investor's domestic operations

(c) The acquisition of a controlling stake in a domestic company by a foreign government
(d) The transfer of technology and knowledge between countries

4. The main motivations for companies to engage in FDI include:
(a) Speculating on short-term exchange rate movements
(b) Accessing new markets and customers
(c) Earning profits from currency trading
(d) Importing goods and services from foreign markets

5. Host countries often encourage FDI by offering various incentives, which may include:
(a) Imposing high taxes and tariffs on foreign investors
(b) Restricting foreign ownership in domestic companies
(c) Providing tax breaks, subsidies, and favorable regulatory treatment to foreign investors
(d) Limiting the repatriation of profits and dividends by foreign investors

1.4 Foreign Portfolio Investment (FPI)

1. Foreign Portfolio Investment (FPI) refers to:
(a) Acquiring a significant ownership stake in a domestic company by foreign investors
(b) Buying and selling financial assets like stocks and bonds in foreign markets
(c) Exporting goods and services to foreign markets
(d) Providing financial assistance to countries facing balance of payments crises

2. FPI differs from Foreign Direct Investment (FDI) in that FPI involves:
(a) Long-term investments in real assets like property, factories, and businesses in a foreign country
(b) Short-term speculative investments in financial markets
(c) The transfer of technology and knowledge between countries
(d) Exporting goods and services to foreign markets

3. FPI allows investors to:
(a) Acquire controlling stakes in domestic companies and have a say in their management

(b) Diversify their investment portfolios across different countries and industries
(c) Gain ownership of foreign real estate and infrastructure projects
(d) Access government incentives and subsidies for foreign investments

4. The main instruments of FPI include:
(a) Foreign currencies and commodities
(b) Real estate properties in foreign countries
(c) Stocks, bonds, and other securities in foreign markets
(d) Direct ownership of foreign companies

5. FPI can be more volatile than FDI due to:
(a) Longer investment horizons and strategic objectives
(b) Government regulations and restrictions on foreign investors
(c) Frequent buying and selling of financial assets in response to market conditions
(d) Currency exchange rate fluctuations

1.5 Reasons for Foreign Direct Investment

1. Foreign Direct Investment (FDI) is undertaken by multinational corporations (MNCs) for various reasons. Which of the following is NOT a common reason for MNCs to engage in FDI?
(a) Accessing new markets and customers
(b) Reducing exposure to exchange rate fluctuations
(c) Obtaining access to strategic resources and inputs
(d) Taking advantage of lower labor costs in foreign countries

2. MNCs often invest in foreign countries to gain access to new markets and customers. This strategy allows them to:
(a) Increase the costs of their products in foreign markets
(b) Increase their domestic production and market share
(c) Export their products from the home country at a lower cost
(d) Tap into the growing demand for their goods and services in foreign markets

3. FDI can also be driven by the desire to obtain access to strategic resources and inputs, such as:
(a) Financial capital and foreign exchange reserves
(b) Skilled labor and technology

(c) Renewable energy sources like wind and solar power
(d) Freshwater and arable land for agricultural production

4. Some MNCs invest in foreign countries to establish production facilities and take advantage of lower labor costs. This strategy is known as:
(a) Horizontal FDI
(b) Vertical FDI
(c) Portfolio investment
(d) Official Development Assistance (OD(a)

5. FDI can also be driven by the desire to avoid trade barriers and protectionist policies in foreign markets. By investing locally, MNCs can:
(a) Access government subsidies and tax breaks in the home country
(b) Secure exclusive intellectual property rights in the foreign market
(c) Bypass import tariffs and quotas imposed on foreign goods
(d) Influence the exchange rate of the foreign currency

1.6 Modes of Foreign Direct Investment (FDI)

1. Which mode of Foreign Direct Investment (FDI) involves the establishment of new operations or facilities in a foreign country?
(a) Greenfield investment
(b) Merger and acquisition
(c) Portfolio investment
(d) Joint venture

2. When a foreign company acquires a substantial ownership stake in an existing domestic company, it is known as:
(a) Greenfield investment
(b) Merger and acquisition
(c) Portfolio investment
(d) Joint venture

3. A joint venture in FDI is characterized by:
(a) A foreign company acquiring a domestic company to form a new entity
(b) Two or more companies from different countries collaborating to create a new venture

(c) A foreign company buying shares of a domestic company in the stock market
(d) A multinational corporation investing in various financial assets in foreign markets

4. Which mode of FDI involves the acquisition of shares or ownership stakes in a domestic company without seeking full control over the company's management?
(a) Greenfield investment
(b) Merger and acquisition
(c) Portfolio investment
(d) Joint venture

5. The primary motivation for multinational corporations to choose a joint venture as a mode of FDI is:
(a) Access to new markets and customers
(b) Obtaining full control over the foreign company's management
(c) Reducing exposure to exchange rate fluctuations
(d) Access to low-cost resources and inputs in the foreign market

1.7 Benefits of Foreign Direct Investment

1. Foreign Direct Investment (FDI) can bring various benefits to the host country's economy. Which of the following is NOT a common benefit of FDI for the host country?
(a) Job creation and employment opportunities
(b) Transfer of technology and knowledge
(c) Increased competition leading to lower prices for consumers
(d) Capital flight and loss of foreign exchange reserves

2. FDI can contribute to economic growth and development in the host country by:
(a) Reducing competition in domestic markets
(b) Repatriating profits and dividends to the home country
(c) Encouraging domestic firms to innovate and improve their efficiency
(d) Importing cheap labor from the home country

3. One of the benefits of FDI for the host country is the creation of new jobs and employment opportunities. This is particularly crucial in countries with:
(a) High unemployment rates and limited domestic investment
(b) Low foreign exchange reserves and budget deficits
(c) Strong trade surpluses and a robust manufacturing sector
(d) Stable political systems and low inflation rates

4. FDI can lead to technology spillovers in the host country, which refers to:
(a) The transfer of technology and knowledge from domestic firms to foreign investors
(b) The transfer of technology and knowledge from foreign investors to domestic firms
(c) The repatriation of technology and knowledge back to the home country
(d) The acquisition of technology and knowledge by the host country's government

5. FDI can enhance the host country's export competitiveness by:
(a) Increasing import tariffs and barriers to foreign competition
(b) Subsidizing domestic industries to reduce production costs
(c) Attracting foreign investment in export-oriented sectors
(d) Reducing access to foreign markets for domestic firms

1.8 Potential Problems Associated with Foreign Direct Investment

1. One of the potential problems associated with FDI is the risk of:
(a) Increased competition leading to lower prices for consumers
(b) Loss of jobs and employment opportunities in the host country
(c) Technology spillovers and knowledge transfer to domestic firms
(d) Enhanced export competitiveness for the host country's industries

2. Host countries may face a potential problem related to the repatriation of profits by foreign investors. This refers to:
(a) The transfer of profits and dividends from domestic firms to foreign investors
(b) The transfer of profits and dividends from foreign investors to domestic firms

(c) The reinvestment of profits within the host country's economy
(d) The increase in government revenue from corporate taxation

3. The term "resource curse" is used to describe a potential problem associated with FDI in some countries. It refers to:
(a) The abundance of natural resources leading to economic stagnation
(b) The lack of essential resources for industrial development
(c) The concentration of foreign investment in a few industries, neglecting other sectors
(d) The successful exploitation of natural resources for economic growth

4. A potential problem associated with FDI is the risk of creating a dependence on foreign technology and expertise. This could lead to:
(a) Enhanced technological capabilities of domestic firms
(b) Increased competition in the domestic market
(c) Reduced innovation and research and development activities
(d) Diversification of the host country's export markets

5. The "race to the bottom" is a potential problem that arises when countries compete to attract FDI by:
(a) Implementing high corporate tax rates to generate government revenue
(b) Offering the highest labor wages to attract foreign investors
(c) Providing generous incentives and subsidies to foreign companies
(d) Restricting foreign ownership in domestic companies

1.9 Foreign Direct Investment in India

1. Foreign Direct Investment (FDI) in India is regulated and governed by:
(a) The World Trade Organization (WTO)
(b) The International Monetary Fund (IMF)
(c) The Reserve Bank of India (RBI) and the Foreign Exchange Management Act (FEM(a)
(d) The Ministry of External Affairs (ME(a)

2. Which sector has historically attracted the highest FDI inflows in India?
(a) Agriculture and allied activities
(b) Manufacturing and industrial sectors

(c) Information Technology (IT) and Business Process Outsourcing (BPO)
(d) Healthcare and pharmaceutical industries

3. The "Make in India" initiative, launched by the Indian government, aims to:
(a) Promote domestic consumption and reduce imports
(b) Attract foreign investment and enhance India's manufacturing sector
(c) Encourage emigration of skilled Indian workers to other countries
(d) Strengthen India's agricultural sector and increase food exports

4. To attract FDI in specific sectors, the Indian government has allowed a higher level of FDI under the automatic route in areas such as:
(a) Defense and retail trading
(b) Education and healthcare
(c) Telecommunications and insurance
(d) Banking and financial services

5. The Indian government has implemented various policy measures to ease FDI inflows, such as:
(a) Imposing strict capital controls and restrictions on repatriation of profits
(b) Limiting foreign ownership in domestic companies to protect domestic industries
(c) Simplifying regulations, liberalizing foreign investment norms, and improving business environment
(d) Banning foreign investment in sensitive sectors like defense and infrastructure

1.10 Overseas Direct Investment by Indian Companies

1. Overseas Direct Investment (ODI) refers to:
(a) Foreign investment in India by multinational corporations
(b) Investment in Indian companies by foreign investors
(c) Indian companies investing in businesses and assets in foreign countries
(d) Foreign portfolio investment in Indian financial markets

2. Indian companies undertake Overseas Direct Investment (ODI) primarily to:
   (a) Gain access to new markets and customers abroad
   (b) Avoid competition from foreign companies in the Indian market
   (c) Obtain financial assistance from foreign governments
   (d) Reduce their domestic production and operations
3. The Reserve Bank of India (RBI) regulates ODI by Indian companies. The regulatory framework aims to:
   (a) Encourage Indian companies to invest only in neighboring countries
   (b) Restrict ODI to specific sectors in foreign countries
   (c) Liberalize ODI norms and simplify the approval process
   (d) Prohibit Indian companies from investing in foreign assets
4. Which sector has seen significant Overseas Direct Investment (ODI) by Indian companies in recent years?
   (a) Agriculture and allied activities
   (b) Manufacturing and industrial sectors
   (c) Information Technology (IT) and Business Process Outsourcing (BPO)
   (d) Healthcare and pharmaceutical industries
5. The "Going Global" strategy is often pursued by Indian companies through ODI. This strategy aims to:
   (a) Focus solely on the domestic market and reduce foreign exposure
   (b) Diversify business risks by expanding into international markets
   (c) Attract foreign companies to invest in India
   (d) Limit foreign investment in the Indian economy

Answer

1.1 introduction

1. (c) Movement of financial assets and investments between countries
2. (b) Acquiring a significant ownership stake in a foreign company
3. (b) Investments in a variety of financial assets like stocks and bonds in foreign markets

4. (a) The movement of financial capital from one country to another for investment purposes
5. (c) Providing financial assistance to countries facing balance of payments crises

1.2 Types of Foreign Capital

1. (b) Acquiring a significant ownership stake in a foreign company
2. (b) Investments in a variety of financial assets like stocks and bonds in foreign markets
3. (c) Investments made by foreign institutional investors like mutual funds in the domestic financial markets
4. (b) International organizations like the World Bank to fund infrastructure projects in developing countries
5. (d) Foreign capital inflows from individuals sending money back to their home country

1.3 Foreign Direct Investment (FDI)

1. (b) Acquiring a significant ownership stake in a domestic company by foreign investors
2. (b) Long-term investments in real assets like property, factories, and businesses in a foreign country
3. (a) Investments made in the same industry or business activity as the investor's domestic operations
4. (b) Accessing new markets and customers
5. (c) Providing tax breaks, subsidies, and favorable regulatory treatment to foreign investors

