Chapter 1-
Nature and Scope of Business Economics

1. Economics originated from **Greek work ''*Oikonomia*'**. '*Oiko*'-**'House'** & '*Nomia*',-**'Management'.**
2. Till 19th century, Economics was also known as **'Political Economy'**
3. Basic Economics problem **unlimited wants,** and **Scarce resources.**
4. Resources shall be allocated to their **highest valued uses.**
5. Economics is study of **transformation of the scarce resources** into G&S to satisfy the most important of our infinite wants
6. The book named **'An Inquiry into the Nature and Causes of the Wealth of Nations'** (1776), by **Adam Smith** is considered as the first modern work of Economics.
7. **Decision making -** process of **selecting an appropriate alternative** that will provide the most efficient means of attaining a desired end, **from two or more alternative** courses of action'.
8. ***Decision making*** arises only if there is choice available. No alternatives no decision making- e.g.- Continue or shut down decision, New Product, Make or buy, Marketing
9. ***Joel Dean*** defined Business Economics as the use of economic analysis to make business decisions involving the best use of an **organization's scarce resources**.-
10. Business Economics is referred as **Managerial Economics**, generally refers to the integration of economic theory with business practice.
11. **Economic theories are hypothetical** and **simplistic** in since based on simplifying assumptions.
12. Business Economics enables application of economic logic and analytical tools to **bridge the gap** between theory and practice.
13. Business Economics is not only valuable to business decision makers, but also useful for managers of **'not-for-profit' organizations**
14. **Difference between Micro and Macro Economics**

Micro Economics	Macro Economics
Greek work '**Mikros**' which means '**Small**'	Greek work "**Makros**' which means '**large**'
"Study of particular firm, particular household, individual price, wages, income, individual industries, particular commodities"- **Prof. Boulding**	"Macro Economics examines the Forest and not the Trees. **Large aggregates"- Prof.Mc.Connel**
Behavior of **individual** firm or industry	***Overall economic phenomena***
It is also called as '**Price Theory**'	It is also called as '**Income Theory**'

15. **The Nature of Business Economics is described as under-**
    (a) **Business Economics is a Science- Explains** cause and effect relationships.
    (b) **Business Economics is an art** -application of rules and principles
    (c) ***Micro Economics based and Macro Analysis based***
    (d) ***Analysis from Private Enterprises Economy viewpoint***
    (e) **Inter-Disciplinary**- Integrates the tools of decision sciences such as Mathematics, Statistics and Econometrics with Economic.

(f) **Pragmatic Approach**-

16. **Normative and positive –**

Positive Economics or Pure economics	**Normative Economics**
It is **based on facts** and there is **no** point of **ambiguity** or **second view**	It tells us about **how the things should be.**
Descriptive in nature & It states **'what is'**	**Prescriptive** in nature & describes **'what ought to be'.**
It explains **cause & effect** relationship and there will be no value judgments/suggestions.	It passes **value judgments /suggestions** and offers advice.
It is based on **past data** and can be **checked** with data	**Cannot be verified** because it is **opinion based** and not fact based
No Matter of debate	Matter of Debate
According to **Robbins**, Economics is neutral between ends.	It is based on welfare economics - (**Marshall &Pigou**) Complete neutrality between ends is, however, neither feasible nor desirable.

17. **Scope of Business Economics**

a. **Microeconomics applied to operational or internal Issues-** *issues within the organization and fall within the purview and control of the management.*

1. Demand Analysis	2. Demand Forecasting	3. Cost analysis
4. Theory of Capital and Investment Decisions	5. and Uncertainty Analysis	6. Market Structure and Pricing Policies
7. Resource Allocation	8. Production analysis	9. Inventory Management
10. Profit analysis		

b. **Macroeconomics applied to environmental or external issues-** *issues out of preview of an organization* The major macro-economic factors relate to

1) The type of economic system.
2) Stage of business cycle.
3) The general trends in national income, employment, prices, saving and investment.
4) Government's economic policies like industrial policy, competition policy, monetary and fiscal policy, price policy, foreign trade policy and globalization policies.
5) Working of financial sector and capital market.
6) Socio-economic organizations like trade unions, producer and consumer unions and cooperatives.
7) Social and political environment.

Central Economic Problems

1. All countries, without exceptions, face the problem of scarcity because their resources are **limited** and these resources have **alternative uses.**
2. If a resource has only a single use, then also the economic problem would not arise.
3. The central economic problem is further divided into four basic economic problems.
   a) **What to produce? Which goods and in what quantities**
   b) **How to Produce? Method of production**,(labour- intensive or capital – intensive)
   c) **For whom to produce?** How the G&S should be distributed among members of the society. Also **shares of different people** in the national product.
   d) **What provisions (if any) are to be made for economic growth?-saving and investment**

4. Understanding different types of Economies

Particular	Capitalist economy	Socialist economy	Mixed Economy
Also Known as	Free market economy or laissez-faire economy	Karl Marx and Frederic Engels in their work 'The Communist Manifesto' published in 1848	Depends on both markets and govt.
Most imp Feature	Private Ownership	Collective Ownership/ Public ownership	*Include the best features of both the controlled economy and the market economy while excluding the demerits of both.*
Other points	Private property is the mainstay. Profit motive is its driving force		
How CEP are solved	Impersonal forces of market demand and supply or the price mechanism		
What To produce	Decided by consumers	Decided by CPE	
How to produce	Cost of production minimum. Labor or capital Intensive		
For Whom to produce	Those who have buying capacity		
What provision are to be made for economic growth?	Depends upon level of interest rate for consumer and rate of return in Market for business firm		

5. Characteristics of each type of economy

Capitalist economy	Socialist economy	Mixed Economy
a. Right to private property b. Freedom of enterprise c. Freedom of economic choice d. Profit Motive e. Consumer Sovereignty f. Competition g. Absence of Government Interference	a. Collective Ownership of means of production by state however, small farms, workshops & trading firms which may remain in private hands. b. Profit- motive and self- interest are not the driving forces c. The resources are used to achieve certain socio-economic objectives. d. Centrally planned economy e. Absence of Consumer Choice- f. Relatively Equal Income Distribution- g. Minimum role of Price Mechanism or Market forces- h. Absence of Competition	a. Government itself must run important and selected industries and eliminate the free play of profit motive and self-interest.

6. Merits of each type of economy

Capitalist economy	Socialist economy	Mixed Economy
a) Self-regulating through price mechanism. b) Rewards efficiency and punishes inefficiency. c) Faster economic growth d) Optimum allocation of resources e) Operative efficiency. f) Lower cost of production g) Better standard of living of consumers h) Incentive for innovation and Technological progress. i) Right to private Property j) No costs for collecting and processing of information	a) Equitable distribution of wealth and income b) Rapid and balanced economic development c) Planned Economy- d) Minimum Wastage and optimum utislisation of resource- e) Unemployment is minimized, f) Absence of profit motive g) Right to work and minimum standard of living h) High Social security	a) Economic freedom and existence of private property b) Price mechanism c) Consumer sovereignty and freedom of choice. d) Appropriate incentives e) Encourages enterprise and risk taking. f) Advantages of economic planning g) Comparatively greater economic and social equality and freedom h) No cut throat competition

7. Demerits of each type of economy

Capitalist economy	Socialist economy	Mixed Economy
a) Precedence of property rights over human rights. b) Inequality and social injustice c) Wide differences in economic opportunities. d) Does not represent the real needs of the society. e) Exploitation of labour f) Consumer sovereignty is a myth g) Misallocation of resources h) Less of merit goods i) Unplanned production. j) Waste of productive resources k) Formation of monopolies l) Environmental degradation.	a) Inefficiency and delays, corruption, red-tapism, favoritism, b) All material means of production are under the control and direction of state. c) Takes away right of private property. d) No incentive for hard work e) Administered prices f) State monopolies become uncontrollable g) Consumers have no freedom of choice. h) No importance topersonal efficiency and productivity. i) The extreme form of socialism is not at all practicable	a) Excessive controls the private sector. b) Poor implementation c) Undue delays

Chapter 2-
Consumer Behaviour and Utility Analysis

1. Utility is want satisfying power of a commodity is called as utility.
2. Utility is subjective term and differs from person to person
3. Utility does not mean usefulness.
4. Utility is ethically neutral.
5. Human beings have virtually unlimited wants, Each single want is satiable (capable of being satisfied)
6. Consumer spends his income on different G&S to attain maximum satisfaction.
7. Difference Between Cardinal and Ordinal Approach

	Cardinal Approach	Ordinal Approach
Assumptions	Measurable and quantifiable	Utility is not quantifiable
Rationale	Human satisfaction can be expressed in monetary terms,	Human Satisfaction is psychological phenomenon
Economists	Alfred Marshall	Hicks and Allen

ORDINAL APPROACH

Refer Table for further discussion:(Table 2.1)

Quantity of Oranges consumed per day	Total utility	Marginal Utility	Price	Consumer's Surplus in Rs.
0	0	0	0	0
1	60	60	40	20
2	110	50	40	10
3	150	40	40	0
4	180	30	40	-10
5	200	20	40	-20
6	210	10	40	-30
7	210	0	40	-40
8	200	-10	40	-50
9	180	-20	40	-60

8. **Total Utility-** The sum total of utility derived from different units of commodity
9. **Marginal Utility-** Additional utility derived from additional unit of a commodity.

   Marginal Utility can also be defined as change in the total utility resulting from one- unit change ($TUn-TU_{(n-1)}$) in consumption of commodity, per unit of time or, Change in Utility/ change in Qty.

10. **Assumptions under Marginal utility analysis and cardinal approach**
    a) **Cardinal Measurability of Utility-** Utility is measurable and quantifiable.
    b) **Comparability of Utility across the goods-** Satisfaction derived by a person from different commodities can be compared.
    c) **Independence of Utilities-**
    d) **Constant Marginal Utility of Money-**

11. **Law of diminishing Marginal utility** states -*as a consumer consumes more of stock, the extra satisfaction that he derives from an extra unit, declines with the increase in consumption of that item.*

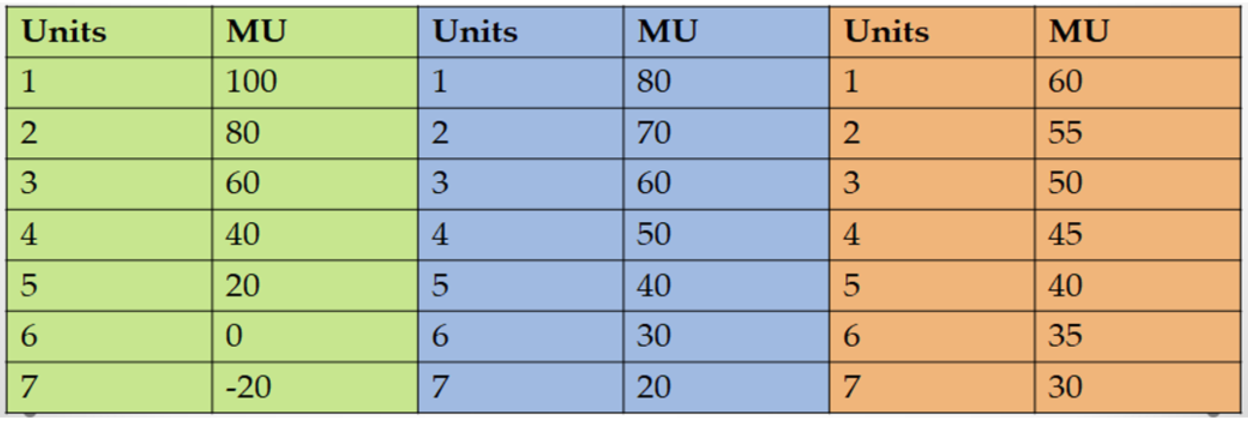
12. If same goods have capacity to satisfy other wants then their marginal utility would not have decreased.

13. **Conclusion as per law of Diminishing marginal utility**
    a) Total Utility increases at **diminishing rate.**
    b) Marginal Utility is **Downward Sloping curve**, moving from **left to right**
    c) Marginal utility is **negatively sloped curve.**
    d) Where Marginal Utility is negative, Total utility decreases.
    e) MU **goes on decreasing** & **becomes negative beyond a certain point of time**.

14. **Assumptions and Exception to Law of Marginal utility**
    a) Standard Units- Suitable size.
    b) Homogeneous units-
    c) Constant Income-
    d) Constant Taste/ fashion- Continuous consumption-
    e) Cardinal approach- Utility is quantifiable

15. **Exceptions to Law-**
    a) **Personal Aspects-** music, hobbies, etc
    b) **Money is excluded-**
    c) **Other possessions-** substitute or complimentary.

16. **Significance of Law**
    a) Law of diminishing marginal utility forms the basis of **Law of demand.**
    b) Law of diminishing marginal utility **indicates consumer's equilibrium and price.**
    c) Law of diminishing marginal utility explains the concept of **consumer surplus**
    d) **Price and MU moves together** up and down.
    e) Marginal utility varies **inversely with the supply**.
    f) MU of the goods increases as the quantity of **complementary goods** increases
    g) MU of the goods decreases as the quantity of **substitute goods** with the consumer increases.



Units	MU	Units	MU	Units	MU
1	100	1	80	1	60
2	80	2	70	2	55
3	60	3	60	3	50
4	40	4	50	4	45
5	20	5	40	5	40
6	0	6	30	6	35
7	-20	7	20	7	30

17. **Law of Equi- marginal utility** - **As per the law of Equi- marginal utility**, If marginal utility of money spent on commodity X is greater than marginal utility of money spent on commodity Y, then the consumer will withdraw some money from purchase of Product Y and will spent on purchase of X, till MU of money in two cases becomes equal.

18. **Maximum Satisfaction-** The consumer will attain maximum satisfaction, and will be in equilibrium when MU of money spent on various goods that he buys, are equal.

19. **Consumer's Equilibrium:** Consumer is in equilibrium when **price of the commodity = MU**.
 Similarly for more than two products, consumer will be in equilibrium if-

$$\frac{MU_X}{Price_X} = \frac{MU_Y}{Price_Y} = \frac{MU_Z}{Price_Z}$$

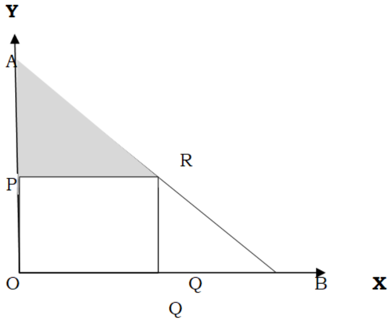
20. The consumer will attain maximum satisfaction, and will be in equilibrium when **MU of money spent on various goods that he buys, are equal.**

21. **Consumer Surplus: What a consumer is ready to pay – what he actually pays.**(refer table 2.1)
    a) The consumer continues to buy a commodity till MU = Price of the commodity
    b) For all the earlier units purchased, MU > price paid. This difference is called as consumer's surplus

22. **Limitations to Consumer surplus**
    a) **Relevant only if cardinal approach to measurement of utility** is assumed.
    b) Consumer's surplus cannot be **measured precisely**
    c) Consumer's surplus derived is affected by availability of **substitutes.**
    d) In case of **necessaries,** consumer's surplus is infinite
    e) Not applicable to **prestigious items**
    f) It is assumed that MU of the **money is constant,** which is unrealistic.

23. **Graphical Interpretation: refer schedule above (2.1)**
    a) Consumer is in equilibrium at 3 units, where price = MU.
    b) Consumer surplus is INR 20 and INR 10 at consumption level of 1 Orange and 2 oranges respectively.

Graphical representation:



a) Total Utility = Area under OARQ.
b) Price paid = Area under OPRQ.
c) Consumer surplus = Area under PAR (Area under OARQ- Area under OPRQ).
d) If market price = OP, then consumer will be in equilibrium, when he buys OQ units of commodity

Ordinal Approach- Hicks and Allen Approach

24. Indifference curve analysis- Assumptions

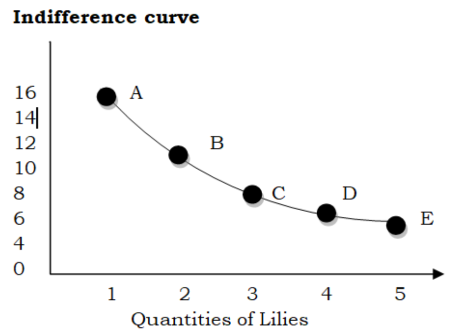
a) **Ordinal Approach to utility- UTILITY is not measurable in monetary terms.**
b) **Consistency in ranking**- If a consumer prefers X to Y and Y to Z , this automatically means that he must prefer X to Z.
c) **Rational Consumer-Ranking and preferences-**
d) **Number of Goods-** Customer prefers that combination which has more commodity in combination and tries to maximize his satisfaction.

25. Indifference curve analysis

a) An Indifference curve is a curve which represents all those combination of goods which gives **same satisfaction** to the consumer.
b) He remains **indifferent** among those combinations.

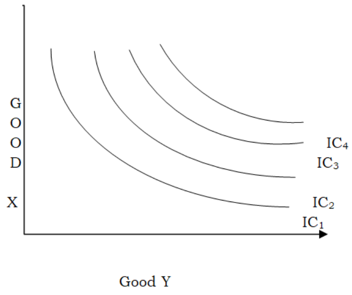
Example:

Combin-ation	Roses	Lilies	Marginal Rate of substitution (MRS)
A	15	1	-
B	11	2	4 Roses per lily
C	8	3	3 Roses per lily
D	6	4	2 Roses per lily
E	5	5	1 Roses per lily



26. Indifference Map:

a) A set of indifference curves is called as **Indifference Map.**
b) An indifference map depicts complete **picture of customer's taste and preferences.**
c) The consumer is *indifferent for any combination lying on same IC.*
d) However he prefers **combination on Higher IC to combinations on lower IC**, as the combinations of higher IC give more satisfaction. So $IC_4 > IC_3 > IC_2 > IC_1.$
e) **Farther the IC from the origin, higher is the satisfaction level.**



27. Marginal rate of Substitutions

a) Marginal rate of substitutions (MRS) indicates how much of one commodity is substituted for how much of another commodity.

b) MRS is indicated by Slope of IC curve at a particular point.

c) MRS show decreasing trend similar to concept of diminishing marginal utility.

28. Property of indifference curve

a) Downward sloping to right- negatively sloped.

b) Convex to the origin- due to diminishing nature of MRS.

c) All point on an IC gives same satisfaction-

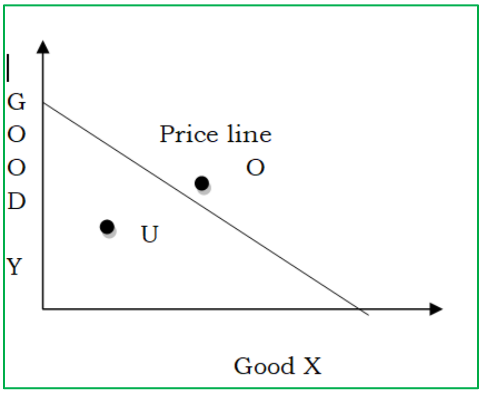
d) Higher IC gives Higher level of satisfaction-

e) Non Intersecting

29. Budget line - Price line, Price opportunity line, Price- income line, Budget constraint line.

a) A Budget line shows all those combinations of two goods which a consumer **can buy spending his given money income on two goods at their given prices.**

b) Budget line is also called as Every point on Budget line represents **full** spending by the consumer.



30. Consumer Equilibrium under indifference curve approach

a) Consumer will try to reach the highest possible IC.

b) However his objective of buying higher quantity of goods is restricted by Budget line.

c) Thus a consumer is in equilibrium when he derives maximum possible satisfaction from the goods, and is in no position to re- arrange his purchase of goods.

31. Assumptions under Ordinal Approach:

a) The consumer has fixed money income which he has to spend wholly on **2 Goods**

b) Prices are constant.

c) The consumer has given an indifference map which shows his scale of preferences

32. Relationship of MRS and price at equilibrium,

a) At equilibrium, slope of price line is equal to slope of Indifference curve.

b) Slope of the line is P_X/P_Y.

c) Slope of indifference curve indicates Marginal rate of substitution of X for Y. $MRS_{XY}=MU_X/MU_Y$.

d) Hence at equilibrium $MRS_{XY}=MU_X/MU_Y= P_X/P_Y$, alternatively, $MU_X/ P_X = MU_Y/P_Y$.

Chapter 3- Demand Analysis

1. **Demand = Willingness (Desire)** and **ability (Resources/Means)** + **willingness to use those means**

2. Demand is determined at certain, **(i) Price (ii) place or (iii) time.**

3. The quantity demanded is a **flow.**

4. **Types of Demand**
   a. **Individual Demand-** sub-system of total demand.
   b. **Market Demand.** sum total demand of all individual demand
   c. **Price Demand -**Demand of consumer at various prices
   d. **Income demand-** DD at various income levels. According to this superior goods have greater demand and as the level of income lowers, inferior goods have higher demand.
   e. **Cross demand-** Demand due to availability of **Substitute goods** or **complementary goods**.
   f. **Short run demand**- refers to the demand with its **immediate reaction**
   g. **Long run demand-** refers to demand which exists over a long period.
   h. **Industry demand**- total demand for the products of a particular industry.
   i. **Company demand** denotes the demand for the products of a particular firm.
   j. **Derived demand**-The demand because of the **demand for some other commodity called 'parent product',**
   k. **Autonomous demand**- **Independent of the demand for other goods.**
   l. **Producer goods** are used for the production of other goods - either consumer goods or producer goods themselves.
   m. **Consumer goods** are used for final consumption.
      - **Durable goods** are those which can be consumed more than once.
      - **Non-durable** goods are those which cannot be consumer more than once

5. **Factors of Demand**
   a. **Price of the commodity:** demand for a commodity is **inversely related** to its price.
      - **Complementary goods Inversely Related**
      - **Competing goods or substitutes- Directly Related**

   b. **Income of the consumer-**
      - *As the level of income rises, increase in demand of necessities is proportionally less than increase in income.*
      - As the income level increase importance of food and other non durable goods in the overall consumption basket and a rise in the importance of durable goods
      - There are some commodities for which the quantity demanded decreases with an increase in money income beyond this level. These goods are called **inferior goods**.[Also called as **Giffen goods**]

   c. **Tastes and preferences of consumers-**
      - Tastes and preferences of consumers are also influence by **'Demonstration effect'** or **'bandwagon effect'**, i.e. by seeing another person use a particular product/ commodity.

- Sometimes, when a product becomes common among all, some people decrease or altogether stop its consumption. This is called **'snob effect'**.
- Highly priced goods are consumed by status seeking rich people to satisfy their need for conspicuous consumption. This is called **'Veblen effect'**

d. Population aspect-

- **Size of the population**-Directly related
- **Composition of population:** Directly if composition is in favor of demand
- **The level of National Income and its Distribution:** Even Distribution More DD, uneven distribution less Demand
- **Consumer-credit facility and interest rates:** Cheaper interest rate and larger availability of credit increases DD

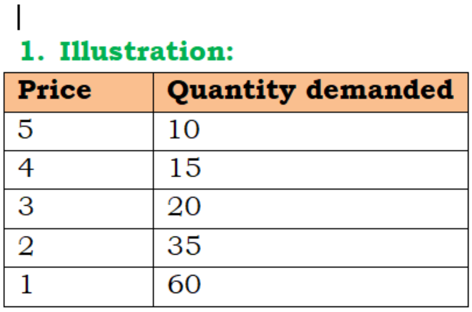
6. Law of Demand

(a) Other things being equal, **inverse relationship between price and quantity demanded,**

(b) The other things which are assumed to be equal or constant are:-

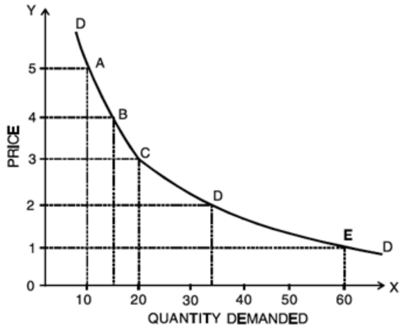
- Prices of related commodities (complementary goods or substitute goods)
- Income of consumers
- Tastes and preferences of consumers, and
- Such other factors which influence demand.

Schedule:-



1. Illustration:

Price	Quantity demanded
5	10
4	15
3	20
2	35
1	60



7. Features of the Demand Curve

(a) **Slopes downwards from left to right**

(b) **Negatively sloped**

(c) May sometimes be a **straight-line** or sometimes a **free hand curve**

(d) Demand curve is also called **Average Revenue curve (ARC).**

(e) The Market Demand curve is **a lateral summation** of individual Demand curve.

8. Rationale of the Law of Demand

a) Law of diminishing marginal utility

b) **Substitution effect:**-When the price of a commodity falls, it becomes **relatively cheaper** than other commodities.

c) **Income effect:** As a result of fall in the price of the commodity, consumer's **real income or purchasing power** increases.

d) **Arrival of new consumer: Rise in number and rise in buying capacity**

e) **Different uses:**

9. Exceptions to the Law of Demand

a) **Conspicuous goods:** **Prestige value** or **snob appeal** or **conspicuous consumption** or **Veblen effect** or **prestige goods effect**.

b) **Giffen goods:** **Inferior goods** , with **no close substitutes** easily available and which occupy a substantial place in consumer's budget are called '**Giffen goods**'

c) **Conspicuous necessities:** The demand for certain goods is affected by the **demonstration effect** of the consumption pattern of a social group to which an individual belongs.

d) **Future expectations about prices:**

e) **Irrational consumer-**

f) **Demand for necessaries**

g) **Ignorant consumer:**

h) **Speculative goods**

10. Expansion and contraction in Demand VS Increase and decrease in Demand

Term	Meaning	Effect
Expansion/ Extension of Demand	Quantity demanded **Increases**, due to decrease in price	**Downward** movement along same Demand curve
Contraction of Demand	Quantity demanded **decreases**, due to increase in price	**Upward** movement along same Demand curve
Increase in DD	Quantity demanded **Increases**, due to change in any factor other than price	**Rightward Shift** of Demand Curve
Decrease in DD	Quantity demanded **decreases**, due to change in any factor other than price	**Leftward Shift** of Demand Curve

11. Elasticity of Demand

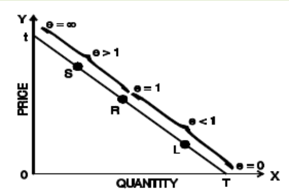
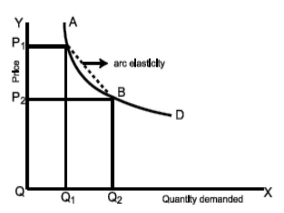
- Elasticity of demand is defined as the **responsiveness of the quantity demanded of a good to changes in one of the variables on which demand depends.**
- *the* **percentage change in quantity demanded** *divided* **by the percentage change in one of the variables** *on which demand depends*

12. Factors affecting demand and name of their elasticity

Factors	Name of Elasticity	Denoted by
Price of the commodity	Price Elasticity	E_P
Income of the consumer	Income Elasticity	E_I
Price of the related product	Cross Elasticity	E_C
Availability of the substitute	Substitution Elasticity	E_S

13. Methods of calculation of Price Elasticity of Demand

Methods	Formula	Used when	Diagram
Percentage change or proportional Method	$(E_P) = \frac{\text{\% change in quantity demanded}}{\text{\% change in Price}}$	1. **Responsiveness of quantity demanded of a commodity, to a change in Price** 2. % change in quantity demanded divided by the % change in price, other things remaining equal	Answer will be in negative denoting Inverse relation

Point Elasticity- **Method of derivative**	$E_p = -dq\ p \div dp\ q$	1. **change in price is infinitesimal (very small)** 2. Makes use of **derivative** rather than finite changes in price and quantity	
Point Elasticity – **Method of Graph**	$E_P \quad \frac{\text{Lower segment}}{\text{Upper segment}}$	1. Applicable only for Straight-line Demand curve touching both the axes.	
Arc Elasticity Method	1. $E_P = \frac{q_1-q_2}{q_1+q_2} \times \frac{p_1+p_2}{p_1-p_2}$	1. Arc Elasticity is a measure of **average responsiveness** 2. **Large change in prices and quantities**	
Total Outlay Method	1. Elasticity is calculated by analysisng the **change in Total expenditure** or Outlay of the household. 2. By this method we can only say whether the demand for a good is elastic or inelastic; we cannot find out the exact coefficient of price elasticity		
$E_P < 1$	• Price and Expenditure moves in **same** direction. • Demand is said to be less elastic, or inelastic		▪ Price Increase and TR increase ▪ Price Decrease and TR decrease
$E_P = 1$	• Total Expenditure remains Unchanged. • Demand is said to be unit elastic		• Price Increase and TR unchanged • Price Decrease and TR unchanged
$E_P > 1$	• Price and Expenditure moves in **opposite** direction. • Demand is said to be elastic		• Price Increase and TR decrease • Price Decrease and TR increase

14. Interpretation of Elasticity of Demand

Description	**Numerical value**	**Interpretation**	**Nature of Curve**	
Perfectly inelastic	**EP =0**	Qty. demanded does not changes as price changes	Vertical line Parallel to Y axis	
Inelastic or less elastic	**0<EP <1**	Qty demanded changes by **smaller percentage** than price	Relatively steeper Demand curve	

Unit Elastic	EP =1	Qty demanded changes exactly by same % as price	45 degree straight line Or rectangular hyperbola	
Elastic	1<EP <∞	Quantity demanded changes by larger percentage than price	Relatively flatter demand curve	
Perfectly elastic	EP =∞	Small change in price will bring infinite change in quantity demanded	Parallel to X axis	

15. Determinants of price Elasticity

a) **Availability of substitutes:**____________________ relationship

b) **Position of a commodity in a consumer's budget:**

- Goods having higher proportion of consumers' spending are ____________ to demand.
- Goods having lower proportion of consumers' spending are _________________ to demand.

c) **Number of uses to which a commodity can be put:**

- Multiple uses have ___________ to demand.
- Specified or particular use have ______________ to demand.

d) **Time period:**

- The long run demand for a commodity is ___________.
- The short run demand for a commodity is _________________ to change in price.

e) **Consumer habits:**

- Habitual Goods ____________________Demand

f) **Tied demand:**

- Goods which have autonomous demand on their own are _______________
- Goods which have tied or joint demand are ______________

g) **Nature of the need that a commodity satisfies:**

- Luxury goods are price ____________-while necessities are price ____________to price change.

h) **Price range:**

- Goods which are in medium range of price level are ______________ to price change.
- Goods which are in very high price range or in very low price range have ____________ DD.