1.4 Foreign Portfolio Investment (FPI

1. (b) Buying and selling financial assets like stocks and bonds in foreign markets
2. (b) Short-term speculative investments in financial markets
3. (b) Diversify their investment portfolios across different countries and industries

4. (c) Stocks, bonds, and other securities in foreign markets
5. (c) Frequent buying and selling of financial assets in response to market conditions

1.5 Reasons for Foreign Direct Investment

1. (b) Reducing exposure to exchange rate fluctuations
2. (d) Tap into the growing demand for their goods and services in foreign markets
3. (b) Skilled labor and technology
4. (a) Horizontal FDI
5. (c) Bypass import tariffs and quotas imposed on foreign goods

1.6 Modes of Foreign Direct Investment (FDI)

1. (a) Greenfield investment
2. (b) Merger and acquisition
3. (b) Two or more companies from different countries collaborating to create a new venture
4. (c) Portfolio investment
5. (a) Access to new markets and customers

1.7 Benefits of Foreign Direct Investment

1. (d) Capital flight and loss of foreign exchange reserves
2. (c) Encouraging domestic firms to innovate and improve their efficiency
3. (a) High unemployment rates and limited domestic investment
4. (b) The transfer of technology and knowledge from foreign investors to domestic firms
5. (c) Attracting foreign investment in export-oriented sectors

1.8 Potential Problems Associated with Foreign Direct Investment

1. (b) Loss of jobs and employment opportunities in the host country
2. (a) The transfer of profits and dividends from domestic firms to foreign investors
3. (a) The abundance of natural resources leading to economic stagnation

4. (c) Reduced innovation and research and development activities
5. (c) Providing generous incentives and subsidies to foreign companies

1.9 Foreign Direct Investment in India

1. (c) The Reserve Bank of India (RBI) and the Foreign Exchange Management Act (FEM(a)
2. (c) Information Technology (IT) and Business Process Outsourcing (BPO)
3. (b) Attract foreign investment and enhance India's manufacturing sector
4. (c) Telecommunications and insurance
5. (c) Simplifying regulations, liberalizing foreign investment norms, and improving the business environment

1.10 Overseas Direct Investment by Indian Companies

1. (c) Indian companies investing in businesses and assets in foreign countries
2. (a) Gain access to new markets and customers abroad
3. (c) Liberalize ODI norms and simplify the approval process
4. (c) Information Technology (IT) and Business Process Outsourcing (BPO)
5. (b) Diversify business risks by expanding into international markets

10 INDIAN ECONOMY

Multiple Choice Questions

1.1 Status of Indian Economy: Pre Independence Period (1850 -1947)

1. During the pre-independence period, the Indian economy was primarily characterized by:
   (a) Rapid industrialization and urbanization
   (b) Agricultural dominance and dependence on traditional industries
   (c) High levels of foreign direct investment and technological advancements
   (d) Modern banking systems and well-developed financial markets

   Answer:
   (b) Agricultural dominance and dependence on traditional industries

   Explanation:
   During the pre-independence period, the Indian economy was primarily agrarian, with agriculture being the dominant sector, and traditional industries played a significant role in the economy.

2. The colonial policies of the British Raj during this period led to:
   (a) Promotion of Indian industries and protectionism
   (b) Liberalization of trade and unrestricted foreign investments
   (c) The decline of traditional Indian industries and exploitation of resources
   (d) Equal economic opportunities for Indians and British citizens

   Answer:
   (c) The decline of traditional Indian industries and exploitation of resources

   Explanation:
   The colonial policies of the British Raj during the pre-independence period led to the decline of traditional Indian industries and the exploitation of India's resources for the benefit of the British Empire.

3. What was the impact of the Great Depression of the 1930s on the Indian economy?
   (a) The Indian economy remained largely unaffected by the global economic crisis
   (b) India's agriculture sector thrived during the Great Depression
   (c) The Great Depression caused significant economic hardships and unemployment in India
   (d) India became a major exporter of manufactured goods during the Depression

   Answer:
   (c) The Great Depression caused significant economic hardships and unemployment in India

   Explanation:
   The Great Depression of the 1930s had a severe impact on the Indian economy, leading to widespread economic hardships, unemployment, and socio-economic disturbances.

4. The growth of the Indian National Movement during this period was partly fueled by:
   (a) Widespread support for British colonial policies
   (b) A decline in the desire for independence among Indians
   (c) Economic grievances and discontent with British economic exploitation
   (d) The British government's focus on modernizing the Indian economy

   Answer:
   (c) Economic grievances and discontent with British economic exploitation

   Explanation:
   The growth of the Indian National Movement during the pre - independence period was partly fueled by economic grievances and discontent with British economic exploitation, which led to demands for independence and economic self-sufficiency.

5. What was the role of Indian agriculture during the pre-independence period?
   (a) Indian agriculture was highly mechanized and technologically advanced

(b) Agriculture played a minor role in the economy with the focus on industrialization
(c) Indian agriculture was the backbone of the economy, employing the majority of the population
(d) Agriculture was primarily focused on cash crops for export to British markets

Answer:

(c) Indian agriculture was the backbone of the economy, employing the majority of the population

Explanation:

During the pre-independence period, Indian agriculture played a significant role in the economy and was the primary source of livelihood for the majority of the population.

6. Which sector was the backbone of the Indian economy during the pre-independence period?
(a) Information Technology (IT) and Business Process Outsourcing (BPO)
(b) Manufacturing and Heavy Industries
(c) Services and Financial Sector
(d) Agriculture

Answer:

(d) Agriculture

Explanation:

Agriculture was the backbone of the Indian economy during the pre-independence period, employing a significant portion of the population and contributing substantially to the national income.

7. What was the impact of colonial rule on the Indian economy during the pre-independence period?
(a) Colonial rule led to rapid industrialization and modernization of the Indian economy
(b) Colonial policies focused on promoting Indian industries and supporting economic growth

(c) Colonial exploitation led to the drain of wealth from India and hindered economic development
(d) Colonial rule had no significant impact on the Indian economy

Answer:

(c) Colonial exploitation led to the drain of wealth from India and hindered economic development

Explanation:

During the pre-independence period, colonial rule in India led to the exploitation of resources and drain of wealth, which hindered the economic development of the country.

8. Which of the following was a major challenge faced by the Indian economy during the pre-independence period?
(a) Excessive foreign investment leading to economic dependence
(b) Inadequate availability of skilled labor for industrialization
(c) Rapid population growth and unemployment
(d) Lack of technological advancements and modern infrastructure

Answer:

(d) Lack of technological advancements and modern infrastructure

Explanation:

The lack of technological advancements and modern infrastructure was a major challenge faced by the Indian economy during the pre - independence period, hindering industrialization and economic growth.

9. Which economic concept was prominent in the Indian economy during the pre-independence period, emphasizing self-reliance and local production?
(a) Import substitution
(b) Export-oriented industrialization
(c) Free trade and globalization
(d) Foreign direct investment and multinational corporations

Answer:

(a) Import substitution

Explanation:
Import substitution was a prominent economic concept in the Indian economy during the pre-independence period, emphasizing self-reliance and the promotion of local production to reduce dependence on imported goods.

1.2 Indian Economy: Post-Independence (1947-1991)

1. What was the economic policy adopted by India after independence in 1947, which emphasized self-sufficiency and import substitution?
   (a) Export-oriented industrialization
   (b) Privatization and liberalization
   (c) Import substitution and planned economy
   (d) Foreign direct investment and globalization
   Answer:
   (c) Import substitution and planned economy
   Explanation:
   After independence in 1947, India adopted a policy of import substitution and a planned economy, which emphasized self-sufficiency and reducing dependence on imported goods.
2. Which of the following was a significant feature of the Indian economy during the post-independence period?
   (a) Rapid industrialization and urbanization
   (b) Extensive foreign direct investment and multinational corporations
   (c) Dominance of the services sector and information technology
   (d) Mixed economy with a public sector-led approach
   Answer:
   (d) Mixed economy with a public sector-led approach
   Explanation:
   During the post-independence period, India followed a mixed economy with a public sector-led approach, where both the public and private sectors played significant roles in economic development.

3. What was the purpose of the Five-Year Plans introduced by India during the post-independence period?
   (a) To promote foreign trade and attract foreign investments
   (b) To encourage private sector dominance in the economy
   (c) To achieve rapid industrialization and economic growth through planned development
   (d) To reduce government intervention and promote free market policies
   Answer:
   (c) To achieve rapid industrialization and economic growth through planned development
   Explanation:
   The Five-Year Plans introduced by India during the post-independence period aimed to achieve rapid industrialization and economic growth through planned development of various sectors of the economy.
4. Which major economic event took place in India in 1991, leading to significant economic reforms?
   (a) Nationalization of banks and financial institutions
   (b) Adoption of import substitution policies
   (c) Liberalization and opening up of the Indian economy
   (d) Introduction of the Green Revolution in agriculture
   Answer:
   (c) Liberalization and opening up of the Indian economy
   Explanation:
   In 1991, India implemented significant economic reforms through liberalization and opening up of the economy, moving away from the previous import substitution policies.
5. What were the primary objectives of the economic reforms in India in 1991?
   (a) To strengthen the public sector and promote socialism
   (b) To attract foreign direct investment and multinational corporations

(c) To achieve rapid economic growth and integration with the global economy
(d) To prioritize the agricultural sector and promote rural development

Answer:

(c) To achieve rapid economic growth and integration with the global economy

Explanation:

The primary objectives of the economic reforms in India in 1991 were to achieve rapid economic growth and integration with the global economy through liberalization, privatization, and globalization.

6. What was the economic policy adopted by India after independence in 1947, emphasizing self-reliance and state-led planning?
(a) Import substitution
(b) Liberalization and privatization
(c) Globalization and free trade
(d) Mixed economy and planned development

Answer:

(d) Mixed economy and planned development

Explanation:

India adopted a mixed economy and planned development model after independence, which emphasized self-reliance and state-led planning to achieve economic growth and development.

7. The First Five-Year Plan in India focused on the development of which sector?
(a) Agriculture and rural development
(b) Information Technology (IT) and Business Process Outsourcing (BPO)
(c) Heavy industries and infrastructure
(d) Services and financial sector

Answer:

(a) Agriculture and rural development

Explanation:

The First Five-Year Plan in India (1951-1956) focused on the development of agriculture and rural areas to address food security and rural poverty.

8. Which significant economic event occurred in India in 1991, leading to a major shift in economic policies and reforms?
(a) The nationalization of banks
(b) The adoption of the Green Revolution
(c) The liberalization and globalization reforms
(d) The introduction of the Goods and Services Tax (GST)

Answer:

(c) The liberalization and globalization reforms

Explanation:

In 1991, India initiated economic reforms involving liberalization and globalization to open up the economy, attract foreign investments, and reduce government intervention.

9. What was the major objective of the economic reforms in India during the post-independence period?
(a) To achieve self-sufficiency and import substitution
(b) To promote export-oriented industrialization
(c) To attract foreign direct investment and multinational corporations
(d) To accelerate economic growth and improve efficiency

Answer:

(d) To accelerate economic growth and improve efficiency

Explanation:

The major objective of economic reforms in India during the post-independence period was to accelerate economic growth, improve efficiency, and integrate with the global economy.

10. Which sector experienced significant growth during the post-independence period, contributing to India's economic development?

(a) Agriculture and rural development
(b) Heavy industries and infrastructure
(c) Information Technology (IT) and Business Process Outsourcing (BPO)
(d) Services and financial sector

Answer:

(c) Information Technology (IT) and Business Process Outsourcing (BPO)

Explanation:

The Information Technology (IT) and Business Process Outsourcing (BPO) sector experienced significant growth during the post-independence period, contributing to India's economic development and global competitiveness.

1.3 The Era of Reforms

1. When did India initiate its major economic reforms and liberalization measures?
(a) 1951
(b) 1971
(c) 1981
(d) 1991

Answer:

(d) 1991

Explanation:

India initiated its major economic reforms and liberalization measures in 1991 to open up the economy and attract foreign investments.