16. Income Elasticity of Demand

Responsiveness of quantity demanded of a good to changes in the income of consumers	$E_i = \frac{\text{Percentage change in quantity Demand}}{\text{Percentage change in income}} \times 100$

17. Income Elasticity of Demand

Type	Relation between income & demand	Example	Formula	Curve
Positive Income Elasticity	**Positive**	Normal and Luxury goods	Ey = 1 Ey > 1 Ey < 1	
Negative Income Elasticity	**Inverse**	Inferior goods	Ey < 0	
Zero Income Elasticity	**Constant** (No change in demand though there is change in income)	Necessaries goods	E = 0	

18. Cross Elasticity of Demand

Cross elasticity of demand is degree of responsiveness of demand for one good to a change in price of other good.				$Ec = \frac{\% \Delta \ Qx}{\% \Delta \ Py}$
Positive Cross Elasticity	**Direct or Positive relation** (Goods must be substitute)	**Tea & Coffee,**	CED = 1 CED > 1 CED < 1	
Negative Cross Elasticity	**Inverse relation** (Goods must be complementar goods	**Car & Petrol**	**CED < 0**	
Zero Cross Elasticity	**Constant** (No change in demand of one product though there is change in price of other product) goods must be unrelated	**Cloth & salt**	**CED = 0**	

19. Methods of demand Forecasting

1. **Survey of Buyers' Intentions: direct interview of potential customers**.
   a. **Complete enumeration method**
   b. **Sample survey method**
   c. **End-use method,** especially used in forecasting **demand for inputs**, involves identification of all final users,

2. **Collective opinion method:**
   a) **Sales force opinion method** or **grass roots approach**. Firms having a wide network of **sales personnel** can use the knowledge, experience and skills of the sales force.
   b) Although this method is simple and based on first-hand information of those who are directly connected with sales, it is **subjective as personal opinions.**

3. **Expert Opinion method:**
   Delphi Technique
   a) The **Delphi technique**, developed by **Olaf Helmer** at the **Rand Corporation of the USA**, provides a useful way to obtain informed judgments from diverse experts

4. **Statistical methods:**
    a) Forecasts using statistical methods are considered as superior methods because they are more scientific, reliable and free from subjectivity.
    b) **Trend Projection method:** This method, also known **classical method**, is considered as a **'naive'** approach to demand forecasting.
        i. **Graphical Method:**
        ii. **Fitting trend equation: Least Square Method:** sum of the squared differences between the calculated and observed value is minimised.

5. **Regression analysis:** Relationship is established between the quantity demanded (dependent variable) and the independent variables (explanatory variables) such as income, price of the good, prices of related goods etc. Once the relationship is established, we derive regression equation assuming the relationship to be linear. The equation will be of the form **$Y = a + bX$.**

6. **Controlled Experiments:** also known as **market experiment method**.
    a) Under this method, future demand is estimated by conducting market studies and experiments on consumer behaviour under actual, though controlled, market conditions.

7. **Barometric method of forecasting:**
    a) Just as meteorologists use the barometer to forecast weather, the economists use economic indicators to forecast trends in business activities. This information is then used to forecast demand prospects of a product, though not the actual quantity demanded.
    b) For this purpose, an **index of relevant economic indicators** is constructed.
    c) Movements in these indicators are used as basis for forecasting the likely economic environment in the near future. There **are leading indicators, coincidental indicators and lagging indicators.** The leading indicators move up or down ahead of some other series.

20. **For Quick Practice**

Factors	Explanation	Elasticity
Nature of the commodity	Necessities.	Inelastic
	Luxurious goods.	Elastic
Level of income	Goods demanded by high income group.	Inelastic
	Goods demanded by low income group.	Elastic
Proportion of expenditure	Commodity on which Proportion of expenditure is low.	Inelastic
	Commodity on which Proportion of expenditure is large.	Elastic
Level of price and change in price	When price level of a commodity is too high and change in price is smaller.	Inelastic
	If price level is low and change in price is large.	Elastic
Number of uses	Commodity which has limited uses.	Inelastic
	Commodity which used to satisfy several wants.	Elastic
Substitutes	Commodity which have less substitutes.	Inelastic
	Commodity having several substitutes.	Elastic
Urgency	Commodity which is required urgently.	Inelastic
	Commodity which is not required urgently.	Elastic
The Period	Demand for commodity is inelastic in long run.	Inelastic
	Demand for commodity is elastic in short period.	Elastic
Tied demand or Joint demand	Demand for those goods, which are tied to others.	Inelastic
Consumer habits	Demand for commodity used by habitual consumer.	Inelastic

Chapter 4- Supply

1. Supply refers to amount of a commodity seller is
    - **Able to sell -** depends upon stock of a commodity
    - **And willing to sell**- depends upon price of a commodity.

2. **Determinants of supply on Factors affecting supply**

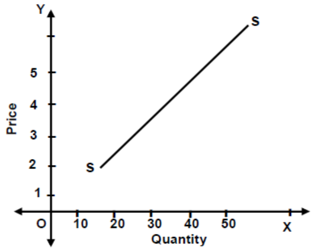
Factors	Relation	Factor	Relation
Price		Cost of Production	
Stock		Techniques of	
Time		Taxation policy	
Natural Resources		Trade policy	
Production		Infrastructure	
Weather conditions		Monetary Policy	

3. **Law of supply** states that "other things being equal" **there is a direct relationship between price and supply.**

4. The law of supply is explained by **Dr. Alfred Marshall.**

5. **Supply Schedule and Graph**

Price	Supply
1	10
2	20
3	30
4	40
5	50



6. **Features of Supply curve**
    a) Slopes upwards from left to the right.
    b) Positively slope
    c) Straight—line or sometimes a free hand curve.
    d) The Market Supply Curve is a lateral summation (totaling) of Individual Supply Curves

7. **Assumptions of Law of supply**
    a. **No change in cost of production**
    b. **No change in technology**
    c. **Normal weather conditions**
    d. **No change in infrastructural facilities**
    e. **No change in amount of Natural Resources**
    f. **No change in Taxation policy**
    g. **No change in monetary and trade policy**

8. Increase and Decrease VS Expansion and contraction in the Quantity Supplied

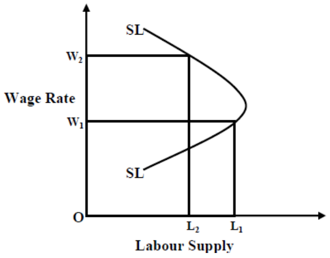
Increase In SS	Decrease In SS	Expansion in SS	Contraction in SS
Increase in Supply take place as a result of changes in factors other than price, while price remains constant.	Decrease in Supply take place as a result of changes in factors other than price, while price remains constant.	Rise in the quantity supplied takes place as a result of changes in price	Fall in the quantity supplied takes place as a result of changes in price
____________________Shift	___________________Shift	Upward Movement along same SS curve	Downward Movement along same SS curve

9. Exceptions to law of Supply

Labour Supply

Wage rate	Labour supply	Total income
Rs.100/hr	12 hr.	1200/day
Rs.250/hr.	15 hr.	3750/day
Rs.700/hr.	10 hr.	7000/day

This is Backward bending supply curve



Need for cash-	Seller may sell at lower price and supply more Qty if needs more cash
Savings	If a person wants a fixed amount of income in the form of interest then, he will save more at a lower rate of interest and save less at a higher rate of interest
Future Expectations	With a small rise in price, if seller expects a further rise in future he will decrease the supply & vice-versa

10. Methods of measurement of Elasticity of supply

Methods of measurement of Elasticity of supply

1. Percentage / Proportionate Method: According to this method elasticity of supply is calculated by dividing a % or proportionate change in supply with the % or proportionate change in price. As explained above

$$\frac{\%\ \text{Change in supply}}{\%\ \text{Change in Price}} \qquad \frac{\frac{S1-S2}{S1} \times 100}{\frac{P1-P2}{P1} \times 100}$$

2. Point Method: This method is used to find out elasticity at a point on supply curve. The elasticity at a point on the supply curve can be measured with the help of following formula.

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

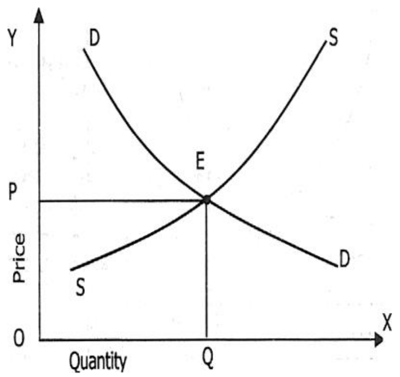
3 Arc Elasticity: when the price change is somewhat larger and we have to measure elasticity over an arc rather than at a specific point on it, in such cases, the concept of arc elasticity is used. In arc elasticity we use the average of the two prices and quantities (Original & new)

ES = $\frac{Q_1 - Q_2}{Q_1 + Q_2} \times \frac{P_1 + P_2}{P_1 - P_2}$	Where P1and Q1 are original price and quantity respectively and P1 and P2 are new price and quantity respectively.

11. **Elasticity of Supply** refers to degree of **responsiveness of supply to change in its price**.
Or, Elasticity of Supply refers to the *ratio between percentage or proportionate change in supply and percentage or proportionate change in price.*

Perfectly Elastic Supply	Relatively Elastic Supply Or, More Elastic	Unitary Elastic Supply	Relatively Inelastic Supply Or, less Elastic	Perfectly Inelastic Supply
Es = ∞	Es> 1	Es = 1	Es< 1	Es = 0

12. **Equilibrium Price:**
The determination of Equilibrium Price using Demand and Supply is explained in the following manner –



- Demand Curve slopes downwards from left to right, while Supply Curve slopes upwards from left to right.
- Point E constitutes the **Stable Equilibrium** for the product, other things remaining equal.
- The Equilibrium Price is OP, and the quantity bought and sold at that level is OQ units.

Chapter 5- Production Analysis

1. According to James Bates and J.R. Parkinson "Production is the organized activity of transformation of Raw material into Finished G&S to satisfy the demand
2. Production is any economic activity, which satisfy human wants.
3. Production = Creation of Utility or Addition of utility.
4. **Methods of Creation of Utility-**
   a) Form Utility
   b) Place Utility
   c) Time Utility
   d) Personal Utility
5. **Factors Of Production**

a) Land

i. Every free gift of nature on Surface of the earth + below the surface of the earth+ above the surface of the earth
ii. No Social Cost: Since no sacrifice is made in creation of land.
iii. Permanent factor:
iv. Passive factor:
v. Heterogeneous factor and site value differs from place to place
vi. Mobility: Geographically land is ____________ but occupationally it is ____________.
vii. Subject to diminishing returns:
viii. Supply: Supply of level is perfectly ________________.

b. Labour

i. Mental or physical exertion to produce G&S, for economic reward.
ii. Perishable Nature- Labourer cannot store his Labour
iii. Labour is said to have no reserve price
iv. Weak bargaining power.
v. Self- Source- Labour is inseparable from the Labourer himself.
vi. Variations in skill and productivity
vii. Productivity differs from person to person
viii. Peculiar relationship between labour supply and Wage rate- Backward bending Supply curve
   a) Direct Relationship: Generally
   b) Reverse Relationship at Higher Prices
   c) Reverse Relationship at Lower Prices

c. **Capital-**

- i. Part of wealth which is **used for further production of wealth**, or which yields an income.
- ii. Capital is a stock concept
- iii. Capital refers to only that part of wealth, that is used for further production. Therefor not all wealth is capital but all capital is wealth.
- iv. Produced means of Production
- v. Man—made means / factor
- vi. Mobility
- vii. Perishable factor- that's why we charge depreciation
- viii. **Types of Capital:**

Fixed Capital:	**Working Capital:**	**Sunk Capital:**	**Floating Capital:**	**Money Capital:**	**Real Capital:**

- ix. **Stages in capital Formation**
  - a) **Savings:** Ability to save depends upon the income capacity of individual.
  - b) **Mobilization of Savings:** network of banking and other financial institutions
  - c) **Investments:**

d. **Entrepreneur-**

- i. Person who **combines the various factors of production** in the right proportions, **initiates the process of production** and **bears the risk involved** in it.
- ii. Also Called as **Organiser, Manager** or the **Risk—Taker.**
- iii. Without the Entrepreneur, the other factors of production would remain unutilized or idle.
- iv. Holds **final responsibility** of the business.
- v. Entrepreneurship gets its **reward (i.e. Profit),** only after all other factors of production have been rewarded, i.e. after Rent, Wages and Interest.

6. Functions of an Entrepreneur

- 01. **Initiating and Running the business:**
- 02. **Risk—Bearing:**
- 03. **Innovations:**

7. Enterprise Objective

- a) **Organic Objectives –** Survival then Growth and Expansion
- b) **Economic Objectives-** Profit Maximizing Objective
- c) **Social Objectives:** Avoid anti—social practices, opportunities for gainful employment , continuous and sufficient supply of unadulterated goods ,does not cause any type of pollution.
- d) **Human Objectives:** All the objectives towards its employees
- e) **National Objectives:**

8. Constrains and Problems in achieving objective

Constrains in achieving the objectives	Enterprise's Problems
a) Information	a) Objective
b) Infrastructure	b) Location of Plant
c) Factors of Production	c) Size of Plant:
d) Economic Aspects	d) Physical Facilities
	e) Finance:
	f) Organisation Structure:
	g) Legal Compliance:
	h) Industrial Relations:

PART B – PRODUCTION FUNCTION

1. Production Function is the **functional relationship** between **physical inputs and physical outputs**
2. The maximum amount of output that can be produced with given quantities of inputs, in the existing state of technology.
3. Production Function gives the minimum quantities of various inputs that are required to yield a given quantity of output.
4. **Cobb-Douglas Production Function**
   a) Output is manufacturing production and **inputs used are Labour and Capital.**

   b) Cobb-Douglas Production Function is $Q=KL^aC^{(1-a)}$,

   Where, ***Q*** *is output,* ***L*** *is Quantity of Labour and* ***C*** *the qty of Capital.* ***K*** *and* ***a*** *are Positive Constants.*

   c) *Labour contributed about 3/4W and Capital about1/4th of the increase in the Manufacturing Production.*
5. **Short run and long run production function**

	Short Run	Long Run
Fixed Factor	**Only one Factor of Production is kept constant or fixed.** [Generally and, Capital or Enterprise is taken as fixed.]	There is **no Fixed Factor** of Production in the long—run planning horizon. **all the factors production are variable.**
Proportion between Factors	Production is increased by increasing proportion of variable factor only, keeping fixed factor constant	Production is changed by changing all the Factor of Production simultaneously
Theory .	**Law of Variable Proportions** is applicable in the short—run.	**Law of Returns to Scale** is applicable in the long—run.

6. **Assumptions:**

- It is related to a **particular unit of time**.
- The **technical knowledge** during that period of time **remains constant**.
- The factors of production are **divisible into most viable units**.
- The producer is using the **best technique available**.

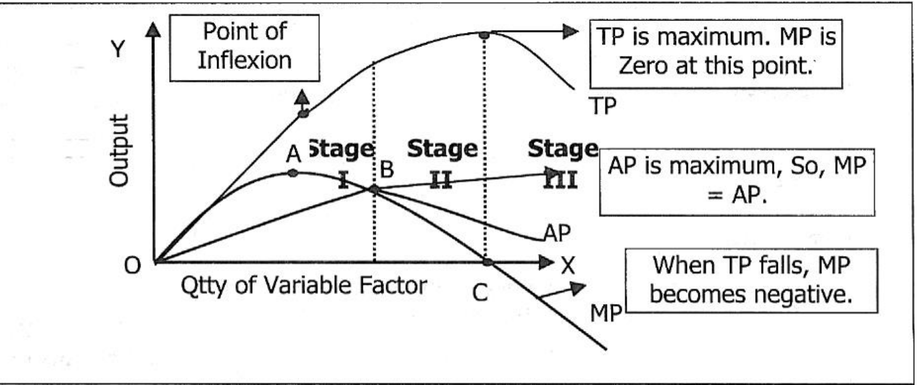
7. Understanding Short term production function

Total Production	Total Output
Average Production	AP = TP/Units of variable input (labour)
Marginal Production (MP)	Additional TP due to an additional unit of input. MP = Change TP / change in Labors Or, Mp = MP = TPn - TPn_1
Relationship between AP and MP	1. Both AP and MP can be calculated by TP. 2. *When AP rises then MP also rises but MP>AP.* 3. *When AP is maximum then MP =AP or say MP curve cuts the AP curve at its maximum point* 4. *When AP falls then MP also falls but MP<AP.* 5. *There may be a situation when MP decreases and AP increases but opposite never happened.*

Schedule

Labour	TP	AP	MP	Analysis
1	2	2	2	MP &AP both increases; MP>AP; TP also increases
2	5	2.5	3	
3	9	3	4	
4	**12**	**3**	**3**	MP=AP, AP = maximum
5	14	2.8	2	MP &AP both decreases, MP<AP; TP increases MP = 0, TP=maximum
6	15	2.5	1	
7	15	2.1	0	
8	14	1.7	-1	AP > MP both decreases TP decreases
9	12	1.3	-2	

Rule	Relationship between TP and MP
1	When TP increases at an **increasing rate**, MP shows an increase.
2	When TP increases at a **decreasing rate**, MP shows a decrease.
3	When TP is **maximum**, MP is **zero**.
4	When TP **decreases**, MP becomes **negative**.



Relationship between Average Product and Marginal Product	a. When AP rises, MP >AP. b. When AP is maximum, MP =AP. c. MP declines slightly earlier than AR d. MP Curve cuts AP Curve from above when AP is maximum. e. *When AP decreases, MP <AP.* f. *MP Curve declines steeply than AP.* g. *MP may become zero and negative later, but AP continues to remain positive*

Note: The point on the TP Curve when MP is maximum, is called Point of Inflexion

8. Law of Variable Proportion/ Law Of Proportionality/ Law Of Diminishing Returns /Law Of Diminishing Marginal Physical Productivity.

(a) The Law of Variable Proportions operates in short run only

(b) Output is increased by varying the quantity of one input.

9. Explanation to Various Stages

a) Explanation to Stage 1

01. **Full Use of Fixed Indivisible Factors-** Fixed Factors are more intensively and effectively utilized. This causes the production to increase at a rapid rate.
02. **Efficiency of Variable Factors-** Through Specialization
03. **No Scarcity of Variable factor**
04. **Reaching the right combination**

b) Explanation to Stage 2-

01. **Inadequacy of Fixed Factor**
02. **Less efficiency of Variable Factor**
03. **Imperfect Substitutes**
04. **Wrong combinations**

Note: Stage II is called Law of Diminishing Returns since MP and AP both show decreasing trend. However, both MP and AP remain positive

c) Explanation to Stage 3

01. **Variable Factor becomes too excessive, Due to this, the total output falls instead of rising.**
02. **Stage III is called Law of Negative Marginal Returns**

Since the second stage is the most important, So stage II will be stage of operation and because of that in practice we normally refer to the law of variable proportion as the law of diminishing returns.

Law of Return to scales- Operates in Long Run Only

1. All factor inputs in the production function can be changed. **The behavior of output consequent to change in the quantities of all factor inputs in the same proportion** (i.e. keeping, the factor proportions unaltered) is known as 'returns to scale'.

Increasing Returns to Scale:	Simultaneous increase in ***all*** the inputs in the same given proportion result in a **more than proportionate increase** in the output.	
Constant Returns to Scale:	**1.** Proportionate increase in ***all*** the inputs results in **proportionate increase** in output. **2.** Constant return to scale is also called **'Linear Homogeneous Production Function'.**	
Diminishing Returns to scale:	Simultaneous increase in ***all*** inputs in the same given proportion result in **a less than proportionate** increase in the output	

2. **Internal Economies and Diseconomies to Scale-** *Use of greater degree of division of Labour and specialised machinery at higher levels of output are generally termed as **Internal Economies.***

Technical	**Managerial**	**Commercial**	**Risk— bearing**	**Financial**
All these factors are within the control of an organization and thus are internal Factors. These factors initially acts Economies but after a pint becomes diseconomies				

3. **External Economies are explained below —**

Cheaper Raw Materials and Capital Equipment for entire industry	Technological development for entire industry	Development of Skilled Labour	Growth of ancillary industries	Better transportation and marketing

4. **External Diseconomies:**

Rise in Factor Prices:	Higher Costs:	Government Restrictions:

Production Optimisation

1. **Isoquant Curve:- "Iso" means equal and "quant" means quantity.**

(a) An Isoquant is a Curve that shows all the combinations of inputs that yield the same level of output.

2. **MRTS=Marginal Rate of Technical Substitution**

(a) MRTS always shows diminishing trend.

(b) MRTS= Change in units of capital/ change in units of labour

Combinati	Units of Labour	Units of Capital	Product Output	MRTS (See Note)
A	5	9	100 units	
B	10	6	100 units	(9- 6)/(10-5) = 0.6
C	15	4	100 units	(6 – 4)/(15 -10) = 0.4
D	20	3	100 units	(4-3)/(20-15) = 0.2

3. **Features of Isoquants:**

(a) Isoquants are convex to the origin, due to diminishing trend of MRTS

(b) Isoquants are negatively sloped, i.e. downwards from left to right.

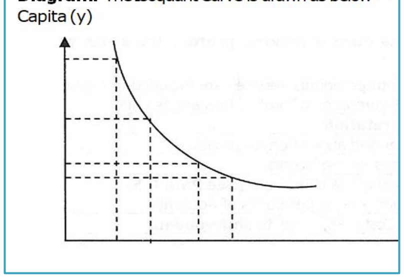
(c) Isoquant do not touch either axis.

(d) Isoquants need not be parallel.

(e) Two Isoquants cannot cut each other, i.e. Isoquants are non—intersecting.

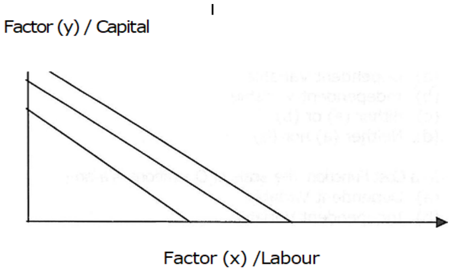
(f) An Isoquant lying above and to the right represents a higher level of output.

Diagram: The Isoquant Curve is drawn as below —



4. **Isocost Lines: Equal—Cost Lines or Budget Line or the Budget Constraint Line.**

Isocost Line shows the various alternative combinations of two Factor Inputs, which a Firm can buy with given amount of money.



5. **Production Optimisation**

1. A Profit Maximising Firm is interested to know what combination of factors of production would minimise its Cost of Production for a given output, and also the optimum level of output.
2. *This is obtained by combining the Firm's Production and Cost Functions, namely Isoquants and Isocost Lines respectively.*
3. Isoquants represent the technical conditions of production for a product, and Isocost Lines represent various "levels of cost"(given the prices of two factors). Together, these can help the Firm to optimize its production.

Chapter 6:

THEORY OF COST AND REVENUE

Meaning

1. Business decisions are generally based on **cost of production** i.e. the money value of inputs and output is considered.
2. In other words, **cost analysis is concerned with the financial aspects of production.**
3. **Types of cost**

Name	Explanation
• Explicit cost • Out-of-Pocket Costs • Outlay Costs. • Accounting Costs	1. Costs which **involve cash payment** towards factors of production. 2. **Recorded in books** of accounts. 3. Rent, Wages & Salaries, Interest on Loans borrowed for business, etc.
• Implicit cost • Notional cost • Imputed cost • Opportunity Costs.	1. Costs **do not involve any cash payment** to outsiders. 2. It is the monetary reward for all factor of production owned by entrepreneur himself 3. **Not recorded in books** of account. 4. Interest on own Capital, Rent of own premises, Salary to Entrepreneur, etc.
Economic Costs	Explicit Costs + Implicit Costs.
Opportunity Cost	1. It refers to the value of **sacrifice made**, or benefit of **opportunity foregone** in accepting a **next best alternative** course of action. 2. Opportunity Cost arises only when alternatives are available. If a resource can be put only to a particular use, there are no Opportunity Costs. 3. Opportunity Costs **do not involve any cash payment** as such. 4. It is considered **only for decision—making** and analytical purposes. 5. Examples: A person quits his job and enters into business. Here, the Salary foregone from employment constitutes Opportunity Cost.
• Direct cost • Traceable cost	1. Direct costs are those which have **direct relationship with a component of operation** like manufacturing a product, organizing a process or an activity etc. 2. They are **charged directly** to product 3. They can be generally **quantified and expressed per unit of output**, e.g. 5 kg of Raw Materials per unit of product, etc.
• Indirect cost • Non-traceable cost	1. Indirect costs are those which are **not easily and definitely identifiable** in relation to a plant, product, process or department. 2. Therefore, such costs are **not visibly traceable** to specific goods, services, operations, etc.; but are nevertheless charged to different jobs or products in **standard accounting** practice and **Apportioned on suitable basis**. 3. Factory Rent, Electric Power, and other Common Costs incurred for general operation of business benefiting all products jointly.