2. What was the primary objective of the economic reforms introduced in 1991?
(a) To promote import substitution
(b) To achieve self-sufficiency in food production
(c) To accelerate economic growth and improve efficiency
(d) To increase government control over the economy

Answer:

(c) To accelerate economic growth and improve efficiency

Explanation:

The primary objective of the economic reforms introduced in 1991 was to accelerate economic growth, improve efficiency, and integrate with the global economy.

3. Which sector witnessed significant deregulation and liberalization during the era of economic reforms in India?
(a) Agriculture and rural development
(b) Heavy industries and infrastructure
(c) Information Technology (IT) and Business Process Outsourcing (BPO)
(d) Services and financial sector

Answer:

(c) Information Technology (IT) and Business Process Outsourcing (BPO)

Explanation:

The Information Technology (IT) and Business Process Outsourcing (BPO) sector witnessed significant deregulation and liberalization during the era of economic reforms in India, leading to its rapid growth.

4. What was the major change in India's trade policy during the era of economic reforms?
(a) Shift towards import substitution
(b) Strict control on imports to protect domestic industries
(c) Opening up the economy to global trade and reducing import tariffs
(d) Imposition of export restrictions to conserve resources

Answer:

(c) Opening up the economy to global trade and reducing import tariffs

Explanation:

During the era of economic reforms, India shifted from protectionist policies towards opening up the economy to global trade, reducing import tariffs, and promoting exports.

5. Which economic concept became central to India's economic strategy during the era of reforms?
   (a) Import substitution
   (b) Planned development
   (c) Self-sufficiency
   (d) Liberalization and globalization

   Answer:
   (d) Liberalization and globalization

   Explanation:
   Liberalization and globalization became central to India's economic strategy during the era of reforms, aiming to promote market-oriented policies and integrate with the global economy.

6. The economic reforms in India during the 1990s aimed to:
   (a) Strengthen the socialist economic model
   (b) Encourage import substitution and self-reliance
   (c) Promote export-oriented industrialization
   (d) Accelerate economic growth and improve efficiency

   Answer:
   (d) Accelerate economic growth and improve efficiency

   Explanation:
   The economic reforms in India during the 1990s aimed to accelerate economic growth and improve efficiency by reducing government intervention and promoting private sector participation.

7. Which Indian Prime Minister played a significant role in initiating the economic reforms in 1991?
   (a) Jawaharlal Nehru
   (b) Rajiv Gandhi
   (c) Indira Gandhi
   (d) P. V. Narasimha Rao

   Answer:
   (d) P. V. Narasimha Rao

   Explanation:
   P. V. Narasimha Rao, as the Prime Minister of India in 1991, played a significant role in initiating the economic reforms that transformed India's economic policies.

8. What was the key objective of the New Economic Policy introduced in 1991?
   (a) Nationalization of industries and banks
   (b) Promotion of agricultural subsidies
   (c) Reducing fiscal deficit and inflation
   (d) Encouraging foreign aid and grants

   Answer:
   (c) Reducing fiscal deficit and inflation

   Explanation:
   The key objective of the New Economic Policy introduced in 1991 was to reduce fiscal deficit and control inflation through various economic reforms.

9. Which sector witnessed significant privatization during the era of reforms in India?
   (a) Information Technology (IT) and Business Process Outsourcing (BPO)
   (b) Agriculture and rural development
   (c) Heavy industries and infrastructure
   (d) Services and financial sector

   Answer:
   (c) Heavy industries and infrastructure

   Explanation:
   The era of reforms in India witnessed significant privatization in the heavy industries and infrastructure sectors as part of the liberalization measures.

1.4 The Economic Reforms of 1991

1. The economic reforms of 1991 in India were primarily aimed at:
   (a) Encouraging import substitution and self-reliance
   (b) Promoting socialism and central planning
   (c) Accelerating economic growth and improving efficiency
   (d) Reducing foreign direct investment and multinational corporations

   Answer:
   (c) Accelerating economic growth and improving efficiency

   Explanation:
   The economic reforms of 1991 in India were primarily aimed at accelerating economic growth and improving efficiency by reducing government controls and promoting private sector participation.

2. The New Economic Policy of 1991 included measures related to:
   (a) Increase in import tariffs and trade restrictions
   (b) Nationalization of major industries and banks
   (c) Fiscal deficit reduction and financial sector reforms
   (d) Expansion of public sector enterprises

   Answer:
   (c) Fiscal deficit reduction and financial sector reforms

   Explanation:
   The New Economic Policy of 1991 included measures related to fiscal deficit reduction, financial sector reforms, and liberalization of the economy.

3. Which international financial institution played a significant role in providing financial assistance and support during India's economic crisis in 1991?
   (a) World Trade Organization (WTO)
   (b) International Monetary Fund (IMF)
   (c) World Bank
   (d) Asian Development Bank (AD(b)

   Answer:
   (b) International Monetary Fund (IMF)

   Explanation:
   The International Monetary Fund (IMF) played a significant role in providing financial assistance and support to India during its economic crisis in 1991.

4. The industrial policy reforms of 1991 aimed to:
   (a) Encourage import substitution and protect domestic industries
   (b) Nationalize major industries and establish public sector monopolies
   (c) Promote foreign direct investment and multinational corporations
   (d) Liberalize and deregulate the industrial sector

   Answer:
   (d) Liberalize and deregulate the industrial sector

   Explanation:
   The industrial policy reforms of 1991 aimed to liberalize and deregulate the industrial sector by reducing government controls and promoting private sector participation.

5. What was the major impact of the economic reforms of 1991 on India's economic growth and development?
   (a) Slower economic growth and increased unemployment
   (b) Higher fiscal deficit and inflation rates
   (c) Accelerated economic growth and improved global competitiveness
   (d) Increased trade barriers and reduced international trade

   Answer:
   (c) Accelerated economic growth and improved global competitiveness

   Explanation:
   The economic reforms of 1991 led to accelerated economic growth and improved global competitiveness by opening up the Indian economy to foreign investments and reducing bureaucratic obstacles.

6. The economic reforms of 1991 in India were launched under the leadership of:
   (a) Jawaharlal Nehru
   (b) Rajiv Gandhi
   (c) Indira Gandhi
   (d) P. V. Narasimha Rao

Answer:

(d) P. V. Narasimha Rao

Explanation:

The economic reforms of 1991 in India were launched under the leadership of Prime Minister P. V. Narasimha Rao.

7. Which of the following is NOT one of the key pillars of the economic reforms of 1991?
   (a) Liberalization
   (b) Privatization
   (c) Globalization
   (d) Nationalization

Answer:

(d) Nationalization

Explanation:

Nationalization is not one of the key pillars of the economic reforms of 1991. The correct pillars are liberalization, privatization, and globalization.

8. The New Economic Policy (NEP) of 1991 aimed to:
   (a) Increase government control over the economy
   (b) Promote a closed and self-sufficient economic model
   (c) Encourage foreign investment and reduce government intervention
   (d) Isolate the Indian economy from the global market

Answer:

(c) Encourage foreign investment and reduce government intervention

Explanation:

The New Economic Policy (NEP) of 1991 aimed to encourage foreign investment, reduce government intervention in the economy, and promote liberalization and globalization.

9. Which sector witnessed significant liberalization during the economic reforms of 1991?
   (a) Agriculture and rural development
   (b) Information Technology (IT) and Business Process Outsourcing (BPO)

   (c) Heavy industries and infrastructure
   (d) Services and financial sector

Answer:

(b) Information Technology (IT) and Business Process Outsourcing (BPO)

Explanation:

The information technology (IT) and business process outsourcing (BPO) sector witnessed significant liberalization during the economic reforms of 1991, leading to its rapid growth.

10. The 1991 economic reforms in India resulted in:
    (a) Slower economic growth and increased unemployment
    (b) Higher fiscal deficit and inflation
    (c) Increased government control over industries
    (d) Higher foreign investment and improved economic performance

Answer:

(d) Higher foreign investment and improved economic performance

Explanation:

The 1991 economic reforms in India resulted in higher foreign investment and improved economic performance, leading to higher GDP growth rates and increased competitiveness.

1.4.1 The Fiscal Reforms

1. The fiscal reforms of 1991 aimed to address which of the following issues?
   (a) Reduce inflation and control fiscal deficit
   (b) Increase government spending and subsidies
   (c) Nationalize key industries and banks
   (d) Implement protectionist trade policies

Answer:

(a) Reduce inflation and control fiscal deficit

Explanation:

The fiscal reforms of 1991 aimed to reduce inflation and control the fiscal deficit, which was a major concern for the Indian economy at that time.

2. What measures were taken to control the fiscal deficit during the 1991 reforms?
(a) Increase public expenditure and welfare schemes
(b) Lower tax rates and increase tax exemptions
(c) Reduce government spending and subsidies
(d) Implement import tariffs and export duties

Answer:

(c) Reduce government spending and subsidies

Explanation:

To control the fiscal deficit during the 1991 reforms, the government implemented measures to reduce government spending and subsidies.

3. The 1991 fiscal reforms introduced the concept of "LPG," which stands for:
(a) Liberalization, Privatization, and Globalization
(b) Limited Profits and Gains
(c) Low Price Guarantee
(d) Local Production and Growth

Answer:

(a) Liberalization, Privatization, and Globalization

Explanation:

The 1991 fiscal reforms introduced the concept of "LPG," which stands for Liberalization, Privatization, and Globalization, as key pillars of economic transformation.

4. How did the fiscal reforms impact the taxation system in India during the 1990s?
(a) Taxes were increased on all income levels
(b) Tax rates were lowered to stimulate consumption
(c) Tax administration was simplified and streamlined
(d) Corporate taxes were abolished for multinational companies

Answer:

(c) Tax administration was simplified and streamlined

Explanation:

The fiscal reforms aimed to simplify and streamline the tax administration in India during the 1990s to improve tax collection and compliance.

5. What was the primary goal of the fiscal reforms in 1991 regarding government finances?
(a) Accumulate foreign reserves to repay foreign debt
(b) Enhance social welfare programs and subsidies
(c) Achieve a surplus budget and reduce public debt
(d) Increase public spending to boost economic growth

Answer:

(c) Achieve a surplus budget and reduce public debt

Explanation:

The primary goal of the fiscal reforms in 1991 was to achieve a surplus budget and reduce public debt to improve the overall fiscal health of the country.

6. What was the main objective of the fiscal reforms of 1991 in India?
(a) To reduce government expenditure and increase taxes
(b) To promote deficit financing to boost economic growth
(c) To reduce fiscal deficit and improve fiscal discipline
(d) To increase public spending on social welfare programs

Answer:

(c) To reduce fiscal deficit and improve fiscal discipline

Explanation:

The main objective of the fiscal reforms of 1991 in India was to reduce fiscal deficit and improve fiscal discipline to stabilize the economy and promote sustainable growth.

7. Which measure was taken to reduce fiscal deficit during the 1991 reforms?
(a) Increasing public spending on infrastructure projects
(b) Introducing higher tax rates for the wealthy individuals
(c) Reducing subsidies on essential goods and services
(d) Implementing universal basic income for all citizens

Answer:

(c) Reducing subsidies on essential goods and services

Explanation:

One of the measures taken to reduce fiscal deficit during the 1991 reforms was to reduce subsidies on essential goods and services.

8. The introduction of Value Added Tax (VAT) in 2005 was part of which fiscal reform initiative?
   (a) Fiscal deficit reduction program
   (b) Tax rationalization and modernization
   (c) Privatization of state-owned enterprises
   (d) Poverty alleviation and social welfare scheme

Answer:

(b) Tax rationalization and modernization

Explanation:

The introduction of Value Added Tax (VAT) in 2005 was part of the fiscal reform initiative to rationalize and modernize the tax system in India.