Committed Fixed Costs	Also known as **"Unavoidable"** Fixed Costs. These costs cannot be controlled.
Discretionary Fixed Costs	Also known as **"Avoidable"** Fixed Costs. These costs can be controlled.
Historical cost / Sunk Cost	Historical cost refers to the cost **incurred in the past** on the acquisition of a productive asset such as machinery, building etc.
Replacement cost	Replacement cost is the money expenditure that has to be incurred **for replacing an old asset**.
Incremental cost	Incremental cost refers to the **additional cost** incurred by a firm.
Private cost	**Private costs** are costs actually incurred or provided for by firms and are either **explicit or implicit**.
Social Cost	1. **Social cost =private cost + external cost.** 2. It includes the cost of resources for which the firm is not required to pay price such as atmosphere, rivers, roadways etc. and the cost in terms of dis-utility created such as air, water and environment pollution.

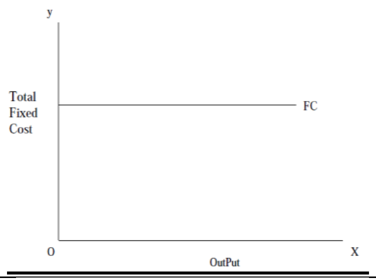
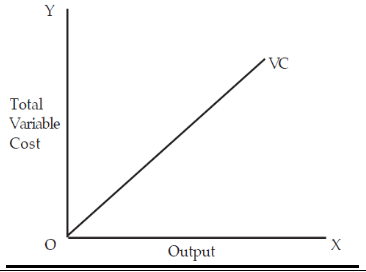
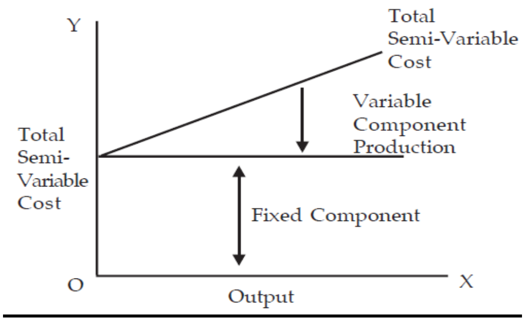
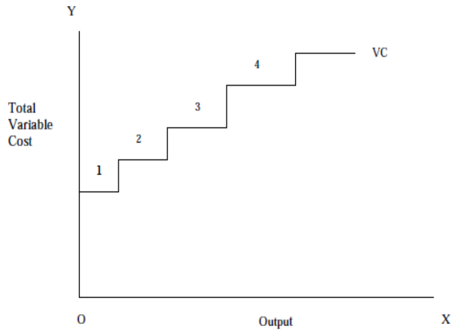
4. Strike the incorrect

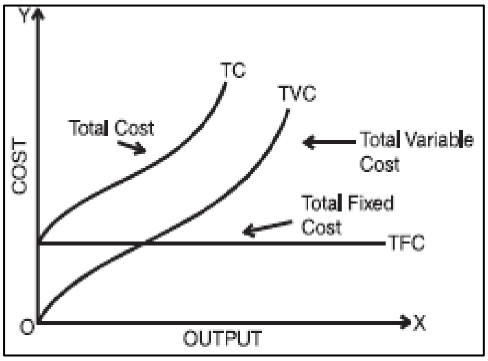
1. Rent is paid to the Landlord, Salary/ wages paid to employee/ workers, Interest on Capital is borrowed and used in business is **Explicit / Implicit** cost.
2. Land is owned by the Entrepreneur, Own people are employed in the firm, Entrepreneur employs his own funds as Capital is **Explicit / Implicit** cost.
3. Entrepreneur himself manages the business is **Explicit / Implicit** cost.

5. Important types of cost

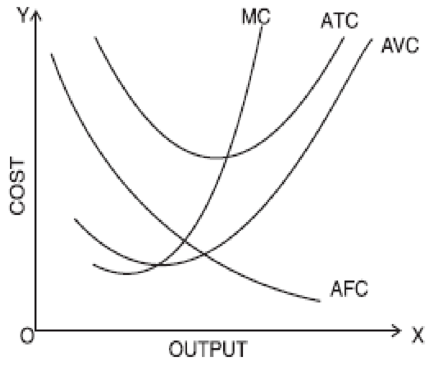
Output (Unit)	Total fixed cost TFC	Total variable TVC	Total cost TC	Average fixed cost AFC	Average variables AVC	Average Total Cost AC	Marginal Cost Rs. MC
0	10	-	10	-	-	-	-
1	10	10	20	10	10	20	10
2	10	18	28	5	9	14	8
3	10	24	34	3.33	8	11.3	6
4	10	28	38	2.5	7	9.5	4
5	10	32	42	2	6.4	8.4	4
6	10	38	48	1.67	6.33	8	6
7	10	46	56	1.43	6.57	8	8
8	10	56	66	1.25	7	8.25	10
9	10	68	78	1.11	7.55	8.67	12

Type	Nature
Fixed Costs	1. Fixed Costs are costs that do not vary with output. 2. They are period—related. 3. They are taken as a function of time and not of output. 4. They are incurred even at zero level of output. 5. Fixed Cost per unit of output decreases with increase in output, and vice—versa. 6. Rent, Insurance, Interest on Loans, Depreciation, etc. are Fixed Costs.

Variable Costs	1. Variable Costs are costs that vary, based on the level of output. 2. They are product—related. 3. They are taken as a function of output and not of time. 4. They are incurred only when production commences. 5. Variable Costs are avoidable costs. 6. Variable Cost per unit of output generally remains constant, if Total Variable Costs vary proportionately with output. 7. Cost of Raw Materials and Wages are Variable Costs.
Marginal Costs	1. Marginal Cost is the addition made to the total cost by production of an additional unit of output. 2. Marginal Costs per unit = $\frac{\text{Difference in Total Cost (TC) between two output levels}}{\text{Difference in Output Quantity at those levels}}$ 3. $TC_n - TC_{n-1}$ 4. Marginal Cost (MC) Curve of a Firm declines first, reaches its minimum and then rises. Hence, Marginal Cost Curve of a Firm is U—shaped.
Cost Function	Mathematical relationship between cost of a product and the various determinants of cost
Short Run	1. Period in which **some factors are fixed and some factors are variable.** Fixed factor have *fixed cost and variable factor have variable cost*. 2. *So, law of variable proportion applies* here. In short-run, output can be increased or decreased by changing variable factors only but fixed factors cannot be varied
Total Fixed cost **(Short run)**	TFC is parallel to X-axis. In the figure given below, even at zero output-fixed cost remain the same in the short run. e.g. rent and insurance 
Total Variable cost (TVC)	Variable Costs are those costs that change with changes in level of output. It has inverse's' shape and *start from origin.* Figure given below shows that as output is zero cost is also zero and as output increases cost increases. e.g. raw material, power etc. 
Semi-variable	There are some costs which are neither perfectly variable, nor absolutely fixed in relation to the changes in the size of output. **Example: Elasticity charges include both a fixed charge and a charge based on consumption.**  

Short run Total cost behaviour	1. It can be noticed that TFC is constant at all levels of output. 2. TVC increases with the increase in output but rate of increase is changing. 3. Initially TVC increases at decreasing rate but after some time it increases at increasing rate. 4. Behaviour of TVC is determined by law of variable proportion.  5. TC increases with increase in output. Changes in TC are determined by TVC. 6. TFC curve is a horizontal line starting from y-axis. 7. TVC curve is upward slopping. Initially it is fatter and later on steeper. 8. TC curve is upward sloping starting from y-axis.

6. Short Run Average Cost

Average Fixed Cost (AFC)	1. Average fixed cost is the total fixed cost divided by the output. 2. **TFC/Q.** 3. The general shape of the **AFC curve is downward sloping** it does not touch the X-axis as **AFC cannot be zero**. 4. It is **not 'U' shape.** This curve is also called **Rectangular Hyperbola.**
Average Variable Cost (AVC)	1. Average variable cost is the total variable cost divided by the output. 2. **TVC/Q.** 3. The average cost curve will **first fall**, then **reach a minimum** and then **rise again**. 4. It has **'U' shape**.
Average Total Cost (ATC)	1. Average total cost is total cost divided by the output. 2. **TC/Q or AFC+AVC.** 3. The ATC curve **first falls**, **reaches it's minimum** and **then rises**. 4. The ATC curve is **'U' shape** due to law of variable proportions.
Marginal Cost (MC)	1. Marginal cost is the change in total cost due to change in the output. 2. MC= Change in Total Cost / Change in Qty. produced 3. MC = Change Total Variable Cost / Change Qty. produced. 4. The MC curve is also **'U' shape**
Behavior of Average – costs in Short - Run	● AFC goes on diminishing with the increase in output but it never becomes zero. ● AVC initially declines but later on goes on increasing. ● ATC initially decreases, constant for a while & finally goes on increasing. ● MC initially decreases & finally increases. ● The point at which ATC is minimum. It is equal to MC. ● AFC curve is a 'rectangular hyperbola' because AFC x Q is always constant. 

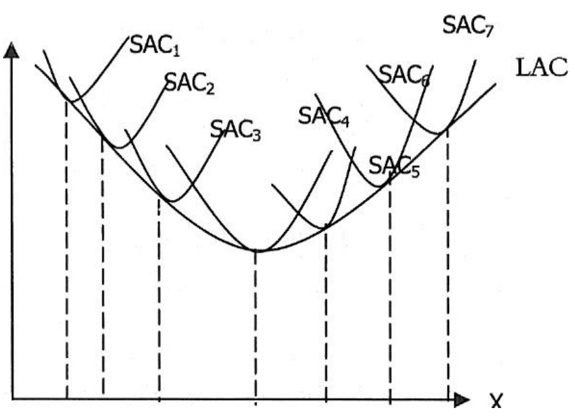
7. Relationship between Average Cost and Marginal Cost Curves

1. **When AC falls** as a result of an increase in output, **MC is less than AC.**
2. **When AC is minimum, MC = AC. So, MC Curve cuts the AC Curve at its minimum.**
3. **When AC increases due to increase in output, MC is greater than AC.**

8. Relationship between ATC and MC

- ✓ Initially ATC & MC both decline with increase in output. In this situation ATC > MC.
- ✓ When ATC is minimum ATC = MC.
- ✓ When ATC & MC both are increasing MC > ATC.
- ✓ When AC is decreasing, MC may be decreasing or increasing.
- ✓ When AC is increasing MC must be increasing.

9. Long run average cost curve



a) **LAC Curve:** A Long Run Average Cost Curve (denoted as **LAC Curve**) depicts the functional relationship between output and the long—run cost of production.

b) **No distinction of Fixed - Variable:** All factors of production are variable in long—run.

c) AC **cannot** be higher in the long—run, than in the short—run. Thus, LAC is the **least—cost** combination, for any particular output level.

d) **Planning Curve:** LAC Curve is called Planning Curve.

e) SAC (Short—Term Average Cost) Curves are called Plant Curves.

f) **LAC derived from SAC:** LAC Curve is derived as an envelop / tangent of all SAC Curves. Further, the

g) LAC Curve is a **U—Shaped Curve**, due to the operation of Law of Returns to Scale.

h) **Selecting the suitable SAC Curve at different output levels:**

i) ***Note: The Firm should select the SAC, not the lowest point of that SAC.***

j) **Deriving LAC Curve in case of numerous / infinite SAC Curves:**

k) In the diagram, the LAC Curve is drawn as a smooth curve, so as to be **tangent** to each of the SAC Curves.

l) **Note:** LAC Curve is tangent to each of the SAC Curves, not the minimum points of the SAC Curves. So

When LAC Curve is —	LAC will be tangent to	Principle
Declining	The **falling portions** of the SAC Curves.	Returns to Scale will first increase, due to internal and external economies. So, LAC will decline.
Rising	The **rising portions** of the SAC Curves.	Returns to Scale will decrease later, due to internal and external diseconomies. So, LAC will rise.

Thus, as a result of initial fall and subsequent increase in LAC, it will be a **U—shaped Curve**.

REVENUE CONCEPT

Qty (Q)	Price pu (AR=P)	TR = PxQ	MR	Space for Diagram
1	22	22	22	
2	20	40	18	
3	18	54	14	
4	16	64	10	
5	14	70	6	
6	12	72	2	
7	10	70	-2	
8	8	64	-6	
9	6	54	-10	
10	4	40	-14	

Meaning	1. Revenue refers to money received by a seller by selling his product in the market. 2. Hence, revenue is sales receipts or sales proceeds.
Total Revenue	1. It is the total money received from the sale of all units of the product. 2. Total Revenue = Price x Quantity (P x Q)
Average Revenue (AR)	1. Average Revenue = Total Revenue/Quantity (TR/Q) 2. Average Revenue is always equal to Price
Marginal Revenue (MR)	1. MR is the change in TR resulting from the sale of an additional unit of a commodity. 2. Marginal Revenue = Change in TR/ Change in Qty. 3. Marginal Revenue= TRn – TRn-1
MR, AR, TR and Elasticity of Demand	Marginal Revenue = Average Revenue (E – 1/E) Where E = Price elasticity of demand 1. If E = 1, Then MR = 0 2. If E > 1, Then MR will be Positive 3. If E < 1, Then MR will be Negative
Behaviour of TR, AR & MR	1. A firm should produce at all if Total Revenue(TR) from its product is equal to or exceeds its Total Variable Cost (TVC) or say TR ≥ TVC (Price ≥ AVC). 2. If TR = TVC, firm's maximum loss will be equal to its Fixed Cost. As we know P x Q = TR and AVC x Q = TVC 3. It will be profitable for the firm to increase output whenever MR > MC and decrease output whenever MR < MC and the firm should continue production till 4. MR = MC and MC curve should cut to MR from below.

Summary of Relationships:

TR and MR	▪ If TR increases, MR will be positive. ▪ When TR is maximum, MR = 0. ▪ If TR decreases, MR will be negative.
MR and AR	▪ MR and AR both decline, but MR falls rapidly than AR ▪ AR Curve is flatter than MR. ▪ MR can be zero and even negative, while AR will never cross below the X axis.

	▪ At the point where MR = 0, Elasticity of Demand on AR Curve will be 1.

Equilibrium Point of the Firm

1. It will be profitable for the Firm to expand its output$_Y$whenever Marginal Revenue (MR) is greater than Marginal Cost (MC), and to keep on increasing output **until MR = MC.**

2. If any unit of production adds more to Revenue than to Cost, production and sale of that unit will **increase** profits. Similarly, if it adds more to Cost than to Revenue, it will decrease profits.

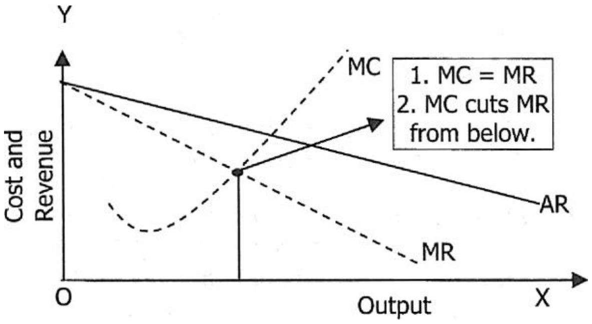
3. Profits will be **maximum** at the point where Additional Revenue (MR) from a unit equals its Additional Cost (MC). So, **MC = MR.**

4. Further, the **MC Curve should cut the MR Curve from below** (and not from above). This is so because, upto this point MR > MC, hence there is an incentive for further production. Beyond this point, MC > MR.

5. This position (i.e. where MC = MR, and MC cuts MR from below) is called **Equilibrium position** for the Firm.

6. Thus, Note: For achieving Equilibrium Position, the conditions to be satisfied are —**MC = MR, and MC Curve should cut MR Curve from below**, i.e. MC should have +ve slope.

7. Merely being in Equilibrium position does not mean that the Firm is making profits. The actual position of profits can be known only on the basis of AR and AC Curves



Situation	Interpretation
If AR > AC	The Firm makes **super—normal profits,** i.e. over and above normal profits.
If AR = AC	The Firm makes **normal profits,** since AC includes normal profits.
If AR < AC	The Firm makes **losses,** but it need not shut down in the short—run. **(See Para C.5) Note:** Here, Loss means **Economic Loss,**and not Loss as per Books of Accounts.

Chapter 7- Meaning and Types of Market

1. **Elements of a Market:** The elements of a Market are —
   a) Buyers and Sellers,
   b) Product or Service,
   c) Bargaining for a Price,
   d) Knowledge about market conditions, and
   e) One Price for a Product or Service at a given time.

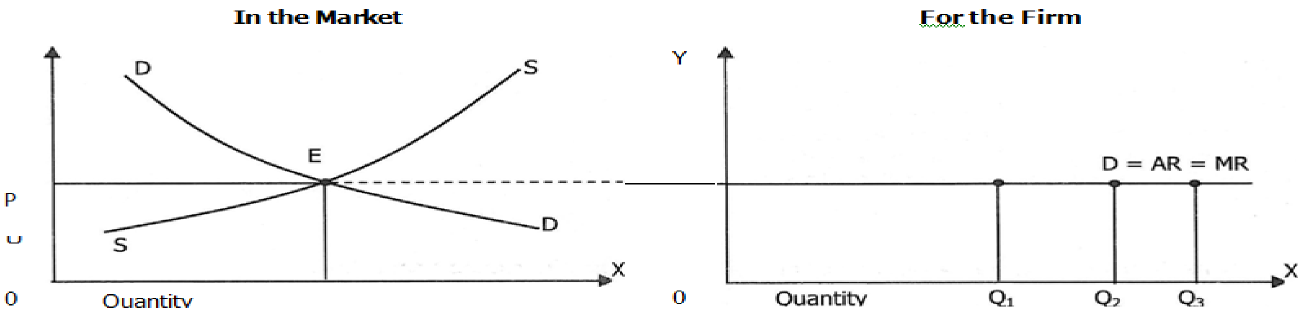
2. **Types of Market -**The Market Structures analysed in Economics are --
   a) ***Perfect Competition:*** *Many Sellers selling identical products to many Buyers.*
   b) ***Monopoly:*** *Single Seller producing differentiated products for many Buyers.*
   c) ***Monopolistic Competition:*** *Many Sellers offering differentiated products to many Buyers.*
   d) ***Oligopoly:*** *A Few Sellers selling competing products to many Buyers.*
   e) ***Duopoly:*** Duopoly is a market situation in which there are only two Firms in the market. It is a sub—set of Oligopoly,
   f) ***Monopsony:*** Monopsony is a market characterized by a Single Buyer of a product or service. It is mostly applicable to Factor Markets in which a Single Firm is the only Buyer of a Factor.
   g) ***Oligopsony:*** Oligopsony is a market characterized by a small number of large buyers. It is also mostly relevant to Factor Markets.
   h) ***Bilateral Monopoly:*** It is a market structure in which there is only a Single Buyer and a Single Seller. Thus, it is a combination of Monopoly Market and a Monopsony Market.

3. Perfect Competition

Large No of Buyers & Sellers	**Homogeneous Products**	**Free Entry / Exit**	**Perfect Knowledge**
Transportation	**Uniform Market Price**	**Indifference / Lack of Preference**	**Mobility of Factors of Production**
Price Taker			

4. How Price is determined in Perfect Competition

a) Revenue (MR) for the Firm, since the price is uniform in the market. So, in Perfect Competition,
b) **D = AR = MR = Price.**



5. Short Run price determination, Optimum output and profit Determination

For Equilibrium

1. ______________________________

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2. ______________________________

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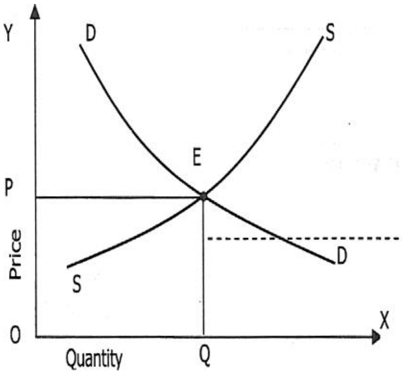
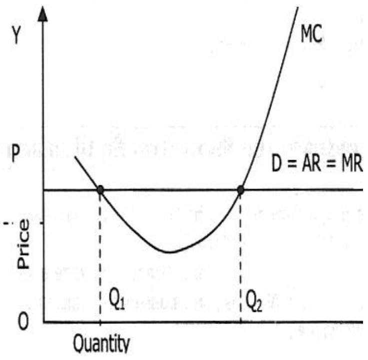




6. For Determination of profit or loss

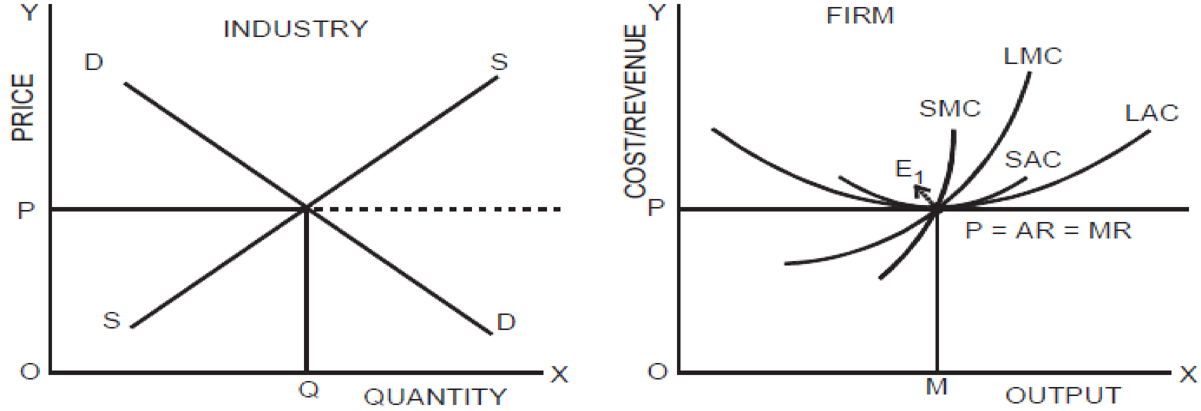
Super profits:	Normal profits:	Losses	Shut Down point
AR > ATC. Super profits also called Economic Profits, abnormal profits and super normal profits.	AR = ATC. It is also called B.E.P (Break-even-Point) means No Loss No Profit. It is called *Marginal Firm.*	AR < ATC.	A Firm will shut down, if AR < AVC, at a point where MC = MR (MC cutting from below

7. Long – run Equilibrium of a firm under Perfect Competition.

In the Long run the firms will be earning just **NORMAL PROFITS and** There is **no further entry or exit of Firms** to / from the market.

1. To earn normal Profits, LAR should be equal to LAC or say LAR = LAC
2. In the long run, following conditions are satisfied:

- The output is produced at the **minimum feasible cost or minimum LAC**
- Consumers pay the **minimum possible price**.
- Full utilization of plants is possible, MC = AC
- There is no wastage of resources. **optimal allocation**
- Firms earn **only normal profits i.e. AC = AR.**
- Firms maximize profits i.e. MC = MR, but level of profits will be normal.
- In the long run **LMC = LMR = P = LAR = LAC = SMC = SAC**
- When LAC falls LAC> LMC and when LAC raises LMC > LAC



Question 1: What can be the profit/ loss condition in long run in Perfect competition?

Answer:____

Monopoly

1. Features of Monopoly

- a) **Single Seller**
- b) **Firm = Industry**
- c) **Entry Restrictions- (i) economic, (ii) institutional, (iii) legal, or (iv) artificial.**
- d) **No substitutes. - Cross Elasticity of Demand** for the Monopolist's Product and any other product is ____________________
- e) **Elasticity of demand-** Price Elasticity of Demand for Monopolist's Product is **less than one.**
- f) Monopolist is a Price—Maker, not a Price—Taker.

2. Why Monopoly exists?

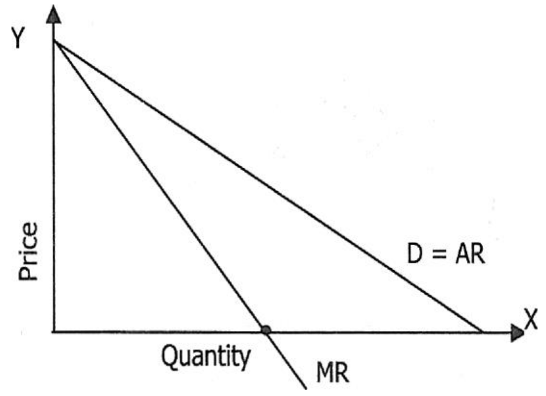
Monopoly is caused by "barrier to entry", i.e. other Firms cannot enter the market. Some reasons for occurrence and continuation of Monopoly are -

- a) **Strategic Control** over scarce resources
- b) **control over a unique product**.
- c) **Patents and Copyrights** g
- d) Governments granting **exclusive rights**
- e) **Substantial Goodwill**
- f) **Natural Monopoly** e.g. Natural Gas Supply, Electrical Power Distribution, etc.
- g) **Stringent Legal and Regulatory Requirements**
- h) Very **high initial start—up costs**
- i) Use of **Anti—Competitive Practices** or Predatory Tactics.
- j) Business Combinations or **Cartels**

3. Effects of Monopoly-

- a) **Higher Prices** for Consumers,
- b) Loss of Consumer Surplus,
- c) **Inability of Consumers to substitute** the goods or services,
- d) *Transfer of Income from Consumers to Monopolists*,
- e) **Restriction of Consumer Sovereignty**

f) **Payment of lower prices by Monopolies to their Suppliers**
g) **Lower levels of Output**, that what would be produced in a competitive environment,
h) **Influence political process** and thereby obtain a favourable legislation,
i) **Lack of Innovation**,
j) **Higher Costs of Output**, the burden of which will be shifted to Consumers
k) **Lack of Productive and Allocative Efficiency**,
l) **Possibility of misuse of** scarce **resources**,
m) Earning of Economic Profits (**above Normal Profits**) in the long run, which is unjustifiable,
n) Use of Monopoly Power to create barriers to entry by undue means,

Qty (Q)	Price	TR = PxQ	AR = TR/Q	MR	Diagram
1	22	22	22	22	
2	20	40	20	18	
3	18	54	18	14	
4	16	64	16	10	
5	14	70	14	6	
6	12	72	12	2	
7	10	70	10	-2	
8	8	64	8	-6	
9	6	54	6	-10	
10	4	40	4	-14	

4. Determination of Demand/ Revenue curve

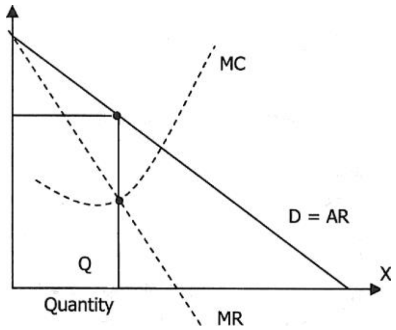
a. Market Demand Curve = Firm's Demand Curve = Average Revenue (AR).

b. **Relationship between AR & MR under Monopoly:**

i. Both AR and MR are **negatively sloped** (downward sloping) curves.

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 even negative.



5. For Short Run Equilibrium

____

____

For Determination of profit or loss

Super profits:	Normal profits:	Losses	Long Run profit
AR > ATC. Super profits also called Economic Profits, abnormal profits and super normal profits.	AR = ATC. It is also called B.E.P (Break-even-Point) means No Loss No Profit. It is called *Marginal Firm*.	AR < ATC.	