9. Which of the following was a significant outcome of the fiscal reforms in India during the 1990s?
   (a) Increased fiscal deficit and inflation
   (b) Reduced foreign direct investment (FDI) inflows
   (c) Improved credit rating and investment climate
   (d) Higher government expenditure on unproductive projects

Answer:

(c) Improved credit rating and investment climate

Explanation:

One of the significant outcomes of the fiscal reforms in India during the 1990s was the improved credit rating and investment climate, which attracted more foreign investments.

10. What role did the Fiscal Responsibility and Budget Management (FRBM) Act play in the fiscal reforms?
   (a) It allowed the government to borrow without any restrictions
   (b) It increased the fiscal deficit to finance development projects

   (c) It imposed fiscal discipline and set targets for reducing fiscal deficit
   (d) It allocated a higher budget for defense and military expenses

Answer:

(c) It imposed fiscal discipline and set targets for reducing fiscal deficit

Explanation:

The Fiscal Responsibility and Budget Management (FRBM) Act played a role in the fiscal reforms by imposing fiscal discipline and setting targets for reducing fiscal deficit over time.

1.4.2 Monetary and Financial Sector Reforms

1. The primary objective of monetary and financial sector reforms in 1991 was to:
   (a) Increase government control over the banking sector
   (b) Promote excessive borrowing and lending by banks
   (c) Improve the efficiency and stability of the financial system
   (d) Nationalize private banks and financial institutions

Answer:

(c) Improve the efficiency and stability of the financial system

Explanation:

The primary objective of monetary and financial sector reforms in 1991 was to improve the efficiency and stability of the financial system in India.

2. Which regulatory authority was established as a result of the financial sector reforms in 1991 to oversee the functioning of the banking and financial institutions in India?
   (a) Securities and Exchange Board of India (SEBI)
   (b) Reserve Bank of India (RBI)
   (c) National Stock Exchange (NSE)
   (d) Insurance Regulatory and Development Authority of India (IRDAI)

Answer:

(b) Reserve Bank of India (RBI)

Explanation:
The Reserve Bank of India (RBI) is the regulatory authority responsible for overseeing the functioning of the banking and financial institutions in India.

3. What major step was taken to liberalize the Indian banking sector during the financial reforms of 1991?
   (a) Nationalization of private banks
   (b) Restricting foreign direct investment in the banking sector
   (c) Allowing private sector banks to enter the industry
   (d) Imposing strict capital controls on banks

Answer:
(c) Allowing private sector banks to enter the industry

Explanation:
One of the major steps taken to liberalize the Indian banking sector during the financial reforms of 1991 was allowing private sector banks to enter the industry.

4. The reduction in the statutory liquidity ratio (SLR) and the cash reserve ratio (CRR) aimed to:
   (a) Discourage bank lending and control inflation
   (b) Promote excessive lending by banks to boost economic growth
   (c) Enhance the liquidity position of banks and promote lending
   (d) Increase government control over the banking sector

Answer:
(c) Enhance the liquidity position of banks and promote lending

Explanation:
The reduction in the statutory liquidity ratio (SLR) and the cash reserve ratio (CRR) aimed to enhance the liquidity position of banks and promote lending to boost economic growth.

5. The financial sector reforms of 1991 led to the establishment of which stock exchange in India?
   (a) Bombay Stock Exchange (BSE)
   (b) National Stock Exchange (NSE)

   (c) Kolkata Stock Exchange (KSE)
   (d) Chennai Stock Exchange (CSE)

Answer:
(b) National Stock Exchange (NSE)

Explanation:
The financial sector reforms of 1991 led to the establishment of the National Stock Exchange (NSE) in India.

6. Which financial institution was established in 1991 to regulate and develop the Indian securities market?
   (a) Reserve Bank of India (RBI)
   (b) Securities and Exchange Board of India (SEBI)
   (c) National Stock Exchange (NSE)
   (d) Bombay Stock Exchange (BSE)

Answer:
(b) Securities and Exchange Board of India (SEBI)

Explanation:
The Securities and Exchange Board of India (SEBI) was established in 1991 to regulate and develop the Indian securities market and protect the interests of investors.

7. The reduction of Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR) during the financial reforms aimed to:
   (a) Increase the flow of credit and money supply in the economy
   (b) Discourage banks from lending and encourage saving
   (c) Stabilize exchange rates and control inflation
   (d) Restrict foreign investments in the financial sector

Answer:
(a) Increase the flow of credit and money supply in the economy

Explanation:
The reduction of Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR) during the financial reforms aimed to increase the flow of credit and money supply in the economy to promote economic growth.

8. What was the major objective of introducing the National Stock Exchange (NSE) in 1994?
   (a) To promote regional stock exchanges in India
   (b) To facilitate trading of commodities and agricultural products
   (c) To attract foreign direct investment (FDI) in the stock market
   (d) To provide an efficient and transparent stock trading platform

   Answer:
   (d) To provide an efficient and transparent stock trading platform

   Explanation:
   The major objective of introducing the National Stock Exchange (NSE) in 1994 was to provide an efficient and transparent stock trading platform in India.

9. Which policy measure was taken to strengthen the banking sector during the monetary reforms of 1991?
   (a) Merger of nationalized banks with private banks
   (b) Deregulation of interest rates for borrowers and depositors
   (c) Imposition of capital controls to restrict foreign capital inflows
   (d) Introduction of a fixed exchange rate system

   Answer:
   (b) Deregulation of interest rates for borrowers and depositors

   Explanation:
   One of the policy measures taken to strengthen the banking sector during the monetary reforms of 1991 was the deregulation of interest rates for borrowers and depositors, allowing banks to set their own rates.

1.4.3 Reforms in Capital Markets

1. The establishment of the Securities and Exchange Board of India (SEBI) in 1992 aimed to:
   (a) Promote the trading of physical commodities in the market
   (b) Regulate and develop the Indian securities market
   (c) Encourage foreign direct investment (FDI) in the capital markets
   (d) Promote the privatization of state-owned enterprises

   Answer:
   (b) Regulate and develop the Indian securities market

   Explanation:
   The establishment of the Securities and Exchange Board of India (SEBI) in 1992 aimed to regulate and develop the Indian securities market and protect the interests of investors.

2. The introduction of rolling settlement in the stock exchanges aimed to:
   (a) Increase the transaction costs for investors
   (b) Encourage short-term speculation in the market
   (c) Settle trades faster and improve market efficiency
   (d) Restrict foreign investors from participating in the market

   Answer:
   (c) Settle trades faster and improve market efficiency

   Explanation:
   The introduction of rolling settlement in the stock exchanges aimed to settle trades faster and improve market efficiency by reducing the settlement cycle.

3. The reforms in capital markets during 1991 allowed for:
   (a) Increased government control over stock exchanges
   (b) Foreign investment only in government securities
   (c) Free pricing of shares by companies during IPOs
   (d) Imposition of capital controls to restrict foreign investments

   Answer:
   (c) Free pricing of shares by companies during IPOs

   Explanation:
   The reforms in capital markets during 1991 allowed for free pricing of shares by companies during Initial Public Offerings (IPOs), giving them the flexibility to determine the issue price based on market demand.

4. The introduction of the Depository System in India aimed to:
   (a) Encourage physical share certificates for ease of trading
   (b) Increase the paperwork and documentation for investors
   (c) Facilitate electronic holding and transfer of securities
   (d) Restrict foreign investors from participating in the market

Answer:

(c) Facilitate electronic holding and transfer of securities

Explanation:

The introduction of the Depository System in India aimed to facilitate electronic holding and transfer of securities, making the process more efficient and reducing paperwork.

5. Which index was launched in 1994 to track the performance of the Indian stock market?
   (a) Bombay Stock Exchange (BSE) Sensex
   (b) National Stock Exchange (NSE) Nifty
   (c) Dow Jones Industrial Average (DJI(a)
   (d) London Stock Exchange (LSE) FTSE 100

   Answer:

   (b) National Stock Exchange (NSE) Nifty

   Explanation:

   The National Stock Exchange (NSE) Nifty was launched in 1994 to track the performance of the Indian stock market and provide investors with a benchmark index.

1.4.4 The 'New Industrial Policy'

1. The 'New Industrial Policy' of 1991 aimed to:
   (a) Promote the growth of small-scale industries only
   (b) Encourage the entry of foreign companies in all sectors
   (c) Deregulate the industrial sector and reduce government control
   (d) Nationalize all private industries for better management

   Answer:

   (c) Deregulate the industrial sector and reduce government control

   Explanation:

   The 'New Industrial Policy' of 1991 aimed to deregulate the industrial sector and reduce government control, promoting private sector participation and attracting foreign investment.

2. Which sector was reserved exclusively for the public sector in the 'New Industrial Policy' of 1991?
   (a) Telecommunication
   (b) Information Technology (IT)
   (c) Defense production
   (d) Retail and consumer goods

   Answer:

   (c) Defense production

   Explanation:

   Defense production was reserved exclusively for the public sector in the 'New Industrial Policy' of 1991 to maintain strategic control.

3. The 'New Industrial Policy' introduced the concept of 'Automatic Approval' for foreign direct investment (FDI) up to what percentage in most sectors?
   (a) 25%
   (b) 40%
   (c) 51%
   (d) 100%

   Answer:

   (d) 100%

   Explanation:

   The 'New Industrial Policy' introduced 'Automatic Approval' for foreign direct investment (FDI) up to 100% in most sectors, except for a few where prior approval was required.

4. What was the major shift in the licensing policy under the 'New Industrial Policy'?
   (a) Licensing was made mandatory for all industries
   (b) Licensing was abolished for all industries
   (c) Licensing was introduced only for large-scale industries
   (d) Licensing was restricted to the service sector

   Answer:

   (b) Licensing was abolished for all industries

Explanation:

The major shift in the licensing policy under the 'New Industrial Policy' was the abolition of licensing for all industries except for a few specified industries.

5. The 'New Industrial Policy' aimed to promote which type of industries in India?
   (a) Heavy industries only
   (b) Traditional and labor-intensive industries
   (c) Export-oriented and high-tech industries
   (d) Industries exclusively for domestic consumption

Answer:

(c) Export-oriented and high-tech industries

Explanation:

The 'New Industrial Policy' aimed to promote export-oriented and high-tech industries in India to enhance competitiveness in the global market.

6. The 'New Industrial Policy' was announced in India in which year?
   (a) 1980
   (b) 1991
   (c) 2000
   (d) 2010

Answer:

(b) 1991

Explanation:

The 'New Industrial Policy' was announced in India in the year 1991 as part of the economic reforms to liberalize and modernize the industrial sector.

7. What was the main objective of the 'New Industrial Policy'?
   (a) To promote heavy industries and state-owned enterprises
   (b) To encourage import substitution and self-reliance
   (c) To boost economic growth through private sector participation
   (d) To protect domestic industries from foreign competition

Answer:

(c) To boost economic growth through private sector participation

Explanation:

The main objective of the 'New Industrial Policy' was to boost economic growth by encouraging private sector participation and reducing the role of the government in the industrial sector.

8. The 'New Industrial Policy' aimed to abolish the Industrial Licensing System for all industries except:
   (a) Large-scale industries
   (b) Small-scale industries
   (c) Export-oriented industries
   (d) Information Technology (IT) industries

Answer:

(b) Small-scale industries

Explanation:

The 'New Industrial Policy' aimed to abolish the Industrial Licensing System for all industries except small-scale industries, which continued to require registration.

9. The 'New Industrial Policy' introduced the concept of Special Economic Zones (SEZs) to:
   (a) Promote traditional industries in rural areas
   (b) Encourage export-oriented industries and attract foreign investments
   (c) Provide tax incentives to large-scale industries
   (d) Nationalize and centralize industrial activities

Answer:

(b) Encourage export-oriented industries and attract foreign investments

Explanation:

The 'New Industrial Policy' introduced the concept of Special Economic Zones (SEZs) to encourage export-oriented industries, attract foreign investments, and boost exports.

10. The 'New Industrial Policy' aimed to reduce the role of the public sector in industries by:
    (a) Promoting disinvestment of public sector enterprises
    (b) Providing subsidies and incentives to public sector companies
    (c) Nationalizing private industries to make them public sector enterprises
    (d) Imposing high taxes on private sector companies

    Answer:
    (a) Promoting disinvestment of public sector enterprises

    Explanation:
    The 'New Industrial Policy' aimed to reduce the role of the public sector in industries by promoting disinvestment of public sector enterprises and encouraging private sector participation.

1.4.5 Trade Policy Reforms

1. The trade policy reforms in India during the 1991 economic reforms aimed to:
    (a) Promote import substitution and restrict foreign trade
    (b) Increase tariffs on imported goods to protect domestic industries
    (c) Liberalize and open up the economy to international trade
    (d) Nationalize all foreign companies operating in India

    Answer:
    (c) Liberalize and open up the economy to international trade

    Explanation:
    The trade policy reforms in India during the 1991 economic reforms aimed to liberalize and open up the economy to international trade, reduce import barriers, and promote export-oriented growth.

2. Which organization is responsible for formulating and implementing India's foreign trade policy?
    (a) Ministry of Finance
    (b) Reserve Bank of India (RBI)
    (c) Ministry of Commerce and Industry
    (d) Securities and Exchange Board of India (SEBI)

    Answer:
    (c) Ministry of Commerce and Industry

    Explanation:
    The Ministry of Commerce and Industry is responsible for formulating and implementing India's foreign trade policy.

3. The introduction of Export-Import (EXIM) Policy in India aimed to:
    (a) Discourage exports and promote domestic consumption
    (b) Streamline the import of luxury goods and technologies
    (c) Facilitate and promote exports and imports for economic growth
    (d) Imposition of high tariffs on both exports and imports

    Answer:
    (c) Facilitate and promote exports and imports for economic growth

    Explanation:
    The introduction of Export-Import (EXIM) Policy in India aimed to facilitate and promote exports and imports to stimulate economic growth.

4. Which trade policy measure was taken to promote Special Economic Zones (SEZs) in India?
    (a) Imposing higher tariffs on goods produced in SEZs
    (b) Restricting the import of raw materials for SEZs
    (c) Providing tax incentives and duty exemptions for SEZs
    (d) Discouraging foreign investment in SEZs

    Answer:
    (c) Providing tax incentives and duty exemptions for SEZs

    Explanation:
    To promote Special Economic Zones (SEZs) in India, trade policy measures included providing tax incentives and duty exemptions for the units operating within the SEZs.

5. What was the major objective of India's trade policy reforms during the 1990s?
    (a) Increase reliance on domestic production and reduce imports
    (b) Promote a closed and self-sufficient economic model
    (c) Encourage export-oriented growth and attract foreign investments
    (d) Isolate the Indian economy from the global market

Answer:
(c) Encourage export-oriented growth and attract foreign investments
Explanation:
The major objective of India's trade policy reforms during the 1990s was to encourage export-oriented growth, reduce import barriers, and attract foreign investments.

6. The trade policy reforms in India during the 1991 economic liberalization aimed to:
(a) Increase tariffs on imports to protect domestic industries
(b) Encourage import substitution and reduce exports
(c) Open up the economy and promote international trade
(d) Impose strict quotas on imports to control trade deficit
Answer:
(c) Open up the economy and promote international trade
Explanation:
The trade policy reforms in India during the 1991 economic liberalization aimed to open up the economy, reduce import restrictions, and promote international trade to enhance economic growth.

7. Which organization was set up in 1995 to promote multilateral trade and resolve trade disputes among member countries?
(a) World Bank
(b) International Monetary Fund (IMF)
(c) World Trade Organization (WTO)
(d) United Nations Conference on Trade and Development (UNCTA(d)
Answer:
(c) World Trade Organization (WTO)
Explanation:
The World Trade Organization (WTO) was established in 1995 to promote multilateral trade and resolve trade disputes among member countries, including India.

8. The trade policy reforms of 1991 led to a shift from an import-substitution strategy to:
(a) A focus on heavy industries and infrastructure
(b) An export-oriented approach and integration with global markets
(c) A closed and self-sufficient economic model
(d) A reliance on foreign aid and grants
Answer:
(b) An export-oriented approach and integration with global markets
Explanation:
The trade policy reforms of 1991 led to a shift from an import-substitution strategy to an export-oriented approach and greater integration with global markets.

9. The reduction of import tariffs and removal of quantitative restrictions aimed to:
(a) Encourage domestic production and promote self-reliance
(b) Increase revenue for the government through import taxes
(c) Discourage foreign direct investment (FDI) in certain sectors
(d) Attract foreign investments and enhance competition
Answer:
(d) Attract foreign investments and enhance competition
Explanation:
The reduction of import tariffs and removal of quantitative restrictions aimed to attract foreign investments, enhance competition, and integrate the Indian economy with the global market.

10. What was the impact of trade policy reforms in India during the 1990s?
(a) Increase in trade deficit and reduced exports
(b) Slower economic growth and higher unemployment
(c) Diversification of export markets and increased foreign investments
(d) Decrease in foreign exchange reserves and higher inflation
Answer:
(c) Diversification of export markets and increased foreign investments

Explanation:
The trade policy reforms in India during the 1990s led to the diversification of export markets, increased foreign investments, and higher economic growth.

1.4.6 GDP Growth Rates Post 1991 Reforms

1. What was the average GDP growth rate of India in the decade following the 1991 economic reforms?
(a) 3.5%
(b) 5.2%
(c) 6.8%
(d) 8.4%
Answer:
(c) 6.8%
Explanation:
The average GDP growth rate of India in the decade following the 1991 economic reforms (1992-2001) was approximately 6.8%.
2. In which year did India witness the highest GDP growth rate in the post-reform period?
(a) 1992
(b) 1996
(c) 2004
(d) 2010
Answer:
(c) 2004
Explanation:
India witnessed the highest GDP growth rate in the post-reform period in the year 2004.
3. During the post-reform period, if the GDP growth rate in a particular year was 7.2%, what was the approximate average growth rate of the previous three years if it was 6.5%, 6.8%, and 6.9% respectively?
(a) 6.2%
(b) 6.4%

(c) 6.7%
(d) 6.9%
Answer:
(c) 6.7%
Explanation:
The approximate average growth rate of the previous three years (6.5%, 6.8%, and 6.9%) is (6.5 + 6.8 + 6.9) / 3 = 20.2 / 3 ≈ 6.7%.
4. In the post-reform period, if the GDP growth rate in a particular year was 8.5%, and the average growth rate of the previous two years was 7.9% and 8.2%, what was the GDP growth rate of the year before the two previous years?
(a) 7.5%
(b) 7.8%
(c) 8.0%
(d) 8.3%
Answer:
(b) 7.8%
Explanation:
Let the GDP growth rate of the year before the two previous years be x.
Average growth rate of the previous two years = (7.9 + 8.2) / 2 = 16.1 / 2 = 8.05%
So, we have the equation: (x + 8.05) / 2 = 8.5
Solving for x: x + 8.05 = 2 * 8.5 = 17
x = 17 - 8.05 = 8.95 ≈ 7.8%
5. What was the percentage increase in GDP growth rate from 1991 to 1992 if the growth rate in 1991 was 4.0% and in 1992 was 5.8%?
(a) 14%
(b) 20%
(c) 30%
(d) 45%
Answer:
(b) 20%

Explanation:

Percentage increase in GDP growth rate from 1991 to 1992 = ((5.8 - 4.0) / 4.0) * 100 ≈ (1.8 / 4.0) * 100 ≈ 0.45 * 100 ≈ 45%.

6. What was the average GDP growth rate in India during the 1990s post the economic reforms?
   (a) 3.5%
   (b) 5.2%
   (c) 6.8%
   (d) 8.3%

   Answer:

   (c) 6.8%

   Explanation:

   The average GDP growth rate in India during the 1990s post the economic reforms was approximately 6.8%.

7. In which year did India witness the highest GDP growth rate in the 1990s post the reforms?
   (a) 1991
   (b) 1994
   (c) 1997
   (d) 1999

   Answer:

   (d) 1999

   Explanation:

   India witnessed the highest GDP growth rate in the year 1999, post the economic reforms.

8. What was the GDP growth rate in India in the year 1999 post the reforms?
   (a) 5.8%
   (b) 6.4%
   (c) 7.3%
   (d) 8.9%

   Answer:

   (c) 7.3%

   Explanation:

   The GDP growth rate in India in the year 1999, post the reforms, was approximately 7.3%.

9. What was the GDP growth rate in India in the year 1993 post the reforms?
   (a) 4.3%
   (b) 5.1%
   (c) 6.2%
   (d) 7.6%

   Answer:

   (d) 7.6%

   Explanation:

   The GDP growth rate in India in the year 1993, post the reforms, was approximately 7.6%.

10. What was the average GDP growth rate in India during the 2000s post the economic reforms?
   (a) 5.2%
   (b) 6.7%
   (c) 8.1%
   (d) 9.5%

   Answer:

   (b) 6.7%

   Explanation:

   The average GDP growth rate in India during the 2000s post the economic reforms was approximately 6.7%.

1.7 NITI AAYOG: A Bold Step for Transforming India

1. What does NITI Aayog stand for?
   (a) National Institute of Technology and Innovation
   (b) National Institution for Technology Implementation
   (c) National Institution for Transforming India
   (d) National Innovation and Technology Institute

Answer:

(c) National Institution for Transforming India

Explanation:

NITI Aayog stands for National Institution for Transforming India. It is a policy think tank of the Government of India, established to replace the Planning Commission.

2. When was NITI Aayog established?
   (a) 2005
   (b) 2010
   (c) 2014
   (d) 2018

Answer:

(c) 2014

Explanation:

NITI Aayog was established on January 1, 2015, to provide strategic and policy inputs to the government for transforming India's socio-economic development.

3. Who is the chairperson of NITI Aayog?
   (a) President of India
   (b) Prime Minister of India
   (c) Finance Minister of India
   (d) Chief Minister of Delhi

Answer:

(b) Prime Minister of India

Explanation:

The Prime Minister of India serves as the chairperson of NITI Aayog.

4. What is the primary role of NITI Aayog?
   (a) Implementing central government schemes at the state level
   (b) Formulating and implementing five-year plans for economic development
   (c) Advising the government on policy matters and providing strategic inputs
   (d) Conducting research on technological advancements

Answer:

(c) Advising the government on policy matters and providing strategic inputs

Explanation:

The primary role of NITI Aayog is to advise the government on policy matters and provide strategic inputs for various aspects of governance and socio-economic development.

5. How is NITI Aayog different from the Planning Commission?
   (a) NITI Aayog focuses on centralized planning, whereas the Planning Commission focused on decentralized planning.
   (b) NITI Aayog is a statutory body, whereas the Planning Commission was a constitutional body.
   (c) NITI Aayog is more flexible and allows for cooperative federalism, whereas the Planning Commission followed a top-down approach.
   (d) NITI Aayog has a fixed tenure, whereas the Planning Commission had a permanent structure.

Answer:

(c) NITI Aayog is more flexible and allows for cooperative federalism, whereas the Planning Commission followed a top-down approach.

Explanation:

NITI Aayog is different from the Planning Commission in that it is more flexible and allows for cooperative federalism, involving the states in the planning and decision-making process.

6. When was NITI Aayog established in India?
   (a) 2000 (b) 2014
   (c) 2017 (d) 2020

Answer:

(b) 2014

Explanation:

NITI Aayog was established on January 1, 2015, by the Government of India to replace the Planning Commission. However, the process of its formation started in 2014.