6. Price Discrimination

Price Discrimination occurs when a Producer sells a commodity to different Buyers, at different prices, for reasons not related to differences in cost.

a) **Objectives:**
  i. To earn Maximum Profit
  ii. To Dispose of Surplus stock
  iii. To enjoy Economies of Scale
  iv. To capture foreign markets
  v. To secure equity thorough pricing.

b) **Examples:** **Doctors**, **Electricity Rates**, **Export Prices, Railways charge**

c) **Conditions for Price discrimination**
  i. **Full control over supply:**
  ii. **Division of market into two or more sub-markets**:
  iii. **Different price elasticity under different markets:**
  iv. **No possibility to resale:**

d) The Monopolist will be charging different prices in the two markets — a higher price in Market with lower elasticity of demand, and a lower price in Market with higher elasticity of demand. This practice of charging different prices to different segments is known as Price Discrimination.

Monopolistic Competition

1. Imperfect competition is found in the industry where there are a large numbers of small sellers, selling differentiated but close substitutes products. E.g. LUX, HAMAM, LIRIL etc. This market contains features of both competitive and monopoly markets.
2. **Large number of sellers and buyers**
3. **Free entry and exit of firms**.
4. **Product differentiation:**
5. **Non price competition:**
6. **Every firm is price maker and price taker of his own product**
7. **Imperfect mobility:**
8. **AR and MR:** In monopolistic competition AR/MR will be more elastic than monopoly market.

Question: Determine Condition for Equilibrium

1. ______________________________

2. ______________________________

Question: will happen to firm in long run- Losses/ profit/ Supernormal profit

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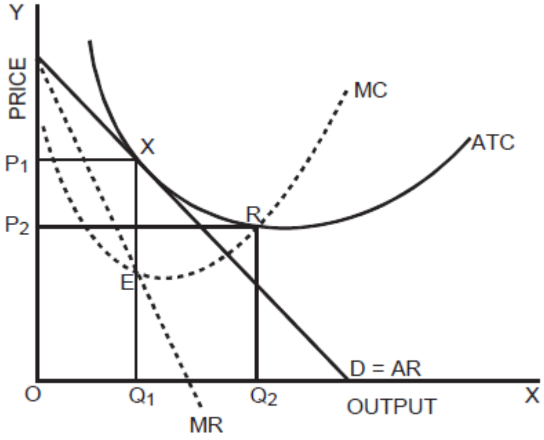
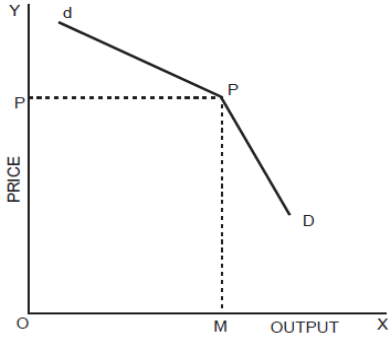
Note: The AR curve in the long-run is not tangent to the ATC curve at the lowest point. This shows each firm produces at before the lowest TAC/LAC or produces less than the optimum output and Charges from the customers a price higher than the competitive price. A firm under monopolistic petition has always excess capacity but perfect competition never has excess capacity and monopoly mayor may not be

OLIGOPOLY MARKET

1. An oligopoly is a market in which there are few producers of a product. Oligopoly is an important form of imperfect competition.
2. Types of Oligopoly
   a) **Pure / Perfect oligopoly -** deals in homogeneous products- Aluminum industry Differentiated / imperfect oligopoly - deals in product differentiated.
   b) **Open oligopoly -** New firms can enter the market and compete with existing firms Closed oligopoly - new entry is restricted.
   c) **Collusive oligopoly -** common understanding or collusion in fixing price and output Competitive oligopoly - Lack of understanding and compete with each other.
   d) **Partial oligopoly -** when industry is dominated by one large firm i.e. price leader Full oligopoly - absences of price leadership.
   e) **Syndicated oligopoly -** Firms sells their products through centralized syndicate/channel
   f) Organized oligopoly -: Firms Organize into a central association for fixing price, output etc



3. Features
   a) Few sellers
   b) Interdependence:
   c) Advertising and selling costs (Non price competition):
   d) There is no generally accepted theory of group behaviour.
   e) Kinked demand curve / Indeterminateness of demand curve



Chapter 8- Business Cycle

1. Business Cycles refer to alternate expansion and contraction of overall business activity as reflected in fluctuations in measures of aggregate economic activity, like Gross National Product, Employment and Income.
2. **Expansion** / Boom / Upswing),
3. **Peak** / Prosperity,
4. **Contraction** / Downswing / Recession), and
5. **Trough** / Depression).
6. **Good trade** characterized by rising prices and low unemployment levels.
7. **Bad trade** characterized by falling prices and high unemployment levels.

8. **Features of Business cycle**
   a) Business cycles **occur periodically**
   b) **Do not exhibit the same regularity**.
   c) The **duration** of these cycles **vary**.
   d) The **intensity** of fluctuations also **varies.**
   e) The **length of each phase is also not definite**.
   f) *Business cycles generally originate in free market economies*****.
   g) They are **pervasive** as well. Disturbances in one or more sectors get easily **transmitted to all other sectors.**
   h) Although all sectors are adversely affected by business cycles, some sectors such as **capital goods industries, durable consumer goods industry** etc, are disproportionately affected.
   i) Moreover, compared to agricultural sector, **the industrials sector is more prone to the adverse effects of trade cycles**.
   j) Business cycles are **exceedingly complex phenomena**;
   k) It is **difficult to make an accurate prediction** of trade cycles before their occurrence.
   l) Repercussions of business cycles get simultaneously felt on nearly all economic variables
   m) Business cycles are **contagious and are international in character**.
   n) Business cycles have **serious consequences on the well-being of the society.**

9. **Expansion: Features**
   a) Increase in ***national output, employment, aggregate demand, capital and consumer expenditure, sales, profits, rising stock prices and bank credit.***
   b) This state ***continues till there is full employment of resources and production is at its maximum*** possible level using the available productive resources.
   c) Involuntary unemployment is almost zero and whatever unemployment is there is either frictional or structural Prices and costs also tend to rise faster. Good amounts of net investment occur.
   d) Increasing prosperity and people enjoy high standard of living due to high levels of consumer spending, business confidence, production, factor incomes, profits and investment.

10. Peak:

a) Peak refers to **the top or the highest point** of the business cycle.

b) Output prices also rise rapidly leading to increased cost of living and greater strain on fixed income earners. **Actual demand stagnates**.

11. Contraction:

a) During contraction, there is fall in the levels of investment and employment.

b) Supply far exceeds demand. Initially, this happens only in few sectors and at a slow pace, but rapidly spreads to all sectors.

c) Producers holds back future investment plans, cancellation and stoppage of orders for equipment and all types of inputs including labour.

d) Decrease in input demand pulls input prices down; incomes of wage and interest earners gradually decline resulting in decreased demand for goods and services.

e) The process of recession is complete and economy into the phase of depression.

12. Trough and Depression:

a) Depression is the severe form of recession and is characterized by extremely sluggish economic activities.

b) During this phase of the business cycle, growth rate becomes negative

c) National income and expenditure declines rapidly.

d) Demand for products and services decreases, prices are at their lowest and decline rapidly forcing firms to shutdown several production facilities.

e) A typical feature of depression is the fall in the interest rate.

f) Large number of bankruptcies and liquidation significantly reduce the magnitude of trade and commerce.

13. Question: How does the economy recover?

Economic activity reaches Trough and then starts **recovering** >>>>> marks the end of pessimism and the beginning of optimism>>>>> Reversal is first felt in the **Labour Market** >>>>> workers accepts wages lower than the prevailing rates. >>>>> **Business Confidence** slowly increases, >>>>> spurring of investment causes **recovery** of the economy. >>>>> **Banking System** now slowly starts expanding credit, matching with the business confidence. >>>>> Employment, Factor Payments, Disposable Incomes, Consumer Spending, Aggregate Demand, etc. all rises

14. Indicators- 3 Indicators (Leading, Lagging, concurrent)

15. Leading Indicators:

a) It is a measurable economic factor that changes before the economy starts to follow a particular pattern or trend. **Variables that change before the Real Output changes**

b) However, Indicators are not always accurate and Experts disagree on the timing of these Leading Indicators.

16. Lagging Indicators:

a) Changes in these indicators are observable ***only after*** an economic trend or pattern has already occurred. **variables that change after the Real Output changes,**

17. Coincident or Concurrent Indicators:

a) It coincides or occurs simultaneously with the business—cycle movements.
b) It gives 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.

18. Role/ Importance of Business cycle in Business Decision making

a) Assessment of Impact on Demand
b) Expansion Decisions:
c) To Frame Business Policies:
d) To plan Production:
e) Market Entry / Product Launch:
f) Cyclical Businesses: Examples: House—Builders, Construction, Infrastructure, Restaurants, Advertising, Overseas Tour Operators, Fashion Retailers, etc.

19. Causes of Business Cycle

Internal Causes	External Causes
Fluctuations in Effective Demand	Wars
Fluctuations in Investment	Post War Reconstruction
Variations in government spending	Technology shocks
Macroeconomic policies	Natural Factors
Money Supply	Population Growth
Psychological factors	

20. Some important Points for MCQ

a) **According to Pigou,** modern business activities are based on the anticipations of business community and are affected by waves of optimism or pessimism.

b) **According to Schumpeter's innovation theory**, trade cycles occur as a result of innovations which take place in the system from time to time.

c) **The cobweb theory propounded by Nicholas Kaldor** holds that business cycles result from the fact that present prices substantially influence the production at some future date.

Chapter -6 National Income Fast Track/ Marathon

National Income: Basics

a) National Income measure **short-run performance of an economy.**
b) National income gives us an idea of the working of an economy .
c) National income accounts provide a **comprehensive, conceptual and accounting framework.**
d) National Accounts help us to understand **how the various transactions from the stage of production of goods and services to the stage of their final disposal are interrelated**.
e) It helps to meet the needs of **Government, private analysts,policy makers** and **decision takers**.
f) National Income Accounting was pioneered by the Nobel prize-winning economists **Simon Kuznets and Richard Stone**
g) The task to measure National Income is undertaken by **Central Statistical Organization (CSO)**, a department of The **Ministry** of Statisticsand **Programme Implementation (MoSP&I)**
h) At the State level, **State Directorates of Economics and Statistics (DESs)** have the responsibility of compiling their State Domestic Product and other aggregates.

Distinguish between Non-economic activities and economic activities

1. Economic Activities- Goods and services that **can be purchased / exchanged with money.**
2. Non-economic activities are those which **produce goods and services but are not exchanged** in a market.

What is the national Income ?

National Income is defined as money value[1] of final goods and services[2] produced by the normal residents[3] of a country, whether operating within the domestic territory[4] of the country or outside produced within in an accounting year[5].

a. Expressed in Money Value-

- It becomes necessary to measure their value against **some commonlyaccepted denominator**.
- Thus, money being the measuring rod.

b. Final Value of Goods and services-

1. **Value final goods and services** are **included** to avoid **double counting**.
2. ***Intermediate goods are those goods and services which are used by producers as input into further stage of production***

The final products are of two types- Consumer Goods and Services and Producer Goods-

1. **Consumer Goods-** Where the goods and services are used for final consumption bythe consumer, it is called as Consumer Goods and services.
   E.g. – TV, Food, Home appliances.

2. **Producers Goods-** Where the final product is used in production of othergoods/ service in future, it is called as Producers goods.

   E.g. Computer used for developing programs or software, Plant and Machinery used in manufacturing of goods

c. Normal resident-

1. **Normal resident** of **a country** refers to **an individual** or an institution who ordinarily resides inthe country and whose center of **economic interest** also lies in that country.
2. **Normal residents** include both, **individuals and institutions**.
3. Here the word **'Resident'** is used and not the word 'Citizen'. Hence, they may or may not be citizen of that country

d. Domestic territory:

1. Domestic territory refers to **geographical or political boundary** of country.
2. It however does not include- **international institutional** (United nations, WHO, WTO) and **foreign embassies** located within geographical territory but includes embassies of this country located outside itsgeographical territory
3. **Indian Ship and Indian aircrafts** performing operations outside countryis also included in domestic territory.

e. Current output:

While calculating National income value of only current production is included, this is because the value of previous year's production is included in Previous year's National Income.

National income does not include the following transactions:

1. **Pure purchase transaction** such as **sale and purchase of used goods/ second- hand goods**, this is because nothing new is produced in the current year.

   However, where the goods are refurbished the added value must be taken in calculation of National Income.
2. **Sale, purchase of securities** is also excluded because it is just a change of ownership.
3. **Transfer payments** are included as there is no economic activity involved. E.g Pocket money by Parents, Gift to Son in law.

Transfer Payment-

1) Transfer payments are unilateral payments for which no productiveservices are rendered in return in the ***current year.***

2) The recipient of this transfer payment **does not make any contribution to current production** in return for these payments

3) E.g Pension is given to a person in C.Y for rendering services in past,Unemployment allowance.

There are two types of transfer payments Viz. Current transfer and Capital transfer

4) **Current transfer** refers to the transfer made out of current income of payer and is added to current income of payee.

5) **Capital transfer** refers to transfer made out of the wealth of the payer and added to wealth of the receiver. (not in our syllabus).

Flow concept vs stock concept

Flow concept: - National income is a flow concept because it is measured **over a period of time**.

USEFULNESS OF NATIONAL INCOME ESTIMATES

- **It is helpful in many ways such as**

a) **Helps business Businesses to forecast the future demand** for their products.

b) shows the **composition and structure** of different sectors and the broad **sectoral shifts in an economy over time.**

a) **Shows income distribution and the possible inequity in the distribution among different income categories .**

b) Helps **government to make various sector-specific development policies, make macroeconomic modeling, comparisons of structural statistics and analysis to increase growth rates.**

c) **Policy Formulation -Combined with financial and monetary data**, national income data provides a guide to makepolicies for growth and inflation.

c) **International comparisons** in respect of incomes and living standards assist

Limitation of National Income

1. **Income Distribution is not clearly reflected: implies that the gap between richand poor is widening**
2. If the increase in GDP is on account of **long working hours, Employment of child labour, and polluted working environment, exclusion of leisure** such increase in GDP is not the real sign of welfare.
3. '**How much is produced**' determines GDP. It does not reflect '**what is produced**'.
4. If more of capital goods are produced the GDP will rise but the welfare may not increase in same manner.
5. **Avoids importance of Non-Market Transaction-** Example, Such as providing music class to society children for fun and other similar activity.

Explain the conceptual difficulties or challenges in measurement of national Income

The conceptual difficulties or challenges in measurement of national Income are:

1. **Lack of an agreed definition of National Income.** (like GDP, GNP, NDP, NNP etc)
2. **Non-availability of accurate distinction between final and intermediate goods.**
3. **Issue of transfer payments**.
4. **Service of durable goods**.
5. **Valuation of New goods at constant price**
6. **Valuation of Government services** –
7. **Data available** are either **inadequacy** or **unreliable** for calculation of national Income
8. **Presence of non-monetize sector**
9. **Production for self-consumption**

6: GDP AND WELFARE

Can the GDP of a country be taken as an index of the welfare of people in that country?

Answer:

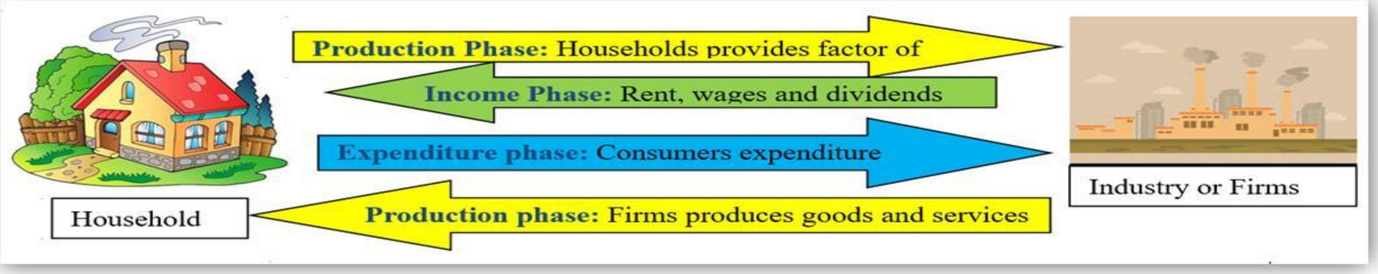
GDP is the sign of welfare increase in GDP Increases welfare yet.

- **Countries may have Same national income and per** capital income but their welfare may vary significantly .
- **Welfare may increase many times but not GDP**.
- **GDP may increase many times but not Welfare –**

THE SYSTEM OF REGIONAL ACCOUNTS IN INDIA

1. All the **states and union territories** of India compute **state income estimates and district level estimates**.
2. Regional accounts **provide an integrated database** on the many transactions taking place at state level.
3. State Income **or Net State Domestic Product (NSDP)**- volume of all goods and services produced in the state.
4. The state level estimates are prepared by respective **State Directorates of Economics and Statistics (DESs)** with assistance of **The Central Statistical Organization assists the States**.
5. **Per Capita State Income** = NSDP (State Income) / midyear projected population of the state
6. Certain activities such as are **railways, communications, banking and insurance and central government administration**, gives services to many states and their economic contribution cannot be assigned to any one state directly are known as the **'Supra-regional sectors'** of the economy. The estimated value in these cases calculated and distributed to the states on the basis of relevant indicators

CIRCULAR FLOW OF INCOME



- Circular flow of income refers to the **continuous circulation of production, income generation and expenditure** involving different sectors of the economy.
- There are three different interlinked phases in a circular flow of income, namely: production, distribution and disposition.

1. **In Production phase-** firms produce goods and services with the help of factor services.
2. **In Income or distribution phase,** the flow of factor incomes in the form of rent, wages, interest and profits from firms to the households occurs
3. **In Expenditure or disposition phase**, the income received by different factors of production is spent on consumption of goods and services and investment goods. This expenditure leads to further production of goods and services and sustains the circular flow.

Circular flow of income can be viewed from two different angles-

1. *What is Real Flow?* Real flow consists of flow of factor service and flow of goods and services among different sector of economy- ***Yellow Arrows***
2. *What is Money flow?* Money flow consists of flow of money for factor services in form of wages, rent, dividend (Green arrow) and money expenditure incurred on purchase of goods and services **(Blue arrow/green).**

ECONOMIC SECTORS OF AN ECONOMY

1. Household Sector:
2. Business Sectors/ Firm/ Producer:
3. Government Sector:
4. Foreign Sector/ Rest of the World

Models of circular flow of Economy

2 Sector	3 Sector	4 Sector
Household Sector Firm Sector	Household Sector Firm Sector Government	Household Sector Firm Sector Government Rest of the world
	Closed Economy	Open economy

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Two Sector Model without savings- Refer Diagram below

Assumptions:

1. There are **only two sectors** in an economy. **Householdsand the firms**.
2. **No savings** is made by either by Household or by Firm.
3. Households **spend entire income** on goods and servicesand **firm distributes entire proceeds** in the form of factor payments.

In this two-sector model without investment it is assumed that all the income earned by the Household is spent on buying **Consumer Goods** from the firm, while all the proceed are distributed as factor payments to households. Thus, the equilibrium will be achieved.

In other words, there is **no leakage in income** and the below mentioned equations hold good-

1. Total production of Goods and services by firm= Total consumption of goods and services by households.
2. Factor Income of household= Total factor payments.
3. Income of the firm= Expenditure of the households.
4. Real flow = Money flow

Two Sector Model with Savings and Investment

Assumptions

1. *We have assumed that* ***savings is done only byHouseholds and not firms.***
2. *All the* ***savings*** *made by the households are* ***invested in capital Market****.*

Savings, Leakage, reduction in flow of income and investment **S=I**

Savings made by the households and the investments may not be equal in all the time. There are three possible situations mentioned below-

i. If Savings= Investment, equilibrium is achieved
ii. Is Savings > Investment, the flow of income declines
iii. Is Savings < Investment, the flow of income rises

Three Sector Model of circular flow of income

The three-sector model consists of Households, Firmsand Government.

1. The equilibrium condition of circular flow of income in 3 sector economy model is: S+T = I+G.
2. If (S+T)> (I+G)- Decline in flow of income
3. If (S+T)< (I+G)- Increase in flow of income

Four Sector Model of circular flow of income

It is also called as open economy model as it is engaged in international operations too.

Explanation:

- Export is denoted by X while Import is denoted by M.

Thus, it can be said that X constitutes injection while M creates leakage into circular flow of income.

1. At equilibrium = S+T+M = I+G+X
2. If S+T+M > I+G+X, there is decline in flow of income.
3. If S+T+M < I+G+X, there is increase in flow of income

Distinction between three and four sector Economy model:

Importance of Circular Flow of Income

1. **Easy to view** the entire system as circular flow of income.
2. Circular flow of income pinpoints the condition of **macroeconomics equilibrium**.
3. It gives an idea as to **how different sectors of economy interacts**
4. It shows how different sectors of economy (Household sector, Business sector, Government and Rest of the world) are **interdependent and are interrelated.**
5. It helps in determining **size of income**. We can estimate national income with the help of output, income and expenditure phases of circular flow of income

Thus,

National Income refers to -

1. Money Value of all the **final goods and services produced** by a country during a year. (Production Phase)
2. **Total Flow of Earnings** of the Factor Owners, in the form of Wages, Salaries, Rent, Interest and Profits, which they receive through the production of goods and services. (Income Generation Phase)

Unit 2- National Income Aggregates

Domestic Product and National Product (Domestic income and National Income)

Particulars	Domestic Products	National Products
Meaning	Money value of Final Goods and service produced by **both, nationals of the country as well as foreign national** located **within domestic territory** of a country during a year	Money value of Final Goods and service produced by **Normal Resident of a country** whether operating within **domestic territory of a country or outside.**
Basis of differentaition	- Addressed with the question of **where** theincome is generated. - It is geography or territory oriented	- It can be addressed with the question of **who** generates the income. - It is Nationality Oriented. - It excludes foreign national

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Net factor Income Earned from Abroad

Net factor Income Earned from Abroad or **NFIA** is the difference between the factor income received and the factor income accruing to rest of the world

National Product at Market Price and National Product at Factor Cost

1) Factor cost refers to **factor payment made by the business to the owners of factor of production in the form of rent, wages, interest and profit**
2) ***National product at Market price = National Product at factor cost + Indirect tax*- Subsidies, or***
3) ***National product at Market price = National Product at factor cost + Net Indirect tax*****

Factor Cost vs Basic Price vs Market Price

1) **Factor cost = Sum total of factor income in form of rent, wages, interest and profit**
2) **Base Price: = Factor cost + Production tax (License, Stamp duty, municipal tax, property tax) – Production subsidies**
3) **Market price = base price + Product tax (Indirect tax/ GST) – product subsidy**
4) **Market Price:** Basic Price + Product tax – Product Subsidy = Market Price.
5) **MP = FC + Net Indirect tax (when production tax and production subsidies are not given)**

Gross Vs Net

Net domestic Product = Gross domestic Product – Depreciation

Net national Product = Gross national Product – Depreciation

1- Gross Domestic Product at Market Price - GDP^{MP}

2- Gross National Product at Market Price - GNPMP

3- Net Domestic Product at Market Price – NDPMP

4- Net National Product at Market Price - NNPMP

5- Gross Domestic product at Factor cost – GDPFC

6- Gross National product at Factor cost – GNPFC

7- Net Domestic product at Factor cost – NDPFC

8- Net National product at Factor cost - NNPFC

Why NNP at factor cost is better measure of National Income than NNP at Market Price?
Answer: *NNP at Market price is affected by factor called as Net indirect tax. If there is change in tax rate and subsidy then NNP at market price figure will change accordingly* ***without*** *actual increasein Factor cost. Also, different countries have different tax rate and thus for* ***internationalcomparison*** *of relative income level.*

Types of Income:	
Disposable income	Income available for disposable and it **includes transfer payments**. *Example, Income may be 10,000 but one may also receive transfer payment which will increase the money received by him to the extent of transfer payment say 2000. Therefore, Income is 10000 while Disposable income is 12000* *Thus,* **Disposable income= Income + Net Transfer payment**** **Disposable income may be more or less depending upon whether Net transferpayment is positive or negative**
National Disposable Income	**National Disposable income is the sum total of National Income at Market priceand net of Current transfer received from rest of the world** GNDI = GNP_{MP} + Net transfer Payments received from rest of the world NNDI = NNP_{MP} + Net transfer Payments received from rest of the world NNDI = GNP_{MP} + Net transfer Payments received from rest of the world- depreciation
Disposable income of Private sectors	There are three disposable income aggregates, namely- 1. Private Income 2. Personal Income 3. Personal Disposable income

Less	Miscellaneous receipts of Govt. department. Fines, fees etc.	30
Less	Personal taxation	60
	Personal Income	640

Per Capital Income	a) It serves as an indicator of the standard of living of a country. b) Per capita income = $\underline{NNP_{FC}/}$ Population

Summary
GNDI = GDP_{MP} + Net transfer payment received from rest of the world
NNDI = NDP_{MP} + Net transfer payment received from rest of the world
Private Income = NNP_{FC} - Income from property and entrepreneurship accruing to govt. commercial enterprises and admin department- Savings of non- Departmental enterprises of government +Interest on national debt +Net Current Transfer payment received from Govt. dept +Net transfer payment received from rest of the world
Personal Income = Private Income – Undistributed profits- Corporate taxes
Personal disposable income = Personal income- Personal taxes- Miscellaneous receipts of Govt. department.

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***Interest that Govt. pays on National debt**: Sometimes govt. borrows fund from private institutionand pays the interest on the same. The interest shall be included in factor payment by it is argued that the monies are utilized for welfare purpose and thus shall be treated as Transfer payment.

**The private sector receives transfer payment both from Govt. and rest of the world. Reverse is also true in many cases.

	Nominal GDP	Real GDP
Also known as	GDP at Current price	GDP at Constant price
Meaning	GDP at Current price is the value of all final goods and services produced within the domestic territory of a country by normal residents, whether nationals or non- nationals, inclusive of depreciation during a year at **market price prevailing in that year**	GDP at Constant price is the value of all final goods and services produced within the domestic territory of a country by normal residents, whether nationals or non- nationals, inclusive of depreciation during a year at **market price prevailing in base year**
		GDP at constant price = $\frac{\text{GDP at Current price}}{\text{Price index of current year}} \times 100$

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GDP Deflator: It is the ratio of Nominal GDP (at Current Prices) to Real GDP (at Constant price)

GDP Deflator: $\frac{\text{Nominal GDP}}{\text{Real GDP}}$.

a) GDP Deflator takes out the Inflation out of Nominal GDP. It deflates the GDP.

b) It converts Nominal GDP to Real GPD

Inflation:

a) Using the GDP deflator, the inflation rate between two consecutive years can be compute using the following procedure:

b) $$\text{Inflation rate in year 2} = \frac{\text{GDP deflator in year 2 -GDP deflator in year 1}}{\text{GDP deflator in year 1}} \times 100$$

Methods of Measuring National Income

There are three ways to measure National Income

1. Product method or Value-added method- Flow of Goods andservices
2. Income Method- Flow of income generated
3. Expenditure Method- Flow of Expenditure on Goods andservices

Net product or Value-Added Method

Meaning	National income by value added method is the sum total of net value added at factor cost across all producing units of the economy less intermediate purchases from all other industries.
Steps 1	Identifying the producing enterprises and classifying them into different sectorsaccording to the nature of their activities (i) Primary sector- production units which produces goods and commodities by exploiting natural resources. Examples- farming, Mining, Fishing, etc. (ii) Secondary sector- This sector transforms one for of commodity into other formsuch as manufacturing (iii) Tertiary sector or service sector- Provides services which are intangible in nature.
Step 2	Estimating the gross value added (GVA **MP**) by each producing enterprise. Gross value added (GVA MP) = Gross Value of production – value of Purchase = Value of output – Intermediate consumption = (Sales + change in stock) –Intermediate consumption.This will Give us GDPMP
Step 3	Conversion: • GDP_{MP}- depreciation= NDP_{MP} • NDP_{MP}- Net indirect tax = NDP_{FC} • NDP_{FC}+ NFIA= NNP_{FC}
Inclusion and exclusions	Precaution in Estimation of National Income by Value-added Method- 1. Production for self- consumption 2. Own account production of fixed assets. 3. Imputed rent of owner-occupied houses. 4. Service of House wives shall. 5. Sale and purchase of existing commodities or second-hand goods shall not beincluded. However. 6. Sale and purchase of Share and Bonds .