7. The primary objective of NITI Aayog is:
   (a) Poverty alleviation and rural development
   (b) To plan and allocate resources for economic projects
   (c) To provide technical support to state governments
   (d) Transforming India by fostering cooperative federalism and sustainable development

   Answer:

   (d) Transforming India by fostering cooperative federalism and sustainable development

   Explanation:

   The primary objective of NITI Aayog is to transform India by fostering cooperative federalism and promoting sustainable and balanced development across the country.
8. Which five-year plan of India was replaced by NITI Aayog?
   (a) First Five-Year Plan
   (b) Second Five-Year Plan
   (c) Eighth Five-Year Plan
   (d) Twelfth Five-Year Plan

   Answer:

   (d) Twelfth Five-Year Plan

   Explanation:

   NITI Aayog replaced the Planning Commission after the completion of the Twelfth Five-Year Plan.
9. NITI Aayog serves as a think tank for the Government of India, providing policy recommendations and strategies. What role does it play in policy formulation?
   (a) It has the authority to implement policies directly
   (b) It acts as an advisory body to the President of India
   (c) It provides policy inputs to the government but has no decision-making power
   (d) It is responsible for drafting all legislative bills related to policies

   Answer:

   (c) It provides policy inputs to the government but has no decision-making power

   Explanation:

   NITI Aayog serves as a think tank and provides policy inputs and recommendations to the government but does not have direct decision-making power. The government retains the authority to implement policies.

1.8 The Current State of the Indian Economy: A Brief Overview

1. What was the approximate GDP growth rate of India in the last fiscal year (2020-2021)?
   (a) 2.0%
   (b) 4.2%
   (c) 7.3%
   (d) 10.1%

   Answer:

   (b) 4.2%

   Explanation: India's approximate GDP growth rate in the last fiscal year (2020-2021) was 4.2%.
2. Which sector of the Indian economy was the worst affected during the COVID-19 pandemic?
   (a) Agriculture
   (b) Manufacturing
   (c) Services
   (d) Mining and construction

   Answer:

   (c) Services

   Explanation:

   The services sector of the Indian economy was the worst affected during the COVID-19 pandemic due to lockdowns and restrictions on movement.
3. Inflation in India is primarily measured using which index?
   (a) Consumer Price Index (CPI)
   (b) Wholesale Price Index (WPI)

(c) Producer Price Index (PPI)
(d) Cost of Living Index (CLI)

Answer:

(a) Consumer Price Index (CPI)

Explanation:

Inflation in India is primarily measured using the Consumer Price Index (CPI), which tracks changes in the prices of a basket of goods and services consumed by households.

4. What was the inflation rate in India in the last reported period?
(a) 2.8% (b) 5.2%
(c) 8.1% (d) 11.5%

Answer:

(a) 2.8%

Explanation:

The inflation rate in India in the last reported period was approximately 2.8%.

5. India's foreign exchange reserves reached a record high in the current year (2021). What is the approximate value of India's foreign exchange reserves?
(a) $100 billion (b) $250 billion
(c) $500 billion (d) $750 billion

Answer:

(c) $500 billion

Explanation:

India's foreign exchange reserves reached a record high of approximately $500 billion in the current year (2021).

6. What was the GDP growth rate of India in the most recent fiscal year (2020-2021)?
(a) 5.4% (b) 7.3%
(c) 9.5% (d) 11.5%

Answer:

(d) 11.5%

Explanation:

The GDP growth rate of India in the most recent fiscal year 2020-2021 was approximately 11.5%.

7. Which sector of the Indian economy experienced a significant contraction during the COVID-19 pandemic?
(a) Agriculture and allied activities
(b) Manufacturing and industries
(c) Services and hospitality
(d) Information Technology (IT) and software

Answer:

(c) Services and hospitality

Explanation:

The services and hospitality sector in India experienced a significant contraction during the COVID-19 pandemic due to lockdowns and restrictions on travel and tourism.

8. Which factor contributed to the surge in India's exports in recent years?
(a) Increase in trade barriers and tariffs by other countries
(b) Depreciation of the Indian rupee against major currencies
(c) Decline in global demand for Indian goods and services
(d) Imposition of strict import quotas by the Indian government

Answer:

(b) Depreciation of the Indian rupee against major currencies

Explanation:

The depreciation of the Indian rupee against major currencies contributed to the surge in India's exports by making Indian goods and services more competitive in the global market.

9. What is the current inflation rate in India (as of the most recent data available)?
(a) 2.5% (b) 4.2%
(c) 6.8% (d) 9.1%

Answer:

(b) 4.2%

Explanation:

The current inflation rate in India, as of the most recent data available, is approximately 4.2%.

10. The Government of India implemented several economic relief measures during the COVID-19 pandemic. Which one of the following is NOT one of those measures?
    (a) Direct cash transfers to low-income households
    (b) Loan moratorium for individuals and businesses
    (c) Subsidies for fuel and food items
    (d) Increase in the Goods and Services Tax (GST) rates

    Answer:

    (d) Increase in the Goods and Services Tax (GST) rates

    Explanation:

    The Government of India did not increase the Goods and Services Tax (GST) rates during the COVID-19 pandemic. Instead, it provided various economic relief measures such as direct cash transfers, loan moratoriums, and subsidies for fuel and food items.

1.8.1 The Primary Sector

1. Which of the following activities is NOT part of the primary sector in the Indian economy?
   (a) Agriculture
   (b) Mining and quarrying
   (c) Manufacturing
   (d) Fishing

   Answer:

   (c) Manufacturing

   Explanation:

   Manufacturing is part of the secondary sector, not the primary sector. The primary sector includes activities related to agriculture, mining, quarrying, fishing, and forestry.

2. What percentage of India's workforce is employed in the primary sector?
   (a) Approximately 15%
   (b) Approximately 30%
   (c) Approximately 50%
   (d) Approximately 70%

   Answer:

   (b) Approximately 30%

   Explanation:

   Approximately 30% of India's workforce is employed in the primary sector, primarily in agriculture.

3. Which crop is the largest contributor to agricultural GDP in India?
   (a) Wheat
   (b) Rice
   (c) Sugarcane
   (d) Cotton

   Answer:

   (b) Rice

   Explanation:

   Rice is the largest contributor to agricultural GDP in India. It is one of the main staple crops and extensively grown in various regions of the country.

4. What is the main source of irrigation in Indian agriculture?
   (a) Tube wells and canals
   (b) Rainwater harvesting
   (c) Dams and reservoirs
   (d) Groundwater recharge

   Answer:

   (a) Tube wells and canals

   Explanation:

   Tube wells and canals are the main sources of irrigation in Indian agriculture, helping to ensure water availability for crops.

5. Which state in India is the largest producer of sugarcane?
(a) Uttar Pradesh
(b) Maharashtra
(c) Andhra Pradesh
(d) Karnataka
Answer:
(a) Uttar Pradesh
Explanation:
Uttar Pradesh is the largest producer of sugarcane in India. It is one of the major sugarcane-producing states in the country.

6. Which state in India is the largest producer of rice, wheat, and pulses?
(a) Maharashtra
(b) Uttar Pradesh
(c) Punjab
(d) West Bengal
Answer:
(b) Uttar Pradesh
Explanation:
Uttar Pradesh is the largest producer of rice, wheat, and pulses in India. It is one of the major agricultural states in the country.

7. The Green Revolution in India primarily focused on increasing the productivity of which crop?
(a) Rice
(b) Wheat
(c) Cotton
(d) Sugarcane
Answer:
(b) Wheat
Explanation:
The Green Revolution in India primarily focused on increasing the productivity of wheat through the introduction of high-yielding varieties, improved agricultural practices, and use of fertilizers.

8. Which state in India is known as the "Granary of India" due to its high agricultural productivity?
(a) Kerala
(b) Gujarat
(c) Punjab
(d) Bihar
Answer:
(c) Punjab
Explanation:
Punjab is known as the "Granary of India" because of its high agricultural productivity, particularly in the production of wheat and rice.

1.8.2 The Secondary Sector

1. Which of the following activities is a part of the secondary sector in the Indian economy?
(a) Agriculture
(b) Mining
(c) Manufacturing
(d) Fishing
Answer:
(c) Manufacturing
Explanation:
The secondary sector includes activities related to manufacturing, processing, and construction. Agriculture, mining, and fishing are part of the primary sector.

2. What percentage of India's GDP comes from the secondary sector?
(a) Around 10%
(b) Around 25%
(c) Around 50%
(d) Around 75%
Answer:
(c) Around 50%

Explanation:

As of the most recent data, around 50% of India's GDP comes from the secondary sector, which includes manufacturing, construction, and other industrial activities.

3. Which city in India is known as the "Manchester of India" due to its prominent role in the textile industry?
   (a) Surat
   (b) Mumbai
   (c) Kolkata
   (d) Coimbatore

   Answer:
   (a) Surat

   Explanation:
   Surat is known as the "Manchester of India" because of its significant contribution to the textile industry, especially in the production of synthetic fabrics and textiles.

4. Which industry is considered the backbone of the Indian economy and a major contributor to the secondary sector?
   (a) Automobile industry
   (b) Information Technology (IT) industry
   (c) Textile industry
   (d) Banking and finance industry

   Answer:
   (c) Textile industry

   Explanation:
   The textile industry is considered the backbone of the Indian economy and a major contributor to the secondary sector. It is one of the oldest and largest industries in India, providing employment to a large number of people.

5. Which state in India is known for its automobile manufacturing hub, often referred to as the "Detroit of India"?
   (a) Tamil Nadu (b) Maharashtra
   (c) Karnataka (d) Gujarat

   Answer:
   (a) Tamil Nadu

   Explanation:
   Tamil Nadu is known for its automobile manufacturing hub, especially in the city of Chennai, and is often referred to as the "Detroit of India."

6. The secondary sector of the economy is also known as:
   (a) The manufacturing sector
   (b) The agricultural sector
   (c) The services sector
   (d) The mining sector

   Answer:
   (a) The manufacturing sector

   Explanation:
   The secondary sector of the economy is also known as the manufacturing sector, which includes activities involved in the processing of raw materials and the production of goods.

7. Which of the following industries is part of the secondary sector in India?
   (a) Information Technology (IT) services
   (b) Tourism and hospitality
   (c) Automobile manufacturing
   (d) Banking and financial services

   Answer:
   (c) Automobile manufacturing

   Explanation:
   Automobile manufacturing is part of the secondary sector as it involves the production of goods (vehicles) through the processing of raw materials.

8. What percentage of India's Gross Domestic Product (GDP) is contributed by the secondary sector?
   (a) Around 10% (b) Around 25%
   (c) Around 50% (d) Around 75%

   Answer:
   (c) Around 50%

Explanation:

The secondary sector contributes around 50% of India's Gross Domestic Product (GDP). This sector plays a crucial role in the industrial development of the country.

9. The Industrial Policy of 1991 aimed to:
   (a) Increase the public sector's dominance in manufacturing
   (b) Discourage foreign investment in industrial activities
   (c) Liberalize and deregulate the industrial sector
   (d) Nationalize all private industries for better control

   Answer:

   (c) Liberalize and deregulate the industrial sector

   Explanation:

   The Industrial Policy of 1991 aimed to liberalize and deregulate the industrial sector to promote private investment and encourage competition.

10. Which organization is responsible for formulating and implementing industrial policies in India?
   (a) Reserve Bank of India (RBI)
   (b) Ministry of Commerce and Industry
   (c) NITI Aayog
   (d) Ministry of Finance

   Answer:

   (b) Ministry of Commerce and Industry

   Explanation:

   The Ministry of Commerce and Industry in India is responsible for formulating and implementing industrial policies to promote economic growth and industrial development.

1.8.3 The Tertiary Sector

1. The tertiary sector of the economy is also known as:
   (a) The manufacturing sector (b) The agricultural sector
   (c) The services sector (d) The mining sector

   Answer:

   (c) The services sector

   Explanation:

   The tertiary sector of the economy is also known as the services sector, which includes activities that provide services to consumers and other sectors of the economy.

2. Which of the following industries is part of the tertiary sector in India?
   (a) Automobile manufacturing
   (b) Information Technology (IT) services
   (c) Steel production
   (d) Textile manufacturing

   Answer:

   (b) Information Technology (IT) services

   Explanation:

   Information Technology (IT) services are part of the tertiary sector as they involve providing services related to information technology and software development.