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Income Method/ Factor Payment Method/ Distributed Share Method

Meaning	National income is calculated by summation offactor incomes paid out by all production unitswithin the domestic territory of a country as wages and salaries, rent, interest, and profit.
Steps 1	Classify the income into appropriate income categories namely, 1. Labour Income or Compensation to employees 2. Capital or Property income or Operating surplus

3. Mixed Income of self employedThis will give NDP^{FC}

Step 3

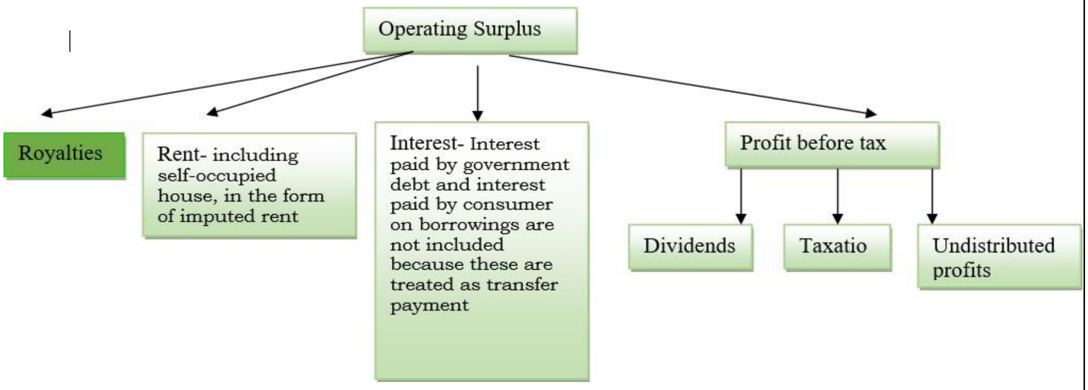
The above exercise will give NDP$_{FC}$. The adjustment of NFIA will give National Income

Labour Income

- This is the ***compensation paid to the labour/ employee*** for the servicerendered by them.
- It is the payment made by the producer to employees or labour, for the services rendered by them, in cash, kind and social security benefits.

Included	Excluded
Salaries and wages in cash including Bonus, DA, HRA	Old age pension shall not be considered while calculating Labour income as it is a transfer payment
Current year pension provision shall be considered.	TA shall be excluded if it is for business work or on reimbursement basis.
Travelling allowance shall be included if it is for travel form office tohome and home to work	Contribution of employee to social security fund shall not be added as it is already part of salary.
Contribution of employer to social security fund shall be added. E.g. Provident fund	Interest free loan given to employee
Commission paid to sales staff	Old age pension
Payment in kind- Rent free accommodation, Free Meal coupon	Income tax of employee
LIC premium paid by employer	Old age pension shall not be considered while calculating Labour income as it is a transfer payment

Operating Surplus



It is the income earned from **ownership and control of Capital**. Therefore, it is alsoknown as income from **property** and **entrepreneurship**.

It includes

- Rent- including self-occupied house, in the form of imputed rent
- Interest
- Royalties for
- Profit before tax

Note:

✓ If the question mentions about Profit before tax than Undistributed profit,dividend and corporate taxes shall be ignore.

✓ If the question does not mention about the profit before tax- add all three

✓ If nothing if prefixed to profit, assume it to be PBT

✓ Interest paid by government debt and interest paid by consumer on borrowingsare not included because these are treated as transfer payment

Mixed Income

- Mixed income is the income generated by **own account workers** and income of **unincorporated enterprises.**
- Example of such mixed income are legal service, agriculture, trading, proprietorship, Plumber, carpenter etc.
- Mixed income contains both components of income namely **capital income and labour income** of those who provides capital and labour service in production process.
- It is the **composite of both labor income and capital income** and arises in case where it is difficult to differentiate between labour element and capital element I factor of production.

Example of such incomes are own account workers like CA, Lawyer, Shopkeeper etc.

Inclusion and exclusion

Include	Exclude
Imputed rent of self-occupied house by owner of this house	Transfer payment- Refer earlier part of the chapter
Value of production for self-consumption	Illegal Income like, smuggling, drug dealing etc.
Imputed value of service provided byowner of production unit	Interest on loan taken for meeting consumption expenditure- eg. Loan to buy house, loan to buy car, etc.
Interest on loan taken for meeting business needs	Interest on national debt- refer earlier discussion
Brokerage service in facilitating the transaction of second-hand goods	Income in respect of second-hand commodities
Income tax and TDS to show gross income	Income arising from transfer of shares and other securities.

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Difficulties

1. It is very difficult to estimate Mixed income in vast country with unincorporated sectors and un-organized sector.
2. Many economists criticize the non-inclusion of interest on national debt in calculation of national Income.
3. The data collected for calculation of NI is highly unreliable and

	understated.

Expenditure Method/ Income disposal Method

Meaning	**In the expenditure approach, national income is the aggregate final expenditure in an economy during anaccounting year.** This approach gives GDP at market price.
Explanation:	Expenditure on final goods and services in the economy is divided into four broad categories, namely 1. **Private final consumption expenditure-** Consumption expenditure done by households. 2. **Investment Expenditure-** Investment expenditure done by producers and Government in an economy. 3. **Government final consumption expenditure-** Consumption expenditure done bygovernment. 4. **Net exports**- foreign component of expenditure in the form of net exports.
Private Final consumption expenditure **Denoted By C**	**The volume of final sales of goods and services to consumer households and nonprofit institutions serving households acquired for consumption (not for use in production) are multiplied by market prices and then summation is done.** It also includes the value of primary products which are produced for own consumption by the households, payments for domestic services which one household renders to another.
Government final consumption expenditure **Denoted By G**	**Government means general government and not the government enterprises** Since the collective services provided by the governments such as defense,education, healthcare etc. are not sold in the market, the only way they can bevalued in money terms is by adding up the money spent by the government in theproduction of these services. This total expenditure is treated as consumptionexpenditure of the government. Government expenditure on pensions, scholarships, unemployment allowance etc. should be excluded because these are transfer payments.
Investment Expenditure **Denoted By I**	Gross domestic fixed capital formation includes final expenditure on machinery and equipment **and own account production of machinery and equipment,** expenditure on construction, expenditure on **changes in inventories,** and expenditure on the acquisition of valuables such as, jewelry and works of art. It comprises of- 1. **Gross fixed investment-** Expenditure on machinery and equipment, expenditure on construction, and expenditure on the acquisition of valuables such as, jewelry and works of art. 2. **Inventory Investment-** This means change in inventory. 3. **Expenditure on residential investment-** Expenditure on purchase or construction of new houses. Own account production of houses, expenditure on major repairs and renovation are to be included in

	expenditure on residential houses
Net Export **Denoted by** X-M	Net exports are the difference between exports and imports of a country during the accounting year. It can be positive or negative.
Formula	**GDP_{MP} = C+I+G+(X-M)** Therefor National Income $Y = C + I + G + (X-M) + NFIA - Depreciation - NIT$
Precautions	1. Goods meant for self-consumption shall be added and proper value shall beassigned in that case. 2. Own account production of machinery and equipment shall be added to calculatefinal expenditure on machinery and equipment. 3. Transfer payments shall be excluded. 4. Expenditure on second-hand goods should be excluded. 5. Expenditure on intermediate products should be excluded.

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Question: Why are net exports added when computing national income by expenditure Method?

Choice of Different method

In many economies, it may **not be possible** to estimate National Income using any **one method exclusively.**

a) **Income Method** is more suitable in **Developed Economies**.

b) **If Commodity Flow and Expenditure** then Expenditure Methodcan be used.

c) An effective procedure is to arrive at National Income using all these three approaches / methods, which serves the following purposes -
   i. to permit cross-checking of different methods, ensuring greater accuracy of data,.
   ii. to provide more details and insights - e.g. Sectoral Contribution to Production, Income Group Distribution, Consumption and Investment Patterns, etc .

In India, a **combination of the three methods** is used, e.g. *Production Method is used for Agricultural Sector*, *Income Method is used for Small Scale Sector* and *Expenditure Method is used for Construction Sector*, to determine Net Value Added in that Sector.

Keynesian Theory of Income determination

Background:

- The Great Depression of the 1930's, was the greatest economic crisis the western world had experienced.
- Many economists then recommended **government spending** as a way of reducing unemployment, but they had no macroeconomic theory by which to justify their recommendations.
- A comprehensive theory to explain Income determination was first put forward by the British economist John **Maynard Keynes** in his masterpiece **'The General Theory of Employment Interest and Money' published in 1936.**

- The Keynesian theory of income determination is presented in two sector model, three sector model and four sector mode.
- *Equilibrium output occur when the desired amount of output demanded by all the agents in the economy exactly equals the amount produced in a given time period. In other words, an economy is said to be in equilibrium when the production plans of the firms and the expenditure plans of the households match.*

Key Words:

<table>
<tr><td>Consumption Function</td><td>1. Functional relationship between aggregate consumption expenditure and aggregate disposable income, expressed as C = f (Y). shows the level of consumption (C) corresponding to each level of disposable income (Y).
2. The consumption function describes the functional relationship between <i>consumption spending and disposable income.</i></td></tr>
<tr><td>Saving Function</td><td>Income not spent on consumption is saved. Thus, saving function denotes the balance after impact of consumption</td></tr>
<tr><td>Marginal Propensity to consume</td><td>The concept of MPC describes the relationship between change in consumption (ΔC) and the change in income (ΔY). The value of the increment to consumer expenditure per unit of increment to income is termed the Marginal Propensity to Consume (MPC).
MPC = Consumption / Income</td></tr>
<tr><td>Marginal propensity to Save (MPS)</td><td>(1 – b) is called (Marginal Propensity to Save) MPS.
MPS = S/ Y</td></tr>
<tr><td>Average propensity to consume</td><td>The average propensity to consume is a ratio of consumption defining income consumption relationship. The ratio of total consumption to total income is known as the average propensity to consume (APC)
APC = Total consumption/ Total income</td></tr>
<tr><td></td><td>
<table>
<tr><th>Income (Y)</th><th>Consumption (C)</th><th>APC (C/Y)</th><th>MPC (ΔC /ΔY)</th><th>MPS (ΔS/ΔY) =(1-MPC)</th></tr>
<tr><td>0</td><td>500</td><td>500/0 =∞</td><td>-</td><td>-</td></tr>
<tr><td>1000</td><td>1250</td><td>1250/1000 = 1.25</td><td>750/1000 = 0.75</td><td>0.25</td></tr>
<tr><td>2000</td><td>2000</td><td>2000/2000 = 1.00</td><td>750/1000 = 0.75</td><td>0.25</td></tr>
<tr><td>3000</td><td>2750</td><td>2750/3000 = 0.92</td><td>750/1000 = 0.75</td><td>0.25</td></tr>
<tr><td>6000</td><td>5000</td><td>5000/6000 = 0.83</td><td>1500/2000 = 0.75</td><td>0.25</td></tr>
<tr><td>10,000</td><td>8000</td><td>8000/10,000 = 0.80</td><td>3000/4000 = 0.75</td><td>0.25</td></tr>
</table>
</td></tr>
<tr><td>Autonomous Expenditure</td><td>Autonomous consumption expenditure is the minimum expenditure to sustain life irrespective of size of income, thus it is income inelastic. The expenditure which do not vary with the level of income. They are determined by factors other than income such as business expectations and economic policy. They are generally made by -----
in the public sector with a view to provide public utilities & to make maximum social benefit.</td></tr>
</table>

Keynesian theory of determination of National Income in two Sector Model.

i. According to Keynes AD=AS________________________________(1)
ii. AD = C+ I ________________________________(2)
iii. Aggregate Supply in terms of Money = Quantity Produced x Price.
iv. Value of Aggregate Supply = National Income.________________________________(3)
v. Income (Y) = C+ S________________________________(4)
vi. Therefore from (1), (2), (3) & (4)
vii. C+S = C+I
viii. S=I
ix. C = a + by

- **Why any other point cannot be Equilibrium NI?**
- **Case 1:** AS > AD i.e C+S > C+I

  Ans: The firm will not be able to sell its stock & firm will reduce the production and cut down on expenditure, as a result demand for factor of production will decrease, in case of Factor will

- reduce and thus spending will fall. This process will continue till equilibrium is reached.

- **Case 2: AS<AD i.e C+S < C+I**

  Ans: Here Demand is greater than supply and hence producer will increase the production leading to higher National income. This will cause upward moment along the line to achieve the equilibrium

Keynesian theory of determination of National Income in three Sector Model.

Y= AS = C + S + T________________________________(2)
Ad = C + I + G________________________________ (3)

∴ Consumption will be- $C = a + b\,(Yd)$

Keynesian theory of determination of NI in Four Sector Model.

In 4 Sector Economy

AS = AD
$C + S + T = C + I + G + (x - m)$
$S + T = I + G + (x - m)$
OR $S + I + m = I + G + x$

Investment Multiplier:

1. The multiplier refers to the phenomenon whereby a change in an injection of expenditure wil leadto a proportionately larger change (or multiple change) in the level of national income.
2. Multiplier explains how many times the aggregate income increases as a result of an increase in investment.
3. The ratio of ΔY to ΔI is called the investment multiplier, k.
4. $\Delta Y = k\ \Delta I$.

5. **The value of the multiplier is found from the equation k = 1/ (1- MPC). Or K = 1/ MPS**
6. **The multiplier shows how shocks to one sector are transmitted throughout the economy.**

Effect of Changes in Autonomous Investment

1. an increase in autonomous investment by ΔIshifts the aggregate demand schedule fromC+I to C+I+ΔI.
2. Correspondingly, the equilibrium shifts from E to $E^1$and the equilibrium income increases more than proportionately from Yo to Y 1.

Till how long these processes go?

1. The more powerful these leakages are, the smaller the value of the multiplier. The leakages are caused due to:
   a) **Progressive rates of taxation**
   b) **High liquidity preference and idle saving or holding of cash balances**
   c) **Demand met out of the existing stocks or through imports.**
   d) Additional income spent on **purchasing existing wealth or purchase of government securities and shares from shareholders or bondholders, income used for payment of debts**
   e) case of full employment additional investment will only lead to inflation, and scarcity of goods and services despite having high MPC

In underdeveloped countries value of multiplier is low, due to structural inadequacies, increase in consumption expenditure is not generally accompanied by increase in production.

Relationship between Investment Multiplier and Marginal Propensity to consumer

Higher the MPC, Higher will be the Value of Multiplier, and Vice versa. Maximum Value of Multiple will be Infinite when MPC is 1. We conclude that value of Multiplier is reciprocal of MPS (1-MPC)

Deflationary Gap

1. If the aggregate demand is for an amount of output less than the full employment level of output, then we say there isdeficient demand.
2. Deficient demand gives rise to a 'deflationary gap' or'recessionary gap'.
3. Recessionary gap also known as 'contractionary gap' arises in the Keynesian model of the macro economy when theequilibrium level of aggregate production achieved in the short-run falls short of what could be produced at full employment.
4. Recessionary gap occurs when the economy is in a business- cycle contraction or recession.

Public finance –
Market Failure and Government Intervention

2.1.1 Market Failure

- Economists presume that people will make choices in their **own self-interest**, in their **greatest personal benefit** and **behave rationally**.
- **Prices provide the accurate signals** for right quantity and right price.
- The term "**market failure**" does not mean the market is not working at all, it only means that the market does not function in the way that it should.
- Market failure - **misallocation of society's scarce resources** - either **overproduction** or **underproduction**.
- There are two types of market failure namely;
    1) Complete market failure. This is a case of "missing markets" and occurs when the market does not supply products at all.
    2) Partial market failure occurs when the market does actually function, but it produces either the wrong quantity of a product or at the wrong price..

2.1.2 Four major reasons for Market Failure

Market power | Externalities | Public Goods | Incomplete Info

Market Power

Point	Explanation
Meaning	1) Market power or monopoly power is the ***ability of a firm to profitably raise the market price*** of a good or service over its marginal cost and can charge a price that gives them positive economic profits. 2) These profits are not achieved due to operating efficiency, but due to market power and dominance. *3) For Buyers: Market Power is the ability of Buyers to influence the Seller into the production of certain goods and services, over and above optimum levels of consumption.* (Generally, Market Power is viewed from the Sellers' Perspective)
Techniques	1. **Lower output:** *(artificial scarcity)* 2. **Higher Price:** 3. **Missing Markets:**

Externalities | Spillover effects | Neighborhood effects | Third-party effects | side-effect

(Kare koi aur bhare koi aur)

Point	Explanation
Meaning and concept	1. **When actions of either Consumers or Producers result in costs or Benefits that do not reflect as part of the Market Price, such costs or Benefits which are not recognized by, and accounted for, by the Market Price are called "Externalities"** 2. An Externality occurs, when a Consumption or Production Activity has an <u>indirect effect on other's consumption or Production activities</u> and such effect are not

<table>
<tr><td></td><td>reflected directly in Market Prices.
3. Externalities are costs (negative externalities) or benefits (positive externalities), which are not reflected in free market prices.</td></tr>
<tr><td>Consequences of Negative Externalities</td><td>1) In Case of Negative Externalities- Marginal Social Cost> Marginal Private Cost.
2) In Case of positive Externalities- Marginal Social Cost< Marginal Private Cost.</td></tr>
<tr><td>Unidirectional and reciprocal Externalities</td><td><table>
<tr><th>Unidirectional Externalities</th><th>Reciprocal Externalities</th></tr>
<tr><td>Occurs when Originator imposes costs or Benefits on another (Recipient) and there is no externality imposed by the Recipient back on the Originator.</td><td>It occurs when 2 persons impose there is costs or on one another.</td></tr>
</table></td></tr>
<tr><td>Production Externalities & Consumption Externalities</td><td><table>
<tr><th>Production Externalities</th><th>Consumption Externalities</th></tr>
<tr><td>Production externality initiated in production which imposes an external cost/ benefit on others may be received by another in consumption or in production.</td><td>Consumption externalities initiated in consumption which produce external costs/ benefits on others may be received in consumption or in production.</td></tr>
</table></td></tr>
<tr><td>Externalities can be positive or negative.</td><td><table>
<tr><th>Positive externalities</th><th>Negative externalities</th></tr>
<tr><td>occur when the action of one party confers benefits on another party</td><td>occur when the action of one party imposes costs on another party.</td></tr>
<tr><td>It is socially desirable</td><td>It is socially undesirable</td></tr>
</table></td></tr>
</table>

8

8 Types of Externalities

1.
2.
3.
4.
5.
6.
7.
8.

2. Goods

Characteristics of Private goods: Private goods refer to those goods that yield utility to people. Anyone who wants to consume them must purchase them.

A few examples are: food items, clothing, movie ticket, television, cars, houses etc.

Properties of Private goods:

1. **Property Right:**
2. **Rivalrous:**
3. **Excludable:**
4. **No Free riding problem:**
5. **Rejectable:**
6. **Additional resource costs**
7. **Efficient Allocation**-
8. **There is no Market Failure.**

Public Goods - Paul A. Samuelson who introduced the concept of 'collective consumption good' in his path-breaking 1954 paper 'The Pure Theory of Public Expenditure' is usually recognized as the first economist to develop the theory of public goods.

a) Characteristics of Public Goods:

1. **Collective in nature:**
2. **No direct payment**
3. **Non-rival in consumption.**
4. **Public goods are non-excludable.**
5. **Public goods are characterized by indivisibility.**
6. **Free Riding Problem & Externalities:**
7. **Example:** Defence, Highways, Education, Scientific Research, Law Enforcement, Lighthouse, Fire Protection, Disease Prevention, Public Sanitation etc. **[Note:** Public Goods are divided into Public Consumption Goods and Public Factors of Production.]

Pure and Impure Public Goods

sn	*Pure Public Goods*	*Impure Public goods*
1.	A pure public good is **non-rivalrous** and **non-excludable.**	There are many hybrid goods that possess **some features of both public and private goods**. Impure public goods are partially rivalrous or congestible.
2.		
3.		

.

Free Riding

1. Free riding is ***'benefiting from the actions of others without paying'***.
2. Consumers can take advantage of public goods ***without contributing sufficiently*** to their production.
3. The ***absence of excludability*** in the case of public goods and the ***tendency of people to act in their own self-interest*** will lead to the problem of free riding.
4. If every individual plays the same strategy of free riding, the strategy will fail because nobody is willing to pay and therefore, nothing will be provided by the market. Then, a free ride for any one

becomes impossible.

1. No public good will be provided in private markets
2. Private markets will seriously under produce public goods even though these goods provide valuable service to the society.

Information failure

a) **Complex nature**:

b) **Information not available quickly and cheaply:**

c) **Ignorant Buyer/seller:**

d) **Inaccuracy**:

e) **Misunderstanding**:

Asymmetric information

a) Asymmetric information occurs when there is an **imbalance in information between buyer and seller** i.e. when the buyer knows more than the seller or the seller knows more than the buyer can distort choices.

b) This lead to Problem of **Adverse Selection – wrong product selected**

'Lemons problem' developed by **George Akerlof** in relation to the used car market.

a) Second-hand cars may be good quality cars or poor quality cars defined as **"lemons".** The owner of a car knows much more about its quality than anyone else & he may not disclose all the mechanical defects of the vehicle.

b) Based on the probability that the car on sale is a 'lemon', the buyers' willingness to pay for any particular car will be based on the **'average quality'** of used cars. Since there is quality uncertainty, to account for this risk, the price offered for any used car is likely to be less.

c)

Adverse Moral Hazard – seen in case of Insurance

1. Moral Hazard is **opportunism** characterized by an informed person's taking **advantage of a less-informed person through an unobserved action**.
2. It arises from lack of information about someone's future behavior.
3. Moral hazard occurs when there is distortion of incentives to take care or to exert effort when **someone else bears the costs of the lack of care or effort**.

Role of Government

Objectives of Government Interventions:

1. To control potential rise in prices. (MRTP Act)
2. To bring in welfare to the under privileged sections of the Society by ensuring equity and fairness, (Subsidy)
3. To provide Incentives to promote production / use of Resources in a socially desirable direction etc. (Organic vegetable).

4. One of the most important activities of the government is to redistribute incomes so that there is equity and fairness in the society.

Argument in favor of Government Interventions:

1. The role of government ***improves the wellbeing of individuals and households***.
2. ***Under production*** of certain goods & higher prices than would exist under conditions of competition(Generic Medicine)
3. ***Non-production of public goods*** (or collective goods) in sufficient quantities by the market. (Parks and Playground)
4. Production and Consumption of a Good or Service affects People and they cannot influence through Markets decision about how much of the Good or Service should be produced e.g. Pollution
5. Reduction or Distortion in choices available to consumers, and consequently lower welfare. (Only Private mode of Transport)
6. Equity and Fairness- to Curb Inequalities in the distribution of Income and Wealth.
7. Instabilities caused by Business cycles and fluctuations which lead to recession, inflation, etc. for prolonged periods, and cannot be corrected by Market system as such.
8. Market's inability to rectify "**Stagflation**" i.e. a State of affairs in which inflation and Unemployment co-exist,
9. Market's inability to rectify "**Contagious Effect**" i.e. forces of instability transmitted from one country to other countries, due to increased international interdependence

Arguments against government interventions:

- Government intervention does not imply that Markets are replaced by Government action. Government can act only as **complement rather than as a substitute** to the Market System in an economy,
- Governments may **not always** be **unbiased and benevolent**.
- Individuals may use Government as a Mechanism for maximizing their **self interest**
- In certain cases, the **cost** incurred by Government to deal with some Market failure could be greater than the cost of Market Failure itself.
- Government intervention may produce **fresh and more serious problems** that the ones sought to be rectified.
- Government intervention is ineffective if it causes **wastage of resources** expended for the intervention
- Governments are likely to commit **serious errors** in its attempt to correct Market failure.

Types of Government interventions

Government interference can be-

∂ **Direct** as a buyer or supplier of public goods / information

∂ **Indirectly** in the form of ***subsidies / taxes*** and regulation / influence to correct distortion in the market which occurs when there are deviations from the ideal perfectly competitive state.

Market Power- Government control

1. **Setting maximum prices** that firms can charge.
2. Price regulation is most often used for **natural monopolies**.
3. **Rate-of-return regulation**. Another approach to regulation is setting **price-caps**.
4. Market liberalization by introducing competition in previously monopolistic sectors such as energy, telecommunication etc.
5. Controls on mergers and acquisitions if there is possible market

domination

6. Price capping and price regulation
7. Profit or rate of return regulation
8. Patronage to consumer associations
9. Tough investigations into cartelization and unfair practices such as collusion and predatory pricing
10. Restrictions on monopsony power of firms
11. Reduction in import controls and
12. Nationalization

Government intervention to Correct Externalities

A. **Direct Control:** (also known as command solutions) - Direct controls ***prohibit*** specific activities that explicitly create negative externalities or require that the negative externality be limited to a certain level.

Examples Include:

- Smoking is completely banned in many public places.
- Stringent rules are in place in respect of tobacco advertising, packaging and labeling etc.
- fix emissions standard which is the legal limit on how much pollutant a firm can emit
- Licensing, production quotas and mandates regarding acceptable production processes are other examples of direct intervention by governments.

B. **Indirect/ market-based Control**:

✓ These provide economic incentives to Market Participants, to achieve the socially optimal solution.

✓ In other words, the government tries to alter the prices of goods through taxes and subsidies and thus change the behaviour of market participants.

1. Setting the price directly through a pollution tax. These taxes are named Pigouvian taxes after A.C. Pigou.
2. Setting the price indirectly through the establishment of the cap-and-trade system.

a) The second approach to establishing prices indirectly is 'tradable emissions permits'.

You might have heard of 'carbon credits'. The use of tradable permits to limit emissions is often called 'cap and trade'.

a) Marketable Licenses (called permits) to emit limited quantities of pollutants can be bought at a specified price from the Regulatory Agency, by Polluters

b) A high polluter has to either- i) pay monetary penalties, or ii) buy more permits both leading to increase in costs and decrease in profits.

c) A low polluter can- i) avoid Monetary Penalties, and ii) sell permits and earn revenue, both making such firm profitable.

i. Problems **in administering an efficient pollution tax.**

∂ **Difficult to Administer-**

∂ **Complex-**

∂ **No Genuine solution-**

∂ **Failure in case of inelastic demand-**

∂ **Adverse effect on employment-**

Government Intervention to correct externalities Positive externalities:

Though positive externality is associated with **external benefits**, we still call it a **market failure** because, left to market, there will be less than optimal output.

A. Direct Control:- Production & Supply
   a) Government enters the market directly as an Entrepreneur, to produce items whose externalities are vastly positive & pervasive.
   b) Examples: R&D, afforestation, Sewage Treatment, Cleaning up Rivers etc.

B. Indirect control:- Subsidies:
   a) Subsidies given by Government reduce the Production Costs of firms.
   b) This leads to higher output and supply.
   c) Thus, such goods will be produced in higher quantities i.e. socially optimum level of output

Government intervention in case of Merit Goods

Meaning and Example

1. Merit Goods- a) are **socially desirable**, b) involve substantial **positive externalities** in their consumption.

Need for Intervention

1. **Lower Output:**.
2. **Equity Fairness:**
3. **Uncertainty in consumption:**
4. **Imperfect information:**

Government can regulate the supply of merit goods in following manner

1. **Direct government provision:**.
2. **Regulation:**.
3. **Subsidies:**.
4. Governments also engage in direct production of environmental quality.