3. What percentage of India's Gross Domestic Product (GDP) is contributed by the tertiary sector?
   (a) Around 10%
   (b) Around 25%
   (c) Around 50%
   (d) Around 75%

   Answer:

   (d) Around 75%

   Explanation:

   The tertiary sector contributes around 75% of India's Gross Domestic Product (GDP), making it the largest sector in terms of its contribution to the economy.

4. Which of the following activities is NOT part of the tertiary sector?
   (a) Banking and finance
   (b) Healthcare and education
   (c) Manufacturing of consumer goods
   (d) Hospitality and tourism

Answer:

(c) Manufacturing of consumer goods

Explanation:

Manufacturing of consumer goods is part of the secondary sector, not the tertiary sector. The tertiary sector includes activities that provide services rather than producing physical goods.

5. The growth of the tertiary sector in India is primarily driven by:
   (a) Increased agricultural production
   (b) Growth in manufacturing industries
   (c) Rising consumer demand for services
   (d) Government subsidies to service providers

Answer:

(c) Rising consumer demand for services

Explanation:

The growth of the tertiary sector in India is primarily driven by the rising consumer demand for various services such as banking, healthcare, education, tourism, and other related services.

Additional Question Bank

1.1 Status of Indian Economy: Pre Independence Period (1850 -1947)

1. During the pre-independence period (1850-1947), the Indian economy was primarily characterized by:
   (a) High industrialization and urbanization
   (b) Self-sufficiency and a robust agricultural sector
   (c) Extensive foreign direct investment (FDI) from European countries
   (d) An export-oriented economy with a strong manufacturing base
2. The dominant sector in the Indian economy during the pre-independence period was:
   (a) Manufacturing and heavy industries
   (b) Services and financial sector

   (c) Agriculture and allied activities
   (d) Information Technology (IT) and software development
3. The economic policies of the British colonial rule in India during the pre-independence period were focused on:
   (a) Promoting domestic industries and protecting them from foreign competition
   (b) Encouraging agricultural modernization and land reforms
   (c) Exporting raw materials to Britain and importing manufactured goods
   (d) Attracting foreign investment and multinational corporations
4. The Indian economy during the pre-independence period faced challenges such as:
   (a) High inflation and rising fiscal deficits
   (b) Rapid industrialization and urbanization
   (c) Limited access to modern technology and infrastructure
   (d) Abundant foreign investments leading to economic dependency
5. The economic policies of the British colonial rule in India had a significant impact on the country's:
   (a) High industrialization and technological advancement
   (b) Import substitution and promotion of domestic industries
   (c) Development of a skilled labor force and educational system
   (d) Deindustrialization and decline of traditional handicrafts

1.2 Indian Economy: Post-Independence (1947- 1991)

1. After gaining independence in 1947, India adopted a development model that emphasized:
   (a) A free-market economy and minimal government intervention
   (b) Import substitution and self-reliance through industrialization
   (c) Attracting foreign direct investment (FDI) to boost economic growth
   (d) Rapid expansion of the agricultural sector and rural development
2. During the post-independence period, the Indian government implemented a series of economic plans known as:
   (a) The Open Door Policy
   (b) The Import-Export Strategy

(c) The Five-Year Plans
(d) The Globalization Initiative

3. The Green Revolution in India, initiated in the 1960s, aimed to:
(a) Promote industrialization and urbanization in rural areas
(b) Achieve self-sufficiency in food production through agricultural modernization
(c) Encourage foreign direct investment (FDI) in the agricultural sector
(d) Develop a strong services sector and modernize the financial system

4. During the post-independence period, the Indian economy faced challenges such as:
(a) High inflation and fiscal deficits
(b) Limited access to international trade and foreign markets
(c) Over-reliance on foreign direct investment (FDI) for economic growth
(d) A strong and stable currency leading to export competitiveness

5. In 1991, India initiated significant economic reforms known as "Liberalization, Privatization, and Globalization" (LPG). The key objectives of these reforms were to:
(a) Promote self-sufficiency and import substitution in all sectors
(b) Expand the public sector and nationalize industries for economic growth
(c) Attract foreign direct investment (FDI) and open up the economy to global markets
(d) Implement protectionist trade policies to shield domestic industries from foreign competition

1.3 The Era of Reforms

1. The era of economic reforms in India began in which year?
(a) 1947
(b) 1975
(c) 1985
(d) 1991

2. The economic reforms in India in 1991 were initiated to address the challenges of:
(a) High inflation and fiscal deficits
(b) Economic stagnation and low growth rates
(c) Over-reliance on agricultural sector and rural development
(d) Trade deficits and balance of payments crisis

3. The 1991 economic reforms in India, known as "Liberalization, Privatization, and Globalization" (LPG), aimed to:
(a) Promote self-sufficiency and import substitution in all sectors
(b) Expand the public sector and nationalize industries for economic growth
(c) Attract foreign direct investment (FDI) and open up the economy to global markets
(d) Implement protectionist trade policies to shield domestic industries from foreign competition

4. The key architect of India's economic reforms in 1991 was:
(a) Jawaharlal Nehru
(b) Indira Gandhi
(c) Rajiv Gandhi
(d) Dr. Manmohan Singh

5. The economic reforms in India since 1991 have resulted in significant changes in various sectors of the economy, such as:
(a) Increased government control over industries and public sector enterprises
(b) Reduced focus on foreign direct investment (FDI) and international trade
(c) Deregulation and opening up of industries to private and foreign participation
(d) Concentration on agricultural subsidies and rural development programs

1.4 The Economic Reforms of 1991

1. The economic reforms of 1991 in India were introduced by the government to address the crisis related to:
   (a) High inflation and fiscal deficits
   (b) Trade deficits and balance of payments crisis
   (c) Over-reliance on the agricultural sector
   (d) Government control over industries
2. Which Prime Minister of India played a crucial role in initiating the economic reforms of 1991?
   (a) Jawaharlal Nehru
   (b) Indira Gandhi
   (c) Rajiv Gandhi
   (d) P. V. Narasimha Rao
3. The economic reforms of 1991 aimed to liberalize and open up the Indian economy by reducing:
   (a) Foreign direct investment (FDI) inflows
   (b) Imports of goods and services
   (c) Export opportunities for domestic firms
   (d) Government control and regulations in various sectors
4. One of the key components of the economic reforms of 1991 was the dismantling of the:
   (a) Reserve Bank of India (RBI)
   (b) Planning Commission of India
   (c) Ministry of Finance
   (d) Ministry of External Affairs
5. The "License Raj" in India, which required businesses to obtain various permits and licenses, was significantly relaxed as part of the economic reforms to encourage:
   (a) Foreign direct investment (FDI) inflows
   (b) Import substitution and self-reliance
   (c) Entrepreneurship and private sector participation
   (d) Agricultural modernization and rural development

1.4.1 The Fiscal Reforms

1. The fiscal reforms of 1991 in India aimed to address the issue of:
   (a) High inflation and fiscal deficits
   (b) Trade deficits and balance of payments crisis
   (c) Over-reliance on the agricultural sector
   (d) Government control over industries
2. One of the key measures introduced as part of fiscal reforms was the reduction of subsidies on:
   (a) Food and agricultural inputs
   (b) Education and healthcare services
   (c) Export-oriented industries
   (d) Foreign direct investment (FDI)
3. The introduction of Value Added Tax (VAT) in India was a significant fiscal reform aimed at:
   (a) Encouraging foreign direct investment (FDI)
   (b) Simplifying the tax structure and promoting ease of doing business
   (c) Expanding government control over industries
   (d) Providing tax exemptions to certain sectors
4. The fiscal reforms of 1991 also emphasized fiscal discipline, which involved measures to:
   (a) Increase government spending and stimulate economic growth
   (b) Reduce government borrowing and control public debt
   (c) Implement higher tax rates on the corporate sector
   (d) Nationalize industries and strategic sectors
5. The reduction in the fiscal deficit as part of the fiscal reforms aimed to restore:
   (a) Export competitiveness and trade surplus
   (b) Public sector dominance in the economy
   (c) Confidence in the Indian economy and attract foreign investment
   (d) The focus on the agricultural sector and rural development

1.4.2 Monetary and Financial Sector Reforms

1. The monetary and financial sector reforms of 1991 aimed to:
   (a) Control inflation by increasing government spending
   (b) Liberalize and modernize the financial system
   (c) Restrict foreign direct investment (FDI) in the banking sector
   (d) Promote agricultural credit and rural development
2. The "Narasimham Committee" was appointed to recommend reforms in the:
   (a) Agricultural sector and rural credit system
   (b) Export and import policies
   (c) Industrial licensing and regulation
   (d) Banking and financial sector
3. The introduction of the "Liquidity Adjustment Facility" (LAF) was a significant monetary reform that aimed to:
   (a) Control inflation by reducing the money supply
   (b) Provide liquidity support to banks through repo and reverse repo operations
   (c) Promote foreign direct investment (FDI) in the banking sector
   (d) Restrict credit flow to the agricultural sector
4. As part of the financial sector reforms, the government encouraged the establishment of new private sector banks to:
   (a) Enhance competition and efficiency in the banking industry
   (b) Nationalize and control the banking sector
   (c) Reduce foreign direct investment (FDI) in the banking sector
   (d) Promote public sector dominance in the financial system
5. The reduction in reserve requirements for banks and the introduction of prudential norms were measures to:
   (a) Stimulate economic growth and increase credit availability
   (b) Control inflation and reduce government borrowing
   (c) Restrict foreign direct investment (FDI) in the banking sector
   (d) Encourage banks to prioritize lending to large corporations

   Answer:
   (a) Stimulate economic growth and increase credit availability

1.4.3 Reforms in Capital Markets

1. The capital market reforms of the 1990s aimed to:
   (a) Encourage foreign direct investment (FDI) in the stock market
   (b) Liberalize and modernize the Indian stock exchanges
   (c) Restrict access to the stock market for domestic investors
   (d) Nationalize and control the capital market
2. The establishment of the Securities and Exchange Board of India (SEBI) was a crucial step in the capital market reforms to:
   (a) Facilitate foreign direct investment (FDI) in the capital market
   (b) Regulate and develop the Indian securities market
   (c) Control government borrowing from the stock market
   (d) Restrict foreign institutional investment in Indian companies
3. The introduction of the Depository System aimed to:
   (a) Discourage foreign direct investment (FDI) in Indian companies
   (b) Increase transparency and efficiency in share transactions
   (c) Encourage public sector dominance in the capital market
   (d) Restrict foreign institutional investment in Indian companies
4. The reforms in the primary market were focused on:
   (a) Increasing government control over Initial Public Offerings (IPOs)
   (b) Facilitating foreign direct investment (FDI) in IPOs
   (c) Simplifying the process of issuing shares and raising capital
   (d) Restricting access to IPOs for retail investors
5. The introduction of the Foreign Institutional Investor (FII) route aimed to:
   (a) Promote foreign direct investment (FDI) in the capital market
   (b) Control the flow of foreign capital in the stock market
   (c) Restrict foreign participation in Indian companies
   (d) Encourage foreign investment in the real estate sector

1.4.4 The 'New Industrial Policy'

1. The 'New Industrial Policy' of 1991 aimed to:
   (a) Promote import substitution and self-reliance in industries
   (b) Control foreign direct investment (FDI) in the manufacturing sector

(c) Liberalize and deregulate the industrial sector for economic growth
(d) Nationalize and centralize the control of industries

2. One of the key features of the 'New Industrial Policy' was the abolition of the Industrial Licensing System, except for:
(a) Industries engaged in the production of hazardous substances
(b) Export-oriented industries
(c) Small-scale industries
(d) Government-owned enterprises

3. The 'New Industrial Policy' aimed to attract foreign direct investment (FDI) by:
(a) Restricting access to certain sectors for foreign investors
(b) Providing tax incentives only to domestic companies
(c) Simplifying procedures and allowing automatic approval for most industries
(d) Discouraging foreign investment to protect domestic industries

4. The 'New Industrial Policy' encouraged the growth of the small-scale sector by:
(a) Providing them with preferential treatment over large-scale industries
(b) Implementing higher tariffs on imports to protect small-scale enterprises
(c) Exempting them from taxes and regulations
(d) Giving them access to easy credit and technology upgradation

5. One of the main objectives of the 'New Industrial Policy' was to create a competitive environment that would lead to:
(a) Monopoly control of industries by a few large corporations
(b) Government control and regulation of all industries
(c) Technological backwardness and import dependence
(d) Global competitiveness and efficiency in the industrial sector

Answer:

(d) Global competitiveness and efficiency in the industrial sector

1.4.5 Trade Policy Reforms

1. The trade policy reforms of the 1990s aimed to:
(a) Encourage import substitution and self-reliance
(b) Restrict foreign direct investment (FDI) in trade activities
(c) Liberalize and open up the Indian economy to global markets
(d) Nationalize and centralize trade activities

2. One of the key measures introduced as part of the trade policy reforms was the reduction of:
(a) Export incentives and subsidies
(b) Tariffs and import restrictions
(c) Foreign direct investment (FDI) in trade sectors
(d) Access to international markets for Indian exporters

3. The trade policy reforms aimed to promote export-led growth by:
(a) Discouraging exports and focusing on domestic consumption
(b) Providing subsidies to import-dependent industries
(c) Encouraging foreign direct investment (FDI) in export-oriented industries
(d) Providing incentives and concessions to boost exports

4. The introduction of the Export-Import (EXIM) Policy aimed to:
(a) Restrict imports and promote self-reliance
(b) Control foreign direct investment (FDI) in the export sector
(c) Facilitate foreign trade and simplify import-export procedures
(d) Promote domestic industries through higher tariffs on imports

5. The trade policy reforms of the 1990s were driven by the objective of:
(a) Isolating the Indian economy from global markets
(b) Reducing foreign competition and protecting domestic industries
(c) Integrating India into the global economy and enhancing competitiveness
(d) Increasing government control and regulation of trade activities

1.5 GDP Growth Rates Post 1991 Reforms

1. The economic reforms of 1991 in India led to a significant impact on the country's GDP growth rate. Which of the following statements about the post-1991 GDP growth rates is correct?
   (a) The GDP growth rate declined sharply after the reforms were introduced.
   (b) The GDP growth rate remained stagnant and showed no significant improvement.
   (c) The GDP growth rate showed steady improvement and accelerated after the reforms.
   (d) The GDP growth rate became highly volatile and unpredictable.
2. The economic reforms of 1991 aimed to boost economic growth and enhance the overall performance of the Indian economy. What was the average GDP growth rate during the initial years (immediately after the reforms) post-1991?
   (a) Below 3%
   (b) Around 5%
   (c) Approximately 7%
   (d) Above 10%
3. India's GDP growth rate during the post-1991 period has often been compared with the growth rates of other emerging economies. What has been the general trend in India's GDP growth rate compared to other emerging economies?
   (a) India's GDP growth rate consistently outperformed other emerging economies.
   (b) India's GDP growth rate remained at par with other emerging economies.
   (c) India's GDP growth rate showed fluctuating performance compared to other emerging economies.
   (d) India's GDP growth rate consistently lagged behind other emerging economies.

4. India's GDP growth rate during the post-1991 period has been driven by various factors, including increased industrialization, foreign direct investment (FDI), and export-oriented growth. Which sector played a crucial role in contributing to the growth during this period?
   (a) Agricultural sector
   (b) Services sector
   (c) Manufacturing sector
   (d) Mining and natural resources sector
5. The period post the 1991 reforms is often referred to as a phase of economic liberalization and growth. What has been the general trend in India's GDP growth rate in recent years (up to the last available dat(a)?
   (a) The GDP growth rate has been consistently declining.
   (b) The GDP growth rate has been relatively stable with minor fluctuations.
   (c) The GDP growth rate has been volatile, with significant ups and downs.
   (d) The GDP growth rate has been consistently increasing.

1.6 NITI Aayog: A Bold Step for Transforming India

1. NITI Aayog was established in India to replace which previous planning body?
   (a) Planning Commission
   (b) Reserve Bank of India (RBI)
   (c) Ministry of Finance
   (d) Securities and Exchange Board of India (SEBI)
2. NITI Aayog stands for:
   (a) National Investment and Trade Initiative
   (b) National Institution for Transforming India
   (c) National Innovation and Technology Incubator
   (d) National Integration and Tribal Inclusion
3. NITI Aayog was established in which year?
   (a) 2005 (b) 2010
   (c) 2014 (d) 2018

4. The primary objective of NITI Aayog is to:
   (a) Regulate and control economic policies in India
   (b) Implement the fiscal and monetary policies of the government
   (c) Formulate long-term development plans and policies for India
   (d) Facilitate foreign direct investment (FDI) in various sectors
5. The Chairman of NITI Aayog is:
   (a) The Prime Minister of India
   (b) The Finance Minister of India
   (c) The Governor of Reserve Bank of India (RBI)
   (d) An elected representative from the Parliament

1.7 The Current State of The Indian Economy: A Brief Overview

1.7.1 The Primary Sector

1. Which of the following activities is typically associated with the primary sector?
   (a) Manufacturing automobiles (b) Providing banking services
   (c) Agriculture and farming (d) Software development
2. The primary sector is also known as the:
   (a) Industrial sector
   (b) Service sector
   (c) Agricultural sector
   (d) Information technology sector
3. Which of the following resources are primarily extracted in the primary sector?
   (a) Oil and gas
   (b) Software and technology
   (c) Banking services
   (d) Textile and apparel
4. In India, the primary sector contributes significantly to the country's:
   (a) Exports and foreign exchange earnings
   (b) Urban infrastructure and development
   (c) Information technology industry
   (d) Industrial manufacturing output

5. Which of the following industries falls under the primary sector?
   (a) Software development
   (b) Textile manufacturing
   (c) Retail banking
   (d) Dairy farming

1.7.2 The Secondary Sector

1. Which of the following activities is typically associated with the secondary sector?
   (a) Agriculture and farming
   (b) Manufacturing and industrial production
   (c) Providing banking services
   (d) Software development
2. The secondary sector is also known as the:
   (a) Agricultural sector
   (b) Service sector
   (c) Industrial sector
   (d) Information technology sector
3. In India, the secondary sector contributes significantly to the country's:
   (a) Exports and foreign exchange earnings
   (b) Urban infrastructure and development
   (c) Information technology industry
   (d) Agricultural output
4. Which of the following industries falls under the secondary sector?
   (a) Software development
   (b) Textile manufacturing
   (c) Retail banking
   (d) Dairy farming
5. The growth of the secondary sector is often considered an important indicator of:
   (a) Environmental sustainability
   (b) Agricultural productivity
   (c) Economic development and industrialization
   (d) Public sector expansion

1.7.3 The Tertiary Sector

1. Which of the following activities is typically associated with the tertiary sector?
   (a) Agriculture and farming
   (b) Manufacturing and industrial production
   (c) Providing banking services
   (d) Oil and gas extraction
2. The tertiary sector is also known as the:
   (a) Agricultural sector
   (b) Service sector
   (c) Industrial sector
   (d) Information technology sector
3. In India, the tertiary sector contributes significantly to the country's:
   (a) Exports and foreign exchange earnings
   (b) Urban infrastructure and development
   (c) Manufacturing output
   (d) Agricultural production
4. Which of the following industries falls under the tertiary sector?
   (a) Software development
   (b) Textile manufacturing
   (c) Retail banking
   (d) Mining and natural resources
5. The growth of the tertiary sector is often considered an important indicator of:
   (a) Environmental sustainability
   (b) Agricultural productivity
   (c) Economic development and modernization
   (d) Public sector expansion

Answer

1.1 Status of Indian Economy: Pre Independence Period (1850 -1947)

1. (b) Self-sufficiency and a robust agricultural sector
2. (c) Agriculture and allied activities
3. (c) Exporting raw materials to Britain and importing manufactured goods
4. (c) Limited access to modern technology and infrastructure
5. (d) Deindustrialization and decline of traditional handicrafts

1.2 Indian Economy: Post-Independence (1947- 1991)

1. (b) Import substitution and self-reliance through industrialization
2. (c) The Five-Year Plans
3. (b) Achieve self-sufficiency in food production through agricultural modernization
4. (a) High inflation and fiscal deficits
5. c) Attract foreign direct investment (FDI) and open up the economy to global markets

1.3 The Era of Reforms

1. (d) 1991
2. (b) Economic stagnation and low growth rates
3. (c) Attract foreign direct investment (FDI) and open up the economy to global markets
4. (d) Dr. Manmohan Singh
5. (c) Deregulation and opening up of industries to private and foreign participation

1.4 The Economic Reforms of 1991

1. (b) Trade deficits and balance of payments crisis
2. (d) P. V. Narasimha Rao
3. (d) Government control and regulations in various sectors
4. (b) Planning Commission of India
5. (c) Entrepreneurship and private sector participation

1.4.1 The Fiscal Reforms

1. (a) High inflation and fiscal deficits
2. (a) Food and agricultural inputs
3. (b) Simplifying the tax structure and promoting ease of doing business
4. (b) Reduce government borrowing and control public debt
5. (c) Confidence in the Indian economy and attract foreign investment

1.4.2 Monetary and Financial Sector Reforms

1. (b) Liberalize and modernize the financial system
2. (d) Banking and financial sector
3. (b) Provide liquidity support to banks through repo and reverse repo operations
4. (a) Enhance competition and efficiency in the banking industry
5. (a) Stimulate economic growth and increase credit availability

1.4.3 Reforms in Capital Markets

1. (b) Liberalize and modernize the Indian stock exchanges
2. (b) Regulate and develop the Indian securities market
3. (b) Increase transparency and efficiency in share transactions
4. (c) Simplifying the process of issuing shares and raising capital
5. (a) Promote foreign direct investment (FDI) in the capital market

1.4.4 The 'New Industrial Policy'

1. (c) Liberalize and deregulate the industrial sector for economic growth
2. (a) Industries engaged in the production of hazardous substances
3. (c) Simplifying procedures and allowing automatic approval for most industries
4. (d) Giving them access to easy credit and technology upgradation
5. (d) Global competitiveness and efficiency in the industrial sector

1.4.5 Trade Policy Reforms

1. (c) Liberalize and open up the Indian economy to global markets
2. (b) Tariffs and import restrictions
3. (d) Providing incentives and concessions to boost exports

4. (c) Facilitate foreign trade and simplify import-export procedures
5. (c) Integrating India into the global economy and enhancing competitiveness

1.5 GDP Growth Rates Post 1991 Reforms

1. (c) The GDP growth rate showed steady improvement and accelerated after the reforms.
2. (b) Around 5%
3. (a) India's GDP growth rate consistently outperformed other emerging economies.
4. (b) Services sector
5. (c) The GDP growth rate has been volatile, with significant ups and downs.

1.6 NITI Aayog: A Bold Step for Transforming India

1. (a) Planning Commission
2. (b) National Institution for Transforming India
3. (c) 2014
4. (c) Formulate long-term development plans and policies for India
5. (a) The Prime Minister of India

1.7 The Current State of The Indian Economy: A Brief Overview

1.7.1 The Primary Sector

1. (c) Agriculture and farming
2. (c) Agricultural sector
3. (a) Exports and foreign exchange earnings
5. (d) Dairy farming

1.7.2 The Secondary Sector

1. (b) Manufacturing and industrial production
2. (c) Industrial sector
3. (a) Exports and foreign exchange earnings
4. (b) Textile manufacturing
5. (c) Economic development and industrialization

1.7.3 The Tertiary Sector

1. (c) Providing banking services
2. (b) Service sector
3. (b) Urban infrastructure and development
4. (c) Retail banking
5. (c) Economic development and modernization

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FOR NOTE