Government intervention in De-merit Goods

Meaning and Example

1. Demerit goods are goods which are believed to be **socially undesirable** and involve **high level of negative externalities**.
2. However, it should be kept in mind that all goods with negative externalities are not essentially demerit goods; e.g. Production of steel causes pollution, but steel is not a socially undesirable good.
3. More than optimal production and consumption.
4. Misallocation of society's scarce resources.
5. Consumers overvalue demerit goods because of imperfect information.

ways for Intervention

1. **Complete ban:**.
2. **Persuasion**.
3. **Through legislations**
4. **Strict regulations** \.

5. Regulatory controls.
6. Imposing unusually high taxes

Reason why Govt. fails to provide such measures -

1. Addiction level
2. Inelastic nature of demand.
3. Sellers can always shift the taxes to consumers without losing customers.
4. Banned goods are secretly driven underground and traded in a hidden market.

Government intervention in other areas

Goods

Reason why certain goods are produced by government despite the fact that it can be produced by Private sector

1. ***Left to the markets and profit motives, these may prove dangerous to the society.***.
2. In the case of such pure public goods where entry fees cannot be charged, ***direct provision by governments through the use of general government tax revenues*** is the only option.

Price intervention: non-market pricing

1. Very often, there is strong political demand for governments to intervene in markets for various goods and services on grounds of fairness and equity.
2. Price floor (a minimum price buyer is required to pay). Price floor means the lowest price fixed by government for a product. The Government fixes floor price for farm products. This regulates income of the farmers.
3. Price ceiling (a maximum price seller is allowed to charge for a good or service). When prices of certain essential commodities rise extremely, government may resort to controls in the form of price ceilings for making a resource or commodity available to all at reasonable prices.
4. In the case of many crops the government has initiated the Minimum Support Price (MSP) programme as well as procurement by government agencies at the set support prices. The objective is to guarantee steady and assured incomes to farmers. In case the market price falls below the MSP, then the guaranteed MSP will prevail.
5.

Government Intervention for Incomplete Information

For combating the problem of market failure due to information problems following interventions are resorted to:

- Government makes it mandatory to have accurate labeling and content disclosures.
- Mandatory disclosure of information,
- .
- Regulation of advertising and setting of advertising standards to make advertising more responsible, informative and less persuasive.

FISCAL FUNCTIONS: AN OVERVIEW CENTRE AND STATE FINANCE

1. The governments of all nations have important economic functions even where markets constitute the basic resource allocation mechanism.
2. There are three main macroeconomic goals for any nation.
   a. The first is economic growth.
   b. The second goal is high levels of employment
   c. third macroeconomic goal is stable price levels.

View of Economists

Adam Smith

Adam Smith is often described as a bold Advocate of Free Markets and Minimal Governmental Activity except in areas of-

- National Defense, Establishment and Maintenance of Highly beneficial Public, Maintenance of Justice, Public Works

Richard Musgrave

Richard Musgrave, in his classic treatise "**The Theory of Public Finance" (1959)** introduced the three-branch taxonomy of the role of Government functions in a Market Economy. -

1. **Allocation Function (Efficiency Focus)-** Aims to correct the sources of inefficiency in the Economic System
2. **Distribution Function (fairness focus**)- Ensures that the Distribution of Wealth and Income is fair and equitable.
3. **Stabilization Function (to ensure price stability)-** Covers Monetary and Fiscal Policy, ensuring Macro-economic stability, Maintenance of High Levels of Employment and Price Stability etc.

The allocation and distribution functions are primarily microeconomic functions, while stabilization is a macroeconomic function.

Allocation Function

1. **Meaning: Optimal or efficient allocation of scarce resources** means that the available resources are put to their best use and no wastages are there.
2. The private sector resource allocation is characterized by market supply and demand and price mechanism as determined by consumer sovereignty and producer profit motives.
3. The state's allocation, on the other hand, is accomplished through the revenue and expenditure activities of governmental budgeting.
4. In its allocation role, the government acts as a complement rather than as a substitute to the market system in an economy.

Reason for Government Intervention in allocation:

1. Public goods will not be produced in sufficient quantities by the market.
2. Nonexistence of markets in a variety of situations.
3. Government intervention will improve in social welfare.

Market failures which hold back the efficient allocation of resources

1. **Imperfect competition and presence of monopoly power**
2. Incomplete markets
3. Externalities Factor
4. Imperfect information
5. Inequalities in the distribution of income and wealth

A variety of allocation instruments are available by which governments can influence resource allocation in the economy.

1. Government may **directly produce** the economic good
2. Government may **influence private allocation** through incentives and disincentives
3. Government may influence **allocation through its competition policies**,
4. Government **sets legal and administrative frameworks**, and

Re-distribution Function

1. The distributive function of budget is related to the basic question of '**for whom**' should an economy produce goods and services.
2. Governments can redistribute income and wealth either through the **expenditure side or through the revenue side of the budget**.
3. On the expenditure side, **governments may provide free or subsidised education, healthcare, housing, food and basic goods etc. to deserving people**.
4. On the revenue side, **redistribution is done through progressive taxation**.

The distribution function of the government aims at-

1. **Equitable Distribution** ensuring increased overall social welfare
2. **Well-being** of those members of the society who suffer from deprivations of different types
3. Providing **equality** in income, wealth and opportunities
4. Providing security for people who have **hardships**, and
5. Ensuring that everyone enjoys **a minimal standard of living**.

Redistribution function/ market intervention for socio- economic reasons performed by governments are:

1. **Progressive taxation** policies of the government
2. Proceeds from progressive taxes used for financing public services, especially those that benefit low-income households
3. **Employment reservations**
4. families below the poverty line are provided with monetary aid and aid in kind
5. **Special schemes for backward regions** and for the vulnerable sections of the population

However, Redistribution measures should be accomplished with minimal efficiency costs by carefully balancing **equity and efficiency** objectives-comment

Stabilization Function

1. Macroeconomic stability is said to exist when:
    a) an economy's output matches its production capacity,
    b) the economy's total spending matches its total output
    c) the economy's labour resources are fully employed, and
    d) Inflation is low and stable.
2. Stabilization function of the government is derived from the Keynesian proposition that *a market economy does not automatically generate full employment and price stability and therefore the governments should pursue deliberate stabilization policies*.
3. Business cycles are ***natural phenomena*** &***market mechanism is limited in its capacity*** to prevent it.
4. In the absence of appropriate corrective intervention it may be ***prolonged for longer periods***.
5. The stabilization issue also becomes more complex as the increased international interdependence (**"Contagion effect"**).
6. Thus, The stabilization function is one of the key functions of fiscal policy and ***aims at eliminating macroeconomic fluctuations arising from suboptimal allocation***.
7. The stabilization function is concerned with the performance of the aggregate economy in terms of:
    a) labour employment and capital utilization,
    b) overall output and income,
    c) general price levels,
    d) balance of international payments, and

e) the rate of economic growth.

8. Monetary policy works through controlling the size of money supply and interest rate in the economy.
9. Fiscal policy by means of its expenditure and taxation decisions.

Centre and State Finance

1) **Fiscal federalism**, a term introduced by Richard Musgrave, deals with the division of governmental functions and financial.
2) Musgrave argued that the **federal or central government should be responsible for economic stabilization and income redistribution**, and the **allocation of resources** should be the **responsibility of the state and local governments.**
3) India is a federation of 28 states and 8 union territories.
4) **The constitution of India** has provided for the division of powers between the central and the state governments.
5) **Article 246 of the Constitution demarcates the powers of the union and the state** by classifying their powers into three lists, namely union list, state list and the concurrent list.
    i. **The union list** contains items on which the union parliament alone can legislate
    ii. **The state list** has items on which the state legislative assemblies alone can legislate
    iii. **The concurrent list**, on which both the parliament and the legislative assemblies can legislate. In the event of conflicting legislation in concurrent list, the law passed by the centre prevails.
6) The central government has greater revenue raising powers. The union government can levy taxes such as *tax on income, other than agricultural income, customs and export duties, excise duties on certain goods, corporation tax, tax on capital value of assets excluding agricultural land, terminal taxes, security transaction tax, central GST, union excise duty, taxes other than stamp duties etc.*
7) The state governments can levy taxes *on agricultural income, lands and buildings, mineral rights, electricity, vehicles, tolls, professions, collect land revenue and impose excise duties on certain items.*
8) The property of the union is exempt from state taxation. The property and income of the states are not liable to be taxed by the centre.
9) Articles 268 to 281 of the constitution contain specific provisions in respect of distribution of finances among states.

Distribution of revenue between the union and states is based on the constitutional provisions as follows:

1) The **Finance Commission** is a constitutionally mandated body that is at the centre of fiscal federalism.
2) The Finance Commission helps in maintaining fiscal federalism in India by performing following functions:
    (a) The **distribution between the union and the states of the net proceeds of taxes**.
    (b) **Determination of principles and quantum** of grants-in-aid to states which are in need of such assistance.
    (c) To **make recommendations to the President** on measures needed to augment (increase) the consolidated fund of a state.

- *The Fifteenth Finance Commission was constituted on 27, November 2017 against the background of the abolition of Planning Commission and the introduction of the goods and services tax (GST). The commission recommended the share of states in the central taxes (vertical devolution) for the 2021-26 to be 41%, which is the same as that for 2020-21.*
- *The criteria for distribution of central taxes among states for 2021-26 period are same as that for*

2020-21. They is ***Income Distance i.e the distance of a state's income from the state with the highest income.***

Area , **P**opulation (2011), **D**emographic performance (to reward efforts made by states in controlling their population), **F**orest and ecology, **T**ax and fiscal efforts:

GST: - Background and facts

1. The introduction of GST, which was rolled out across the country on 1 July 2017.
2. The GST subsumes the majority of indirect taxes – excise, services tax, sales tax, octroi (entry tax). The GST has made India's indirect tax regime unitary in nature.
3. The states levy and collect state GST (SGST) and the union levies and collects the central GST (CGST).
4. For any particular good or service or a combination of the two, the SGST and CGST rates are equal. An integrated GST (IGST) is applied on inter-state movement of goods and services and on imports and exports..
5. During the five-year transition period, the top five GST compensation-receiving states were Maharashtra, Karnataka, Gujarat, Tamil Nadu, and Punjab.
6. As per the supreme court verdict in May 2022, the Union and state legislatures have "equal, simultaneous and unique powers "to make laws on Goods and Services Tax (GST) and the recommendations of the GST Council are not binding on them.

THE PROCESS OF BUDGET MAKING: SOURCES OF REVENUE, EXPENDITURE MANAGEMENT AND MANAGEMENT OF PUBLIC DEBT

1. A Budget is a statement that presents the details of **'where the money comes from'** and **'where the money goes to'.**
2. The government budget is a document presented for approval and legislation by a government.
3. The budget also contains estimates of the government's accounts for the next fiscal year called **budgeted estimates.**
4. Need for Government Budget: Budget is required -
    a) To efficiently allocate limited resources to ensure maximum social welfare.
    b) To reallocate resources in accordance with its declared priorities.
    c) To ensure redistribution of Income and Wealth.
    d) For Reduction/ elimination of economic fluctuations to bring in stability, sustainable increase in real GDP and reduction in regional Disparities.

THE PROCESS OF BUDGET MAKING

1. The budget is prepared by the Ministry of Finance in consultation with NITI Aayog and other relevant ministries.
2. Despite the fact that the union budget is presented on1st February, the process of budget preparation commences in August-September of the previous year.
3. **Annual Financial statement**:.
4. The budgetary procedures are -
   a. *Preparation of the budget*
   b. *Presentation and enactment of the budget and*
   c. *Execution of the budget*
5. The budget process mainly consists of two types of activities:
   a. The administrative process,;
   b. The legislative process.

The budget speech of the Finance Minister is usually in two parts.

The finance minister makes a detailed budget speech at the time of presenting the budget before the Lok-Sabha.

A. **Part A of the budget speech gives an outline of the prevailing macro economic situation of the country and the budget estimates for the next financial year**

B. **Part B of the budget speech details the progress**

C. **The Annual Financial Statement** shows the **receipts and expenditure** of government in three separate parts under which government accounts are maintained, namely:
   a. Consolidated Fund of India
   b. Contingency Fund of India, and the
   c. Public Account.

D. The expenditures of certain categories (e.g. the emoluments and allowances of the President of India and his/her office, and emoluments of Judges of supreme courts and high ranking personnel of constitutional bodies across India) are 'charged' on the Consolidated Fund of India and are not subject to the vote of parliament, are also indicated separately in the budget.

E. *By convention in an election year, the budget may be presented twice. The first one is to first to secure a Vote on Account for a few months. This is followed by the Annual financial statement for that year or the full-fledged Budget.*

F. The Parliament has to pass the Finance Bill within 75 days of its introduction.

SOURCES OF REVENUE

The broad sources of revenue are:

1. The **Department of Revenue of the Ministry of Finance** exercises control in respect of the revenue matters relating to **direct and indirect union taxes**. The department is also administering goods and services tax (GST), central sales tax, stamp duties too.
2. The Department of Revenue exercises control in respect of matters relating to all the direct and indirect union taxes through two statutory boards, namely,

a) the Central Board of Direct Taxes (CBDT) - Matters relating to the levy and collection of all direct taxes
b) the Central Board of Indirect Taxes and Customs (CBIC). - Matters relating to the levy and collection of all indirect taxes (GST, Customs and central excise duties, service tax)

3. Government receipts are classified under two categories:

a) Revenue receipts		b) Capital receipts	
Tax revenue	Non tax revenue.	debt capital receipts	non debt capital receipts
1. Corporation tax 2. Taxes on income 3. Wealth tax 4. Customs duties 5. Union excise duties 6. Goods and services tax including GST compensation cess 7. Taxes on union territories	1. Interest receipts, 2. Dividends and profits from public sector enterprises and surplus transfers from Reserve Bank of India 3. Other Non-tax revenues and 4. Receipts of union territories	1. Market loans for different purposes 2. Short term /Treasury bill borrowings 3. Securities issued against small savings, 4. State provident fund (Net) 5. Net external debts 6. Other receipts (Net)	1. Recoveries of loans and advances 2. Miscellaneous capital receipts (disinvestments and others)

- **Debt capital receipts** Comprise of market loans and short term borrowings by the government, borrowing from the Reserve Bank of India and loans taken from foreign governments/institutions.
- **Non debt capital receipts** include recoveries of loans advanced by the government to PSEs, state governments, foreign governments and union territories and sale proceeds of government assets, including those realized from divestment of government equity in public sector undertakings (PSUs).

PUBLIC EXPENDITURE MANAGEMENT

1. The **Department of Expenditure of the Ministry of Finance** is the nodal department for overseeing the public financial management system. It is responsible for
   a. the implementation of the recommendations of the Finance Commission,
   b. monitoring of audit comments/observations, and preparation of central government accounts.
   c. Additionally, it also assists central ministries/departments in
   d. controlling the costs and prices of public services,
   e. reviewing systems and procedures to optimize outputs and outcomes of public expenditure.

In Expenditure budget, the Central government expenditure is classified into six broad categories as below:

A. Centre's Expenditure:

a) Establishment Expenditure of the Centre- includes establishment-related expenditure of the ministries/departments, and attached and subordinates offices.
b) Central sector schemes- include those schemes which are entirely funded and implemented by the central agencies under union government ministries/departments.
c) Other central expenditures including those on CPSEs and Autonomous Bodies

B. Centrally Sponsored Schemes and other Transfers: The transfers include
   a) Centrally sponsored schemes
   b) Finance Commission transfers and
   c) Other transfers to states

PUBLIC DEBT MANAGEMENT

1. In emerging market and developing economies, **the government is generally the largest borrower**.
2. Government debt from internal and external sources contracted in the Consolidated Fund of India is defined as Public Debt.
3. **Public debt management refers to the task of determining and implementing the strategy, by the fiscal and monetary authorities, the size and composition of debt, the maturity pattern, interest rates, redemption of debt etc**
4. Debt management strategy is based on three broad pillars namely, ***low cost of borrowing, risk mitigation and market development.***

5. The **institutions responsible for public debt management are:**
   a) **Internal Debt Management Department (IDMD) (28 states and 2 UT)** – Division of RBI
   b) **External Debt - Department of Economic Affairs in Ministry of Finance (MOF)**
   c) **Ministry of Finance; Budget** Division and Reserve Bank of India – Other liabilities such as small savings, deposits, reserve funds etc.

6. **The Fiscal Responsibility and Budget Management (FRBM) was passed in 2003** to provide a legislative framework for reduction of deficit and thereby debt of the central government. The objectives of the act are:
   a) inter-generational equity in fiscal management,
   b) long run macroeconomic stability,
   c) better coordination between fiscal and monetary policy, and
   d) Transparency in fiscal operation of the government.

Budget concepts (Type of budgets)

surplus budget	• When estimated government receipts are more than the estimated government expenditure it is termed as surplus budget.
deficit budget	• When estimated government receipts are less than the government expenditure.
Balanced budget	• A balanced budget is a budget in which revenues are equal to expenditures.
Unbalanced budget	The budget may either be surplus or deficit.
Capital Receipts	• Capital receipts are those receipts that lead to a reduction in the assets or an increase in the liabilities of the government.
Revenue Receipts	• Revenue receipts can be defined as those receipts which neither create any liability nor cause any reduction in the assets of the government. • There are two sources of revenue receipts for the government — tax revenues and non-tax revenues.
Capital Expenditure	• There are expenditures of the government which **result in creation of physical or financial assets or reduction in financial liabilities**.

Revenue Expenditure	• Revenue expenditure is expenditure incurred for purposes **other than creation of physical or financial assets** of the central government.
Revenue Deficit	• The revenue deficit refers to the excess of government's revenue expenditure over revenue receipts. • Revenue deficit = Revenue expenditure – Revenue receipts
Budgetary Deficit or Overall Deficit	• Budgetary Deficit is defined as the excess of total estimated expenditure over total estimated revenue, both revenue and capital.
Fiscal Deficit	• Fiscal deficit is the difference between the government's total expenditure and its total receipts **excluding borrowing** (non-borrowed receipts). • Fiscal Deficit = Revenue Deficit + (Capital Expenditure - Capital Receipts excluding borrowing) • The fiscal deficit will have to be financed by borrowing.
Primary Deficit	• Primary deficit is **defined as fiscal deficit of current year minus interest payments on previous borrowings.** • **Primary deficit = Fiscal deficit – Net Interest liabilities**
Finance Bill	The Bill produced immediately after the presentation of the union budget detailing the Imposition, abolition, alteration or regulation of taxes proposed in the budget.
Outcome budget	• The outcome budget measures **budgetary allocations of schemes and its annual performance targets measured through output and outcome indicators.**
Guillotine	• The parliament has very limited time for examining the expenditure demands of all the ministries. • Once the prescribed period for the discussion on demands for grants is over, the speaker of Lok Sabha puts all the outstanding demands for grants, whether discussed or not, to the vote of the house. This process is popularly known as 'Guillotine'.
Cut Motions	• Motions for reduction to various demands for grants are made in the form of cut motions seeking to reduce the sums sought by government on grounds of economy or difference of opinion on matters of policy or just in order to voice a grievance.
Consolidated Fund of India	• All revenues received, loans raised and all moneys received by the government in repayment of loans are credited to the Consolidated Fund of India • All expenditures of the government are incurred from this fund.
Contingency Fund of India	• A fund placed at the **disposal of the President** to enable him/her to make advances to the executive/Government to meet urgent unforeseen expenditure. • Contingency fund enables the government to meet unforeseen expenditure and does not require prior legislative approval.
Public Account	• Under provisions of Article 266(1) of the Constitution of India, public account is used in relation to all the fund flows where government is acting as a banker. • Examples include Provident Funds and Small Savings. • This money does not belong to government but is to be returned to the depositors. • The expenditure from this fund need not be approved by the parliament.

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Fiscal Policy – Meaning and Objective

Meaning:

1. *Fiscal policy involves the use of* ***government spending, taxation and borrowing*** *to influence both the pattern of economic activity and level of growth of aggregate* **demand, output and employment.**
2. Fiscal policy is in the nature of a demand-side policy.
3. An economy which is producing at full-employment level does not require government action in the form of fiscal policy.

Objective of Fiscal policy:

1. Achievement and maintenance of full employment,
2. Maintenance of price stability,
3. Acceleration of the rate of economic development, and
4. Equitable distribution of income and wealth,

The importance as well as order of priority of these objectives may vary from country to country and from time to time.

Discretionary fiscal policy

1) Discretionary fiscal policy refers to a ***deliberate policy actions*** on the part of the government to change the levels of expenditure and taxes to influence the level of national output, employment, and prices.
2) Discretionary Policies seek to address the GDP measure [i.e. GDP = C + I + G + (X – M)], Where C = Private Consumption, I = Private Investment, G = Government spending, (X – M) = Net exports.
3) Governments can influence economic activity (GDP) by controlling G directly and influencing C, I, and (X – M) indirectly through changes in taxes, transfer payments and expenditure policies.

Non- Discretionary fiscal policy

1) Non- discretionary fiscal policy or automatic stabilizers are part of the structure of the economy and are *'built-in'* fiscal mechanism that operates **automatically** to reduce the expansions and contractions of the business cycle.
2) It occurs when there is changes in economic conditions cause government expenditures and taxes automatically.
3) Example: personal income tax, corporate income tax, and transfer payment.

Explanation

1. **Automatic Stabilizers during Recession when incomes are reduced**
   a) ***Progressive tax structure***
   b) Government expenditures & ***transfer payments***
2. **Automatic Stabilizers during Inflation/ Demand-pull inflation**
   a) ***Progressive tax structure***
   b) Government expenditures & ***transfer payments***

Four Instruments/ tools of Fiscal Policies

Taxes	***Taxes determine the size of disposable income*** in the hands of the general public. **Action during Inflation-** **Action during Recession**
Government expenditure	Government expenditures include: 1. **current expenditures** to meet the day to day running of the government, 2. **capital expenditures** which are in the form of investments made by the government in capital Equipments and infrastructure, and 3. **Transfer payments** i.e. pension, unemployment allowance **During a recession and impact of Multiplier** **During Expansion/ Inflation phase**- **There are two concepts of public spending during depression- 'pump priming' and 'compensatory spending'.** 1. Pump priming assumes that when private spending becomes deficient, certain volumes of public spending will help to revive the economy. 2. Compensatory spending is said to be resorted to when the government spending is carried out with the obvious intention to compensate for the deficiency in private investment.
Public Debt	**Meaning and Types:** 1. Public debt may be *internal* or *external*; 2. when the government borrows from its own people in the country, it is called **internal debt.** 3. When the government borrows from outside sources, the debt is called **external debt.** 4. Public debt takes two forms namely, **market loans** and **small savings.** 5. **In the case of market loans**, the government issues treasury bills and government securities . 6. **The small savings** represent public borrowings, which are not negotiable and are not bought and sold in the market. **Action During Inflation:** **Action During Recession:**
Budget	**Action during Recession:** **Action during Inflation:**

Types of Fiscal

There are two basic types of Fiscal- **Expansionary and contractionary**

	Expansionary Fiscal policy	Contractionary Fiscal Policy
When Used?	Expansionary fiscal policy is designed to **stimulate** the economy- 1. During the contractionary phase of a business cycle. 2. When there is an anticipation of a business cycle contraction.	Designed to **restrain** the levels of economic activity of the economy - 1. During an Inflationary phase. 2. When there is anticipation of a business-cycle expansion which is likely to induce inflation.
Scenario	1. Decline / slump in overall economic activity, 2. Decline in Real Income (Real GDP) 3. Higher rates of unemployment 4. Fall in aggregate demand (i.e demand-deficit recession), 5. Production of lower quantity of goods and services	1. Increase in Aggregate Demand (i.e. Demand-pull inflation) 2. Increase in economic activities of consumption and Investment, due to higher levels of disposable incomes with households and firms, 3. higher factor prices, leading to higher cost of producing goods.
Tools	• Lower personal and corporate taxes, • Higher levels of Government spending. • Reduction in Government borrowing and • Higher budget deficit or reduced surplus	• Higher personal and corporate taxes • Reduced levels of Government spending • Increase in Government Borrowing, and • Smaller Budget deficit or higher surplus
Gap	1. A recessionary gap, also known as a contractionary gap, is said to exist if the existing levels of aggregate production is less than what would be produced with full employment of resources.	1. Inflationary Gap or Expansionary Gap- 2. It arises Aggregate demand rises beyond what the economy can potentially produce by fully employing its given resources.

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National Debt

- A Nation's debt is the difference between its Total Past Deficits and its total Past surpluses
- If a government as borrowed money over the years to finance its deficits and has not paid it back through accumulated surplus, then it is said to be in Debt.
- A surplus budget reduces National Debt and a deficit budget will add to the National Debt.

FISCAL POLICY FOR LONG-RUN ECONOMIC GROWTH

- When government supports building a modern infrastructure, the private sector is provided with the requisite overheads it needs.
- Government provision of public goods such as education, research and development etc. provide momentum for long-run economic growth.
- A well-designed tax policy that rewards innovation and entrepreneurship, without discouraging incentives will promote private businesses who wish to invest and thereby help the economy grow.

Fiscal policy for Reducing Inequality

Means and Methods:

1. **Direct Tax:**

2. **Indirect taxes**

Government Spending on Expenditure:

1. Redistributing income from the rich to the poorer sections of the society.
2. Poverty alleviation programmes. free or subsidized medical care, education, housing, essential commodities etc. to improve the quality of living of poor
3. Infrastructure provision on a selective basis
4. Various social security schemes such ad old-age pensions, unemployment relief.
5. Subsidized production of products of mass consumption
6. Public production and/ or grant of subsidies to ensure sufficient supply of essential goods, and
7. Strengthening of human capital for enhancing employability etc.

Shortcoming and Limitations of Fiscal policy

1. **Timing Problem:** Discretionary fiscal policy may create more problems due to time delays (i.e lags) which include-
   a) Recognition Lag- Delay in recognizing the economy's problems, and the need for Government Intervention,
   b) Decision Lag- Delay in evaluating the possible alternative policies, and in deciding the most appropriate policy
   c) Implementation Lag- Delay in evaluating the possible alternative policies, and in deciding the most appropriate policy,
   d) Impact Lag- outcomes of a policy are not visible for some time.

2. The effect of this is that Fiscal Policy changes may at times be badly timed, so that it is highly possible that an expansionary policy is initiated when the economy is already on a path of recovery and vice-versa

3. **Government constrains:**
   - Difficulties in instantaneously changing governments' spending and taxation policies.
   - Difficult to reduce government spending on various items such as defense and social security as well as on huge capital projects which are already midway.
   - Public works cannot be adjusted easily along with movements of the trade cycle because many huge projects such as highways and dams have long gestation period. Besides, some urgent public projects cannot be postponed for reasons of expenditure cut to correct fluctuations caused by business cycles.

4. There are **possible conflicts** between different objectives of fiscal policy.

5. Supply-side economists are of the opinion that certain fiscal measures will cause disincentives. For example, increase in profits tax may adversely affect the incentives of firms to invest and an increase in social security benefits may adversely affect incentives to work and save.

6. **Negative effect of Deficit financing**: Deficit financing increases the purchasing power of people. The production of goods and services, especially in under developed countries may not catch up simultaneously to meet the increased demand. This will result in prices spiraling beyond control.

7. Increase is government borrowing creates perpetual burden on even future generations as debts have to be repaid.

8. **"Crowding Out" Effect:** If Governments compete with the private sector to borrow money for spending, this may cause interest rates to go up. Firms' willingness to invest may be reduced. Individuals too may be reluctant to borrow and spend and the desired increase in Aggregate demand may not be realized.

Crowding out

Meaning and Example:

1. When spending by government in an economy **replaces** private spending, the private sector is said to be crowded out. (Note: Government spending has to "Support" and "enhance" private spending not merely "replace" it.)
2. "Crowding out" effect is the negative effect that a fiscal policy may generate, when money from the private sector is "crowded out" to the public sector.

Impact on Investment:

1. **High Interest Rate-**

2. **Impact on market's ability of self-correction:**

Positive Aspects-

- a) during deep recessions, crowding-out is less likely to happen as private sector investment is already minimal and therefore there is only insignificant private spending to crowd out.
- b) Moreover, during a recession phase the government would be able to borrow from the market without increasing interest rates.

CHAPTER- 8 MONEY MARKET

1. Money- Meaning and Basics

1. Money refers to assets which are commonly used and accepted
   - **as a means of payment** or **Exchange**
   - **medium of transferring purchasing power**
   - **store of value, which means people can save it and use it later—smoothing their purchases over time**

2. To put it a different way, money is something that holds its **value over time**, can be **easily translated into prices**, and is **widely accepted**. Many different things have been used as money over the years—among them, cowry shells, barley, peppercorns, gold, and silver.

3. For **policy purposes,** money may be defined as the **set of liquid financial assets**, the **variation in the stock** of which will have **impact on aggregate economic activity**.

4. **Anything that would act as a medium of exchange is not necessarily money**. For example, a bill of exchange may also be a medium of exchange, but it is not money since it is not generally accepted as a means of payment. Money is a totally liquid asset as it can be used directly, instantly, conveniently and without any costs or restrictions to make payments.

5. **Currency which represents money does not necessarily have intrinsic value**. As you know, fiat money has no intrinsic value, but is used as a medium of exchange because the government has, by law, made them "legal tender," which means that they serve by law as means of payment

6. In modern days, money is not necessarily a physical item; it may also constitute **electronic records.**

7. Fiat money is **materially worthless**, but has value simply because a nation collectively agrees to **ascribe a value to it**. In short, money works because people believe that it will.

2. Characteristics of Money

Money, though not having any inherent power to directly satisfy human wants, by acting as a medium of exchange, it commands purchasing power and its possession enables us to purchase goods and services to satisfy our wants.

Following are the important characteristics of Money-

- Generally **A**cceptable
- Durable or **L**ong-lasting
- Effortlessly **R**ecognizable.
- Difficult to **C**ounterfeit i.e. Not easily reproducible by people
- Relatively **S**carce, but has elasticity of supply
- **P**ortable or easily transported
- Possessing **U**niformity;

- Divisible into smaller parts in usable quantities or fractions without losing value.

There are few other features of money

- **Better than barter:** By decomposing the single barter transaction into **two separate transactions of sale and purchase**, money eliminates the need for **double coincidence of wants.**
- **Common Measure of value:** It is convenient to measure the prices of all commodities in terms of a single unit, rather than record the relative price of every good in terms of every other good.
- **Comparability:** Goods and services which are otherwise not comparable are made comparable through expressing the worth of each in terms of money.
- **Liquidity and Reversibility:** Additionally, money also commands reversibility as its value in payment equals its value in receipt. All assets other than money lack perfect reversibility in the sense that their value in **payment is not equal to their value in receipt**
- Liquidity refers to the extent to which financial assets can be sold at close to full market value at short notice. That is, they can easily be converted into another form of money, such as cash.

Unit 2: Demand for Money

1. Demand for Money

1. If people desire to hold money, we say there is demand for money.
2. As we are aware, the demand for money is in the nature of derived demand; it is demanded for its purchasing power.

The Demand for Money is because of two reasons-

a) Demand for **liquidity and demand to store value**. It represents the desire of people to hold money as an asset instead of *other assets like bonds in their asset portfolio*. Although it gives little or no return, individuals, households as well as firms hold money because it is liquid and offers the most convenient way to accomplish their day to day transactions.

b) People wish to have **command over real goods and services** with the use of money.

3. Demand for money has an important role in the determination of **interest, prices** and **income** in an economy.

2. Variables/ Factors on which Demand for Money depends

Sr. no	Factor	Nature of relationship	Relationship
1	Income and Expenditure	Direct	Higher the income and expenditure, higher will be the demand of the money. This is because with the higher income the tendency to expend will also rise and thus demand will also rise.
2	General price Index	Direct	If the general price index is high, one will try to hold money.
3	Interest (Opportunity cost)	Inverse	Opportunity cost is the interest rate a person could earn on other assets. Thus, higher the rate more will be temptation to invest in other assets.
4	Degree of Financial Innovation	Inverse	Financial innovation like internet banking, ATM, UBI based payments etc. reduces the need of holding the money. **Google pay and Paytm**

3. Theories of Demand for Money

Theories of Demand for Money:

- a) Quantity theory of Money (QTM) - Classical Approach or Fisher's Approach
- b) Cash Balance Approach - Neo-classical Approach or Cambridge Approach
- c) Liquidity Preference Theory - Keynesian Theory

Post Keynesian Theories –

- d) Inventory Approach- Baumol
- e) Friedman Theory, and
- f) Demand for Money as Behavior towards Risk-Tobin

4. Quantity Theory of Money [QTM]

1. The quantity theory of money was propounded by **Irving Fisher of Yale University** in his book '**The Purchasing Power of Money**' published in 1911.
2. QTM demonstrate that there is **strong relationship between money and price level**.
3. **Changes in the general level of commodity prices** or changes in the value or purchasing power of money are determined by **changes in the quantity of money in circulation**.
4. Fisher's version, also termed as ***'equation of exchange'*** or '***transaction approach'*** is formally stated as follows :
5. As per Fisher's approach-

- **Quantity of Money demanded = price level (P) x Total volume of transaction (T)= Supply of Money (MV+M'V')**
- **Therefore, MV= PT** (where only Actual money is considered and not credit money)
- **And MV+M'V' = PT** (where both Actual and Credit money is used)(Credit money means demand deposits by bank)

Here,

i. M= Total Amount of Money in circulation
ii. V= Transaction Velocity of Circulation- means average number of times a **unit of money** is spent in purchasing goods and services
iii. M'= Total quantity of Credit Money
iv. V'= Velocity of Circulation of Credit money.
v. P= Average Price Level
vi. T= Total Number of Transactions- T is a function of national income. Since full employment prevails, the volume of transactions T is fixed in the short run.

6. Thus, more the number of transactions people want, greater will be the demand for money.

5. Cash balance approach/ Neo classic Approach/ Cambridge approach

1. In the early 1900s, Cambridge Economists **Alfred Marshall, A.C. Pigou D.H. Robertson** and **John Maynard Keynes** forward **neo-classical theory or cash balance approach.**
2. As per the Cambridge version the demand of the money is because of the following two reasons-
   a) enabling the possibility of split-up of sale and purchase to two different points of time rather than being simultaneous. i.e. avoiding double coincidence of wants. since the sale and purchase of commodity does not place simultaneously, they need temporary abode of purchasing power, **Transaction need**
   b) being a hedge against uncertainty. **Precautionary need.**

3. **Demand for Money= Proportion of income that people want to hold as cash (k) x income (PY).**

$$(M^d) = k\,PY$$

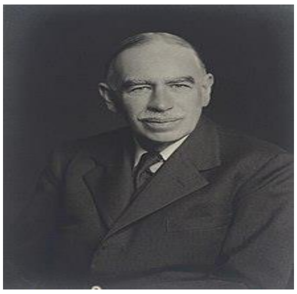
Where,

- Y = Real national income
- P = Average price level of currently produced Goods & services
- PY= Nominal Income
- K = Proportion of PY that people want to hold as Cash Balances

4. The term **'k'** in the above equation is called **'Cambridge k'**. This represents the portion of nominal income that people want to hold as cash balance.
5. Higher the income, higher will be the quantity purchased and thus greater money amount of money will be needed.

Liquidity theory of demand/ Keynesian Theory of Demand for Money

'Liquidity preference', a term that was coined by John Maynard Keynes in his masterpiece 'The General Theory of Employment, Interest and Money' (1936), denotes people's desire to hold money rather than securities or long-term interest-bearing investments.



According to Keynes, people hold money (M) in cash for three motives:

(i) Transactions motive,
(ii) Precautionary motive, and
(iii) Speculative motive.

Description

Transaction Motive

a) It is need for cash for current transaction for **personal and business (trade) exchange.**
b) This need arises due to timing gap between Receipt of Income and Planned Expenditures.
c) This need is further classified into- i) Income motive (for individuals & households), and ii) Trade

Motive (for Business Firms).

d) Transaction Demand is directly related to the level of Income not affected by interest rates.

e) Transactions Demand (Lr) = Earnings (Y) x Ratio of income which is kept for transaction purposes (k)

f) Keynes considered the aggregate demand for money for transaction purposes as the sum of individual demand and therefore, the aggregate transaction demand for money is a function of national income.

Precautionary Motive

a) Individuals & businesses keep a portion of their income to finance unforeseen, unpredictable and unanticipated Expenditures.

b) Precautionary demand depends on the **size of income, prevailing economic & political conditions and personal traits of the individual such as Optimism / pessimism, farsightedness etc**.

c) Precautionary Motive Cash Balances are considered **Income-Elastic** and by itself **not very sensitive to Rate of Interest.**

Speculative Motive

a) This need reflects people's desire to hold cash, in order to be equipped to **exploit any attractive investment opportunity requiring cash expenditure.** i.e. to take advantage of favorable business situation

b) The theory explains the portion of cash to be kept in asset portfolio depending upon the interest rate prevailing.

c) Higher the interest rate, lower the speculative demand for money, and vice-versa.

Explanation

1. According to Keynes, people demand to hold money balances to take advantage of the future changes in the rate of interest, which is the same as future changes in bond prices. It is implicit in Keynes theory, that the 'rate of interest', i, is really the return on bonds.
1. Keynes assumed that the expected return on money is zero, while the expected returns on bonds are of two types, namely:
   (i) the interest payment
   (ii) the expected rate of capital gain.
2. The market value of bonds and the market rate of interest are inversely related. A rise in the market rate of interest leads to a decrease in the market value of the bond, and vice versa.
2. Investors have a relatively fixed conception of the **'normal' or 'critical' interest rate R_C** and compare the **current rate of interest R_N** with such 'normal' or 'critical' rate of interest

Situation	**If current Rate (Rn) > Critical Rate (Rc)**	**If Current rate (Rn) < Critical Rate (Rc)**
Process	Investors expect a fall in the Interest Rate (rise in Bond Prices), and now they will convert their cash into Bonds since- a) They can earn high rate of return on Bonds. b) They expect Capital Gains resulting from a rise in Prices.	Investors expect a rise in Interest Rate (fall in Bond Prices), and hence they hold their wealth in Liquid Cash because- a) Loss, i.e Interest foregone is small. b) Anticipated capital losses (fall in prices) is avoided. c) Return on Money will be high than that on Bonds, d) Idle Cash held can be used to buy bonds at lower price and thereby.
Action	Asset Portfolio would consist only	Asset portfolio would consist wholly of

	of **Bonds.**	**Money/Cash.**

Summing up,

- ✓ so long as the current rate of interest is higher than the critical rate of interest, a typical wealth-holder would hold in his asset portfolio only government bonds,
- ✓ if the current rate of interest is lower than the critical rate of interest, his asset portfolio would consist wholly of cash.
- ✓ When the current rate of interest is equal to the critical rate of interest, a wealth-holder is indifferent to holding either cash or bonds.
- ✓ In this case discontinuity of Individual curve disappears & a continuous downward sloping function showing the Inverse Relationship between Interest Rate & Demand is obtained.

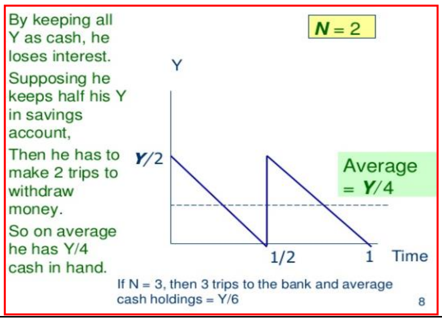
The concept of Liquidity Trap

1. Liquidity trap is a situation when expansionary monetary policy (increase in money supply) does not increase the interest rate, income and hence does not stimulate economic growth.
2. It is a situation in which the general public is prepared to hold on to whatever amount of money is supplied, at a given rate of interest. They do so because of the fear of adverse events like deflation, war. In a liquidity trap, the monetary policy is powerless to affect the interest rate.
3. There is a liquidity trap at short term zero percent interest rate. When interest rate is zero, public would not want to hold any bond, since money, which also pays zero percent interest, has the advantage of being usable in transactions.
4. In other words, investors would maintain cash savings rather than hold bonds. The speculative demand becomes perfectly elastic with respect to interest rate and the speculative money demand curve becomes parallel to the X axis. This situation is called a 'Liquidity trap'.
5. Since the opportunity cost of holding money is zero, even if the monetary authority increases money supply to stimulate the economy, people would prefer to hoard money.
6. Consequently, excess funds may not be converted into new investment. The liquidity trap is synonymous with ineffective monetary policy .
7. The Bank of Japan's experience is a real-life example of the Keynesian economic theory of a liquidity trap.

POST-KEYNESIAN DEVELOPMENTS

6. Inventory Approach

1. Baumol (1952) and Tobin (1956) developed a deterministic theory of transaction demand for 'real cash balance', known as Inventory Theoretic Approach.
2. Inventory models assume that there are two media for storing value-
   a. money & interest-bearing alternative financial asset.
3. As per Baumol, receipt of income, say Y takes place once per unit of time but expenditure is spread at a constant rate over the entire period of time.
4. There is a fixed cost of making transfers between money and the alternative assets e.g. broker charges.
5. Individual or business firms try to hold optimum cash balance so that balance between opportunity cost and transaction cost is met.
6. As per Baumol model, optimum cash balance is given by $(2AT/i)^{1/2}$.



By keeping all Y as cash, he loses interest.

Supposing he keeps half his Y in savings account,

Then he has to make 2 trips to withdraw money.

So on average he has Y/4 cash in hand.

If N = 3, then 3 trips to the bank and average cash holdings = Y/6

Where A= annual cash requirement

T= transaction cost/ transaction

I= interest/annum

7. FRIEDMAN'S THEORY

1. Milton Friedman (1956) extended **Keynes' speculative** money demand within the framework of asset price theory.
2. **Milton Friedman** (1956) treats the demand for money as for demand for **capital assets**.
3. Demand for money is affected by the same factors as demand for any other asset, namely
   a) Permanent income.
   b) Relative returns on assets. (which incorporate risk)

Explanation:

As per Friedman there are Four determinant of demand-

Factor	Particulars
Permanent Income	1. Friedman maintains that it is **permanent income** – and not current income as in the Keynesian theory – that determines the demand for money. 2. Permanent income which is Friedman's measure of wealth is the present expected value of all future income. 3. Permanent Income is calculated by discounting future cash incomes. 4. discount rate, defined as the average return on the five assets, namely ***money, bonds, equity, physical capital and human capital***
Price level	☐ If the price level rises the demand for money increases and vice versa. ☐ Thus, it's directly related to price level
Opportunity cost	☐ Nominal demand for money rises if the opportunity costs of money holdings (i.e. returns on bonds and stock) decline and vice versa. ☐ Thus, there is an inverse relationship between demand for money and opportunity cost
Inflation	☐ Nominal Demand for Money is influenced by inflation. A positive Inflation Rate reduces the real value of Money Balances, thereby increasing the opportunity cost of Money Holdings. ☐ Thus, there is an inverse relationship between demand for money and inflation

8. Demand for money as a behaviour towards risk

1. According to Tobin, an individual's behaviour shows risk aversion. (risk avoiding behavior)
2. If an individual chooses to hold a greater proportion of risky assets such as bonds or shares in his portfolio - then higher average return but higher degree of risk.
3. Therefore, people prefer a mixed or diversified portfolio of money, bonds and shares, with each person opting for a little different balance between risk and return.

Tobin's Liquidity Preference Function

Basics of theory: Tobin analysed that the **Risk – Avoiding behaviour of Individuals** provided the basis-

a. For the Liquidity Preference, and
b. For a negative relationship between the Demand for Money and the Interest Rate. If this payment is increased, Investor is willing to put a greater proportion of the Portfolio into the Risk Asset (i.e

Bonds) and thus a smaller proportion into money.

c. Thus, Demand for Money is primarily based on the Portfolio Management Principles.

Unit 3: Supply of Money

1. Meaning and introduction

1. "Money supply" denotes the **Total Quantity** of **Money** available to **the people in the economy**. The Quantity of money at any point of time is a measurable concept.
2. Supply of Money- Stock or Flow concept- It refers to the total amount of money **at any particular point of time**, thus it is a Stock Concept.
3. Change in the Stock of Money (i.e. increase or decrease per month or year), is a Flow Variable.
4. **Stock of Money in General Parlance-** Generally, Stock of money refers to the Stock of money available to **'Public'** as means of payments and store of value. Such stock of money is always less than the Total Stock of Money that really exists in an Economy.
5. **Meaning of Public-**

The term 'Public' includes all Economic Units-	**The term 'Public' excludes Producers of Money**
a) Households, Firms, and Institutions, b) Quasi-Governmental Institutions, c) Non- banking Financial Institutions, d) Non- Departmental Public Sector Undertakings, e) Foreign Central Banks and Foreign govt. f) International Monetary Fund which holds a part of Indian Money in India in the form of Deposits with RBI.	a) Government, which includes- • Central Government • All State Governments • Local Bodies. b) Banking System - • Reserve Bank of India & • All banks that accept Demand Deposits (Note)

Rationale of measuring supply of Money in Market-

Measurement of money is important because of two reasons-

1. Money supply analysis facilitates analysis of Monetary Developments to provide a **deeper understanding of the causes of Money Growth**.
2. It is important from monetary policy perspective as it provides a framework to evaluate **whether the stock of money in market is consistent with standard for price stability** and to understand nature of **deviation from standard**.
3. Also, the other reason is to stabilize Price level and GDP growth.

2. Sources of Money supply

Supply of the money in an economy depends upon-

a) Decision of **central bank**, and

b) The **supply responses of Commercial banking system** of country wrt. to policy of central bank. Commercial banks create **Credit Money** in an economy.

1. There are two broad sources of Money Supply, i.e **High Powered Money**, and **Credit Money**. These are explained as under-

	High Powered Money / Fiat Money i.e. Currency issued by the Central Bank	Credit Money, i.e. Money created by Commercial Banks
1	The **Central Banks** of all the countries are **empowered to issue Currency**. Therefore, the Central Bank is primary source of Money Supply in all Counties.	Total Money Supply in the Economy is also determined by the extent of Credit created by the Commercial Banks.
2	The Currency issued by the Central Bank is **'Fiat Money'** and is backed by supporting **Reserves and its value is guaranteed** by the Government. ***	Banks create Money Supply in the process of borrowing and lending transactions with the public.

Central Board Digital Currency and Crypto Currency

1. RBI is going step by step for the issuance of its own CBDC (Digital Rupee (e₹)), with minimal or no disruption to the financial system.
2. Reserve Bank broadly defines CBDC as the legal tender issued by a central bank in a digital form. It is akin to sovereign paper currency but takes a different form, exchangeable at par with the existing currency and shall be accepted as a medium of payment, legal tender and a safe store of value.
3. CBDCs would appear as liability on a central bank's balance sheet.

3. MEASUREMENT OF MONEY SUPPLY IN INDIA

1. From April 1977, following the recommendations of the Second Working Group on Money Supply (SWG), the RBI has been publishing data on four alternative measures of money supply denoted by M1, M2, M3 and M4 besides the reserve money. These are known as **Monetary Aggregates.**
2. Different aggregates represent different level of Liquidity. **M1 being most liquid and M4 being least liquid.**

3. The following table will explain what is included in Monetary Aggregates

Item	Computation
M1 – Narrow Money	Currency notes and coins with the Public + Net Demand Deposits of Banks (CASA Deposits) + Other Deposits with RBI. (Other than those held by government) Note: Net Demand Deposits = Total Demand Deposits **Less** Inter – Bank Deposits **(Also refer note below)**
M2	MI + Savings Deposits with Post Office Savings Banks.
M3- Broad Money	MI + Net time Deposits with the Banking System.
M4	M3 + Total deposits with Post Office Savings banks (excluding National Savings Certificates)

1.

NEW MONETARY AGGREGATES and LIQUIDITY AGGREGATES-

On the recommendations of the working' Group on Money (1998), RBI has started publishing 4 set of new Monetary aggregates on the basis of the Balance Sheet of the Banking Sector as per Progressive Liquidity Norms.

Reserve Money, NM1, NM2, NM3

1. **Reserve Money-** Reserve Money can be computed in two ways as under- Note: Net result is same in both.

Method 1 –	**Method 2-**
Currency in Circulation / held by public + Bankers' Deposits with the RBI - **Note:** These are Commercial Banks Deposits with RBI for maintaining Cash Reserve Ratio (CRR) & as Working Funds for clearing adjustments. +Other Deposits with the RBI	Net RBI Credit to Government +RBI Credit to Commercial Sector +RBI's Claims on Banks +RBI's Net Foreign Assets +Government's Currency Liabilities to the Public -RBI's Net Non- Monetary Liabilities.

a) Reserve Money is also known as **Central bank Money**, **Base Money** or **High- Powered Money**.

b) Management of Reserve Money is important to stabilize Liquidity, Growth & Price Level in an Economy.

Currency with the Public
Add: Demand Deposits with the Banking System
Add: Other Deposits with RBI
New Monetary Aggregate 1 (denoted as NMI)
Add: Short term Time Deposits of Residents (including and up-to Contractual maturity of 1 Year)
New Monetary Aggregate 2 (denoted as NM2)
Add: Long term time deposits of Residents
Add: Call / Term Funding from Financial Institutions
New Monetary Aggregate 3 (Denoted as NM3)
Add: All deposits with the Post Office Savings Banks (excluding National Saving certificates)
Liquidity Aggregate 1 (Denoted as L1)
Add: Term Deposits with Term Lending Institutions and Re-financing Institutions
Add: Term Borrowing by Financing Institutions and Certificates of Deposits issued by Financing Institutions
Liquidity Aggregate 2 (Denoted as L2)
Add: Public Deposits of Non- Banking Financial Companies
Liquidity Aggregate 3 (Denoted as L3)

4. DETERMINATION OF MONEY SUPPLY

The alternative approaches in respect of determination of Money Supply, are as under-

1. According to the first view, money supply is determined **exogenously** by the central bank.
2. According to Second view money supply is determined **endogenously** by changes in the economic activities which affect people's desire to hold currency relative to deposits, rate of interest etc.
3. Accordingly, supply of nominal money in the economy is determined by the **joint behavior** of the *central bank, the commercial banks and the public*.

Money Multiplier approach to supply of money- Milton Friedman & Anna Schwartz.

1. A one-rupee increase in the monetary base causes the money supply to increase by more than one rupee.
2. **Money multiplier m** is defined as ratio that relates change in money supply to the given change in monetary base. It denotes by how much money supply will change with change in monetary base

$$M = m \times MB$$

Money Multiplier = 1 /R

3. For example, if R =10%, the value of money multiplier will be 10. If the reserve ratio is only 5%, then money multiplier is 20.

4. Thus, the higher the reserve ratio, the less of each deposit banks loan out, and the smaller the money multiplier.

Credit Multiplier approach to supply of money-

1. Credit Multiplier:

a) It describes the amount of Additional Money created by Commercial Bank through the process of lending available Money in excess of the Reserve Requirement.
b) It reflects the bank's ability to increase the Money Supply.
c) It is also called "Deposit Multiplier" or "Deposit Expansion Multiplier".
d) Credit Multiplier = $\frac{1}{\text{Required Reserve Ratio}}$

1. Reserves may be as the result of-
   a. The regulations of the Central Bank (RBI) – referred as Statutory Reserves, or
   b. Decisions taken by the Commercial Banks themselves – referred as Excess Reserves.
2. **Excess Reserves and its Impact:** **Excess reserve represents the additional reserve maintained by** commercial bank with RBI over and above the minimum required ratio to be kept. 'Excess reserves' are the difference between total reserves (TR) and required reserves (RR). **Therefore, ER=TR-RR.**
   a. Excess Reserve is affected by the Cost and Benefits of holding such Reserves. For this purpose-
   b. **Cost** = Interest that could have been earned by giving these amounts as Loans, i.e Opportunity Cost,
   c. **Benefit** = Assurance as to adequate liquidity in the banking system, to meet withdrawal of Deposits by Public.
3. **These** costs and benefits are influenced by two factors, viz. **Market Interest Rates and Expected Deposits Outflows**, which have following impact-

Situation	Effect on excess Reserves
If interest rate increases	Banks will prefer to reduce Excess Reserves and give them as Loans to have higher earnings. So, the ratio of Excess Reserves to Deposits falls.
If Interest Rate decreases	Opportunity Cost of holding excess Reserves declines and Excess reserves will rise.
If deposit outflows are expected to increase	Banks will want more assurance against the possibility and will increase the Excess Reserves Ratio.
If deposit Outflows are expected to decrease	Decline in Expected Deposit Outflows will reduce Excess Reserves

Therefore, we conclude that the banking system's excess reserves ratio r is negatively related to the market interest rate.

5. DETERMINATION OF MONEY SUPPLY

Three factor as immediate determinants (also called as **'proximate determinants')** of money supply are-

a) the stock of high-powered money (H)
b) the ratio of reserves to deposits or reserve-ratio r = {Reserves/Deposits R/D} and
c) the ratio of currency to deposits, or currency-deposit ratio c={C/D}

A. Stock of High- Powered Money (H)

a) H (High-powered money) represents the behavior of the **Central Bank.**

b) With all other variables unchanged, Total Supply of Nominal Money will **vary directly with the Supply** of Nominal High – Powered Money.

B. Ratio of Reserves to Deposits (RDR)

a) RDR (Reserves to Deposits Ratio) represents the behaviour of the **Commercial Banks,** in determining Money Supply through "Credit Money".

b) Thus the **Inverse relation exists**.

C. Ratio of Currency to Deposits (CDR)

a) CDR represents the behaviour of the **General Public**, in determining Money Supply. It represents the behaviour of public to hold money in for of cash.

b) The time deposit-demand deposit ratio i.e. how much money is kept as time deposits compared to demand deposits, also has an important implication for the money multiplier and, hence for the money stock in the economy. An increase in **TD/DD ratio** means that greater availability of free reserves and consequent enlargement of volume of multiple deposit expansion and monetary expansion.

Impact of Other factors on Money Supply & Money Multiplier

Effect of Government expenditure on Money supply-

a) Whenever the Central and State Governments' cash balance falls short of the Minimum requirement, they are eligible to avail of the facility called **Ways & Means Advances (WMA) / Overdraft (OD) Facility.**

b) When Government incurs expenditure, it involves debiting Government balances with RBI, and Crediting the Receiver (e.g. Salary Account of Employee) Account with the Commercial Bank.

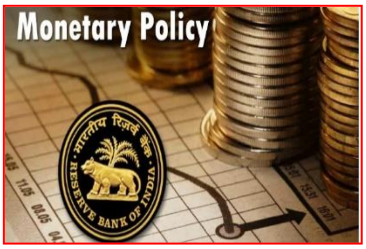
c) So, it results in generation of Excess Reserves, (i.e. excess balances of Commercial Banks with RBI).

d) Excess reserves thus created can potentially lead to an increase in Money supply through the Money Multiplier process e.g. When the Employee uses this money for making payments for purchase of goods etc.

Unit 4: Monetary Policy

Reserve Bank of India uses **monetary policy** to manage **economic fluctuations** and **achieve price stability**, which means that inflation is low and stable.

Reserve Bank of India conducts monetary policy by adjusting the supply of money, usually through buying or selling securities in the open market.



When central banks lower interest rates, monetary policy is easing. When it raises interest rates, monetary policy is tightening.

1. Monetary Policy

1. **Meaning:** Monetary Policy refers to the use of **Monetary Policy Instruments** which are at the **disposal of the Central Bank** for achieving various objectives.

2. **Monetary Policy refers to- Action programme** of the Monetary Authorities (Generally central bank), to **control and regulate Demand & Supply** of Money with the Public and flow of credit,With the view to **achieve predetermined** Macro-Economic **Goals**.

3. Monetary Policy encompasses all actions of the Central bank which are aimed at –
   - **Directly** controlling the **Money supply**, and
   - **Indirectly** at regulating the **Demand** for Money.
4. Monetary Policy is in the nature of **"demand-side"** Macro-economic Policy and works by stimulating or discouraging Investment and Consumption spending on Goods & services.

2. Monetary Policy Framework

In the execution of Monetary Policy, the Central Bank functions within a specified monetary policy Framework which has 3 components as under-

1. **Monetary Policy Objectives-** providing explicit Guidance to the Policy Makers.
2. **Analytics of Monetary Policy-** which focus on Transmission Mechanisms for implementation.
3. **Operating procedures-** which focus on operating targets and instruments.

Monetary Policy Objectives

1. The Reserve Bank of India Act, 1934 in its preamble sets out the objectives of RBI as "to **regulate the issue of Bank notes** and the **keeping of Reserves** with a view to securing **Monetary Stability** in India generally to **operate Currency and Credit System** of the country to its advantage".
2. **Prima Objectives:** The most common objectives of Monetary Policy of the Central Banks across the World are –
   - **Price Stability-** Establishment and Maintenance of stability in Prices (or controlling inflation)
   - **Economic Stability-** Maintenance of Full Employment and achievement of high level of economy's growth

5. for the following objectives-
   a. to **regulate** the availability, cost and use of Money & Credit,
   b. to promote **economic growth**,
   c. ensuring an adequate flow of credit to the productive sectors,
   d. sustaining - a moderate structure of interest rates to encourage investments, and
   e. creation of an efficient market for government securities.
   f. to ensure **Price Stability**,
   g. to achieve **optimum levels** of output and employment,
   h. to obtain Balance of Payments **equilibrium,**
   i. to ensure **stable currency**, or

What is an Impact of Conflicting Objectives?

Based on the pre-determined National Priorities, the Monetary Policy Makers must exercise appropriate trade-offs to balance the conflicting objectives.

3. Analytics of Monetary Policy – Transmission Mechanism for Implementation

The process or **Channels** through which the **change of Monetary Aggregate** affects the level of **Product and Prices** is known as "Monetary Transmission Mechanism". It describes how policy – induced changes in the nominal Money Stock / Short – Term Nominal Interest Rates impact real variables like Aggregate Output and Employment.

In simple terms, the transmission can be summarised in two stages.

i. Changes to monetary policy affect interest rates in the economy.

ii. Changes to interest rates affect economic activity and inflation.

A. Saving and Investment Channel

Monetary policy influences economic activity by **changing the incentives for saving and investment.**

- **Lower interest rates on bank deposits-** induce to **save Less** their money >>>> Induce to **spend their money more** on goods and services >>>>> encourage households to borrow more
- **Lower lending rates -** can increase investment spending by businesses as the cost of borrowing is lower >>>>> Increases demand too >>>>> returns on these projects are now more than the cost of borrowing.

B. Cash-flow Channel

Monetary policy **influences interest rates**, which affects the decisions of households and businesses by changing the amount of cash they have available to spend on goods and services.

- A reduction in lending rates - reduces interest repayments on debt >>>>> increasing the amount of cash available for households and businesses >>>>>>leaving them with more disposable income.
- A reduction in lending rates - reduces the amount of income from deposits >>>>>> and restrict their spending.
- 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)

C. Asset Prices and Wealth Channel

- The asset prices and wealth channel typically affects consumption and investment.
- Lower interest rates support asset prices (such as housing and equities) by encouraging demand for assets than debt instruments.
- Higher asset prices also increase the equity (collateral) of an asset that is available for banks to lend against. This can make it easier for households and businesses to borrow.
- An increase in asset prices increases people's wealth. This can lead to higher consumption and housing investment as households generally spend some share of any increase in their wealth.

D. Exchange Rate Channel

- The exchange rate can have an important influence on economic activity and inflation.
- It is typically more important for sectors that are export-oriented or exposed to competition from imported goods and services.

- If the Reserve Bank lowers the cash rate it means that interest rates in India have fallen compared with interest rates in the rest of the world
- Lower interest rates reduce the returns investors earn from assets in India. Lower returns reduce demand for assets in India, with investors shifting their funds to foreign assets (and currencies) instead.
- A reduction in interest rates (compared with the rest of the world) results in a lower exchange rate, making foreign goods and services more expensive compared with those produced in India. This leads to an increase in exports and domestic activity. A lower exchange rate also adds to inflation because imports become more expensive in Indian rupees.

Effectiveness: The effectiveness of different Channels function depends on

1. Stage of Development of the Economy, and
2. Underlying Financial Structure of the Economy.

4. Operating Procedures and Instruments

Quantitative tools – The tools applied by the policy that impact money supply in the entire economy, including sectors such as manufacturing, agriculture, automobile, housing, etc.

1. **Reserve Ratio** Banks are required to keep aside a set percentage of cash reserves or RBI approved assets. Reserve ratio is of two types:
   a. **Cash Reserve Ratio (CRR)** – Banks are required to set aside this portion in cash with the RBI. The bank can neither lend it to anyone nor can it earn any interest rate or profit on CRR.
   b. **Statutory Liquidity Ratio (SLR)** – Banks are required to set aside this portion in liquid assets such as gold or RBI approved securities such as government securities. Banks are allowed to earn interest on these securities, however it is very low.

2. **Open Market Operations (OMO)** -In order to control **money supply and inflation**, the RBI buys and sells government securities in the open market. These operations conducted by the Central Bank in the open market are referred to as Open Market Operations.
   a. When the RBI sells government securities, the liquidity is sucked from the market,
   b. when RBI buys securities the liquidity is injected from the market
   c. The objective of OMOs are to keep a check on temporary liquidity mismatches in the market, owing to foreign capital flow.

3. **Qualitative tools** - Unlike quantitative tools which have a direct effect on the entire economy's money supply, qualitative tools are selective tools that have an effect in the money supply of a specific sector of the economy.
   a. **Margin requirements** – The RBI prescribes a certain margin against collateral, which in turn impacts the borrowing habit of customers. When the margin requirements are raised by the RBI, customers will be able to borrow less.
   b. **Moral suasion** – By way of persuasion, the RBI convinces banks to keep money in government securities, rather than certain sectors.
   c. **Selective credit control** – Controlling credit by not lending to selective industries or speculative businesses.

4. **Market Stabilisation Scheme (MSS) –**
   - a. It was introduced following MOU between RBI and the Government of India with the primary aim of aiding the Sterilization Operations of RBI.
   - b. Sterilization is the process by which the Monetary Authority (RBI) sterilizes the effects of significant Foreign Capital Inflows on Domestic Liquidity, by off – loading a portion of the Stock of Government Securities held by it.
   - c. Government borrows from RBI (additional to its Normal Borrowing) and issues Treasury Bills / Dated Securities for absorbing the excess liquidity from the market arising from Large Capital Inflows. MSS absorbs the excess liquidity from the market

5. **Policy Rates –**
   - a. Fixed Repo Rate quoted for sovereign Securities in the overnight segment of LAF is considered as the Policy Rate. (India has many other Repo Rates in operation)
   - b. RBI uses this rate for balancing liquidity.
   - c. Its change gets transmitted through Money Market to the entire Financial System & alters all other Short-Term Interest Rates & Influences aggregate Demand – key determination of level of Inflation & Economic Growth.
   - d. If RBI wants to make it more expensive for banks to borrow money, it increases the Repo Rate. Similarly, if it wants to make it cheaper for Banks borrow money, it reduces the Repo Rate. In other words, an increase in the Repo Rate will lead to higher Liquidity and vice – versa, other things remaining constant.

6. **Bank rate** – The interest rate at which RBI lends long term funds to banks is referred to as the bank rate. However, presently RBI does not entirely control money supply via the bank rate. It uses Liquidity Adjustment Facility (LAF) – repo rate as one of the significant tools to establish control over money supply.Bank rate is used to prescribe penalty to the bank if it does not maintain the prescribed SLR or CRR.

7. **Liquidity Adjustment Facility (LAF)** – RBI uses LAF as an instrument to adjust liquidity and money supply. The following types of LAF are:
   - a. **Repo rate:** Repo rate is the rate at which banks borrow from RBI on a short-term basis against a repurchase agreement. Under this policy, banks are required to provide government securities as collateral and later buy them back after a pre-defined time.
   - b. **Reverse Repo rate: It** is the reverse of repo rate, i.e., this is the rate RBI pays to banks in order to keep additional funds in RBI.
   - c. It is linked to repo rate in the following way: **Reverse Repo Rate = Repo Rate – 1**

8. **Marginal Standing Facility (MSF) Rate:** MSF Rate is the penal rate at which the Central Bank lends money to banks, over the rate available under the rep policy.
   - a. **Banks availing MSF Rate can use a maximum of 1% of SLR securities.**
   - b. MSF Rate = Repo Rate + 1MSF Rate = Repo Rate + 1 .

Monetary Policy Framework Agreement (MPFA)

1. The Reserve Bank of India (RBI) Act, 1934 was amended on June 27, 2016, for giving a statutory backing to the Monetary Policy Framework Agreement (MPFA) and for setting up a Monetary Policy Committee (MPC).

2. It is an Agreement reached between the Government of India and RBI on the Maximum tolerable Inflation Rate that RBI should target to achieve price stability.
3. The amended RBI 2016 Act provides for a statutory basis for the implementation of the 'Flexible Inflation targeting Framework'.
4. Announcement of an Official Target Range for Inflation is known as Inflation Targeting.
5. The Expert Committee under Urijit Patel, in January, 2014, suggested RBI abandoned the **'Multiple Indicator'** Approach and made Inflation Targeting the primary objective of its Policy.

Inflation Target

1. Inflation target is set once in every 5 years.
2. Central Government has notified 4% Consumer Price Index (CPI) Inflation as the target for the period from 5 August 2016 to 31 March 2021 (Upper Tolerance Limit – 6%, Lower Tolerance Limit – 2%)
3. RBI is mandated to publish a Monetary Policy report every 6 months, explaining the Sources of Inflation and the Forecast of Inflation for the coming period of 6 – 18 months.
4. Following Factors are notified by the Central Govt. as constituting failure to achieve Inflation Target –
   - Average Inflation > Upper Tolerance Level of Inflation Target for any 3 consecutive quarters, or
   - Average Inflation < Lower Tolerance level for any 3 Consecutive Quarters.
5. CPI is chosen for Inflation Target, since it closely reflects cost of Living and has larger influence on Inflation Expectation compared to other Indicators / Anchors.

9. Challenges in Implementation of Monetary policy

Following are the main challenges in implementation of Monetary Policy

1. Rudimentary and Non – competitive Financial System
2. Lack of Integrated Money and Inter – Bank Markets,
3. Uncertainties surrounding the economy, due to both Internal & external sources.
4. Issues related to Operational Autonomy of the Central Bank
5. Extent of co-ordination between Fiscal and Monetary authorities.

CH 9: INTERNATIONAL TRADE

Distinction between International Trade and Domestic trade

Point	International Trade	Domestic Trade
Meaning	Exchange of goods, services, resources etc. between / amongst different countries.	Exchange of goods, services, resources, etc within domestic territory of a country.
Persons	Transactions between Residents of different countries.	Transactions between / amongst Residents of the same country.
Currency	2 or more currencies are involved.	Only one currency (Local Currency) is involved.
Regulations	This involves multiple Legal Systems, detailed documentation, procedural formalities, Trade Barriers, Shipping and Transportation issues etc.	This involves law of only one country and less documentation and procedural formalities.
Tariff	Customs Tariff is applicable.	Domestic Tariff/ taxes are applicable.

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Advantages and Disadvantages of International trade

Advantages	Disadvantages
1. **Powerful stimulus to economic efficiency**. 2. Efficient use of productive resources. 3. Provides access to new markets and new materials. 4. Enables nations to acquire foreign exchange reserves. 5. Opening up of new markets. 6. Human resource development. 7. Strengthens bonds between nations. 8. **Wide range of Products**. 9. **Innovation**. 10. **Employment**. 11. **Competition**.	1. Not equally beneficial to all nations. 2. Economic exploitation by strong country. 3. **Threatens local infant industries**. 4. Substantial environmental damage. 5. Trade cycles and the associated economic crises get transmitted. 6. Risky dependence of underdeveloped countries. 7. Lack of transparency and predictability. 8. Negative impact on **Labour class**, **exploitation of Resources**, **unsustainable production and consumption**, excessive exports may cause shortages of many, Import of **unwanted and harmful goods** .

Theories of International Trade

A. Mercantilist approach- 16th and 18th century

1. Mercantilism, which is derived from the word mercantile, "trade and commercial affairs".
2. **Exports were viewed favorably** if they resulted in inflow of Gold, while Imports were not considered conducive for Balance of economic growth, since it resulted in outflow of Gold.
3. As per this approach one country can grow economically, only at the expense/ detriment of another, and there is no **"win-win"** favorable situation in International Trade. The Trade according to Mercantilism is **"Zero-Sum Game"**, as one country's gain is the other Country's loss.

1.2.2 The Theory of Absolute Advantage

(they get more from international trade from what they can get doing production individually)

1. Theory of Absolute Cost Advantage was propounded by ***Adam Smith***
2. Under this Theory, an exchange of goods will take place **only if each of the two countries can**

produce one commodity at an absolutely lower production cost than the other country.

3. Each Country which has an absolute advantage over another country in the production of an item, can trade such item, and hence gain in terms of International Trade.
4. Absolute Advantage refers to the ability of a Party (an Individual, a firm, or Country) to produce more of a good or service than the competitors, using the same amount of resources.
5. Assumptions of the Absolute Advantage Theory:
   a. Trade between the **two countries** and **two-commodity** framework for his analysis.
   b. There is no transportation cost.
   c. Used labour as the only input.
   d. He assumed that labour was mobile within a country but immobile between countries.

Comparative advantage theory- Ricardo's Theory

1. *David Ricardo* developed the classical theory of comparative.
2. The law of comparative advantage states that ***even if one nation is less efficient than (has an absolute disadvantage with respect to) the other nation in the production of all commodities, there is still scope for mutually beneficial trade***.
3. The first nation should specialize in the production and export of the commodity in which its ***absolute disadvantage is smaller*** (this is the commodity of its comparative advantage) and import the commodity in which it's absolute disadvantage is greater (this is the commodity of its comparative disadvantage).
4. Because of comparative advantage, trade raises the living standards of both countries. Douglas Irwin (2009) calls comparative advantage "good news" for economic development.
5. This theory also assumed that Labour is the only factor of Production.

Advantages	Disadvantages
Trade can take place, even if one country has absolute disadvantage in both products.	It is too simplistic a Model to consider. It does not recognize many practical barriers to International Trade.
One country's Gain need not be another country's Loss.	Labour is considered as the only Factor Input in the analysis of Absolute Advantage.
This theory recognizes the importance of division of labour, specialization and consequent benefits.	It emphasizes only Supply-side conditions and ignores domestic demand in respective countries
Global output is maximized.	

HECKSHER-OHLIN theory (H-O Theory) or Modern Theory

1. This theory is also known as factor-endowment theory of trade or Modern Theory of Trade.
2. Factor endowment means Availability of usable resources including both natural and man-made means of production.
3. Accordingly, **international trade occurs because different countries have different factor endowment.**

4. The Heckscher-Ohlin (H-O) model studies the case that **two countries have different factor endowments under identical production function and identical preferences**.
5. If a country is a capital abundant one, it will produce and export capital-intensive goods relatively more cheaply than another country. Capital-abundant countries have comparative cost advantage in the production of goods that need capital-intensive technology.
6. According to this theory, international trade is but a **special case of inter-regional trade**.
7. The Heckscher-Ohlin Trade Theorem establishes that **a country tends to specialize in the export of a commodity whose production requires intensive use of its abundant resources** and **imports a commodity whose production requires intensive use of its scarce resources**. (this is the crux of the theory)
8. *The Factor-Price Equalization Theorem states that international trade equalizes the factor prices between the trading nations. Therefore, with free trade, wages and returns on capital will converge across the countries.*

Comparison of Theory of Comparative Costs and Modern Theory

Theory of Comparative Costs	Modern Theory
Difference between countries arises because of comparative costs of **Labour and** differences in productive efficiency of workers	Difference between countries arises because of differences in **factor endowments.** This is **2-factor model** and can be extended to morefactors.
Based on **labour theory of value**	**Based on money cost** which is more realistic.
Treats international trade as **quite distinct from domestic trade**	International trade is only a special case of**inter-regional** trade.
Normative; tries to demonstrate thegains from international trade	**Positive**; concentrates on the basis of trade

New Trade Theory

- American economist and journalist Paul Krugman received the 2008 Nobel Prize for Economics for his work in economic geography and in identifying international trade patterns.
- Krugman defended free trade. He was passionate and showed deep concern for the well- being of which can be understood from his book “In Praise of Cheap Labor,” published in Slate in 1997.

NEW TRADE THEORY (NTT)

Concept: New Trade Theory developed in the late 1970s and early 1980s focuses on the role of increasing returns to scale and network effects.

NTT explains that there are two reasons for advantages to countries by engaging in International Trade.

Economies of scale- supply side	Network effect – demand Side
1. As a firm produces more of a product, its cost per unit keeps going down. 2. So if the firm serves domestic as well as foreign market instead of just one, then it can reap the benefit of large scale of production consequently the profits are likely to be higher. 3. They shall produce and export too. 4. This happens because of governmental support and various other factors.	1. One person’s value for a good or service is affected by the value of that good or service to others. 2. The value of the product or service is enhanced as the number of individuals using it increases. 3. This is also referred to as the ‘bandwagon effect’. Consumers like more choices, but they also want products and services with high utility, and the network effect increases utility obtained from these products over others.

	4. A good example will be Mobile App such as What's App and software like Microsoft Windows.

Unit 2 – Instruments of Trade Policy

1. Trade liberalization refers to opening up of domestic markets to goods and services from the rest of the world by bringing down trade barriers.

Basics

Meaning of Trade policy: Policy that encompasses all instruments those governments may use to ***promote or restrict imports and exports***.

Objectives: The main purpose of trade policy is typically to ***restrict imports and/or encourage exports.***

Other objectives include:

1. The highest possible degree of free trade.
2. An efficient internal market and open trade policy.
3. A strengthened multilateral trade system the world trade organization (WTO)
4. Increasing trade among different countries and greater investment.

Tariff

1. Tariffs, *also known as customs duties*, are basically *taxes or duties* imposed on import or export.
2. Tariffs are often identified with import duties.
3. **Purpose of tariff:** Tariffs are aimed at altering the relative prices of goods and services imported. Tariffs leave the world market price of the goods unaffected; while raising their prices in the domestic market.

1. ***To protect the domestic import-competing industries.***
2. ***The main goals of tariffs are to raise revenue for the government.***
3. Discourage import, increase price of imported goods and reduce volume of imported goods.

There are few disadvantages of imposing tariff

1. Tariff decrease the volume of international trade.
2. The prospect of market access of the exporting country is worsened.
3. Tariffs discourage domestic consumers from consuming imported foreign goods.
4. Domestic market incorrectly increases prices than would be possible in the case of free trade.
5. Tariffs discourage efficient production in the rest of the.

Forms of Import Tariff

A. Specific Tariff (irrespective of Value): A specific tariff is an import duty that assigns a **fixed monetary tax per physical unit** of the good imported.

B. *Ad valorem* (on value): An *ad valorem* tariff is levied as a **constant percentage of the monetary value** of one unit of the imported good.

C. **Mixed Tariffs:** It is the combination of **Specific tariff** or **Ad Valorem** tariffs.

For example, duty on cotton: 5 per cent *ad valorem* Or Rs. 3000/per ton, whichever is higher.

D. **Compound Tariff or a Compound Duty:** Ad valorem + specific tariff. : Fixed + Variable

For example: duty on cheese at 5 per cent *ad valorem* plus 100 per kg.

E. **Technical Tariff**: Duty is calculated on the components of the imported item

1. E.g. Rs. 3000/ on each solar panel plus Rs.50/ per kg on the battery.

F. **Tariff Rate Quotas**: Imports entering under the specified quota portion are usually subject to a lower (sometimes zero) tariff rate. Imports above the quantitative threshold of the quota face a much higher tariff.

G. **Variable Tariff:** A duty typically fixed to bring the price of an imported commodity up to the domestic support price for the commodity.

H. **Escalated Tariff**: Duty Rates on raw materials, semi processed goods and final products are **progressively higher.**

1. For example, a four percent tariff on iron ore or iron ingots and twelve percent tariff on steel pipes.

I. **A prohibitive tariff** is one that is set so high that no imports will enter.

J. **Anti-dumping Duties**

1. It is applicable when article is **imported at less than its nominal value**, foreign seller dumps goods in a country at less than sale prices in his market, or less than Full average cost.
2. Dumping is done to
   a) Constitutes international price discrimination.
   b) Harms the domestic producers of the importing country.
   c) drive out established domestic producers from the market and to establish monopoly position.
   d) Promotes consumption of foreign goods at undesirable levels.
   e) Affects national interest in certain situations.

K. **Safeguard Duties**: There may be genuine case where the other country is not dumping their product but actually producing at lower cost. This will still create negative effect in domestic economy of importing company.

L. **Countervailing Duties**

1. It is levied on imports from any country which pays directly or indirectly***, any subsidy on the manufacture, production*** etc. of an article

M. **Tariffs as Response to Trade Distortions:** when some countries engage in 'unfair' foreign-trade practices, the affected importing countries, respond quickly by measures in the form of tariff responses referred to as "trigger-price" mechanisms.

N. **MFN Tariffs**: MFN tariffs are what countries promise to impose on imports from **other members of the WTO**, unless the country is part of a preferential trade agreement (such as a free trade area or customs union).

1. This means that, in practice, MFN rates are the **highest** (most restrictive) that WTO members charge one another.

O. **Preferential tariff**: Under **Preferential Tariff** countries promise to give another country's products lower tariffs than their MFN rate. Many time even **nil rate.**

P. **Bound Tariff**: A bound tariff is a tariff which a WTO member binds itself with a **legal commitment not to raise it above a certain level.**

Q. **Applied Tariff**: An 'applied tariff' is the duty that is actually charged on imports on a most-favored nation (MFN) basis. Applied tariff can also be lower than Bound tariff.

Non-Tariff Measures (NTM) and Non-tariff barriers (NTB)

- The non- tariff measures constitute the hidden or 'invisible' measures that interfere with free trade.

⅄ Non-Tariff Measures (NTM) –	⅄ Non-tariff barriers (NTB) –
a. These are policy measures, other than Ordinary Custom Tariff,. b. NTMs include regulations that **restrict trade** or that **facilitate higher trade**. These have a wider scope.	a. Non-tariff barriers which are **simply discriminatory non-tariff measures** imposed by governments to favor domestic over foreign suppliers. b. NTBs are thus a subset of NTMs that have a 'protectionist or discriminatory intent'.

- **Depending on their scope NTMs are categorized as Technical Measures & Non-technical Measures:**

- **Technical Measures:**

Meaning- Technical measures refer to ***product-specific properties such as characteristics of the product, technical specifications and production processes***.

TYPES OF TECHNICAL NTMs

Technical Barriers to Trades- (TBT)

1. Technical Barriers to Trade (TBT) cover **both food and non-food traded products.**
2. It refers to mandatory 'Standards and Technical Regulations' that define the specific characteristics that a product should have, such as its size, shape, design, labeling / marking / packaging, functionality or performance and production methods.

Sanitary and Phytosanitary (SPS) Measures

1. SPS measures are applied to protect human, animal or plant life from risks arising from additives, pests, contaminants, toxins or disease-causing organisms and to protect biodiversity.

Non-technical Measures:

Meaning- Non-technical measures relate to trade requirements; for example; ***shipping requirements, custom formalities, trade rules, taxation policies***, etc.

It is further distinguished as-

1. ***Hard measures*** (e.g. Price and quantity control measures),
2. ***Threat measures*** (e.g. Anti-dumping and safeguards) and
3. ***Other measures*** such as trade-related finance and investment measures.

Furthermore, categorization also distinguish between-

1. ***Import-related measures***- imposed by the importing country, and
2. ***Export-related measures***- imposed by the exporting country itself.
3. ***Procedural obstacles (PO)*** which are practical problems in administration, transportation, delays in testing, certification etc. that may make it difficult for businesses to adhere to a given regulation.

TYPES OF NON-TECHNICAL NTMs

Import Quotas

1. **Import quota** is a direct restriction which specifies that only a certain physical amount of the good will be allowed into the country during a given time period.
2. **Binding Quota** is set below the free trade levels of imports, is enforced by issuing licenses.
3. **Absolute Quotas** of a permanent nature limit the quantity of imports to a specified level during a specified period of time and the imports can take place any time of the year. No condition is attached to the country of origin of the product.
4. **A Tariff Rate Quota** When country allocation is specified, a fixed volume or value of the product *must originate in one or more countries*.
5. **Unilateral Quota,** a country unilaterally fixes a ceiling on the quantity of the import of a particular commodity.
6. **A Bilateral Quota** results from negotiations between the importing country and particular Supplier Country, or between the Importing Country and export groups within the supplier Country.

1. **Price Control Measures:** These are also known as 'para-tariff' measures.
2. **Non-automatic Licensing and Prohibitions:**
3. **Financial Measure**: The objective of financial measures is to increase import costs by regulating the access to and cost of foreign exchange for imports and to define the terms of payment.
4. **State Trading:** These measures grant exclusive privileges an special preferences to a few Operators/ Agencies.
5. **Local Content Measure:** These measures include rules on local content requirements that mandate a specified fraction of a final good should be produced domestically.
6. **Distribution Restrictions:** Distribution restrictions are limitations imposed on the distribution of goods in the importing country involving additional license or certification requirements. These may relate to geographical restrictions or restrictions as to the type of agents who may resell.
7. **Service Restrictions**: Producers may be restricted from providing after- sales services for exported goods in the importing country.
8. **Procedural Obstacles**: There are procedural obstacles which increase the transaction costs thereby discouraging imports e.g. Licenses, Administrative Delay, Permission of

Foreign Exchange Remittance etc.

9. **Licensing**: Prospective Importers are required to apply and obtain a license from the Licensing Authorities.
10. **Rule of origin**: Rules of origin are the criteria needed by governments of importing countries to determine the national source of a product.
11. **Embargos**: An embargo is a total ban imposed by government on import or export of some or all commodities to particular country.

Exports related Measures

1. **Export Quotas**: A quota on the export of a product from a country.
2. **Ban on exports**
3. **Export tax**
4. **Export Subsidies**
5. **Voluntary Export Restraints (VERs):** Voluntary Export Restraints (VERs) refer to a type of ***informal quota administered by an exporting country voluntarily restraining the quantity of goods that can be exported out of that country during a specified period of time.***

Unit 3 – Trade Negotiation

Trade Agreement

a. **Trade negotiations-** It is a process in which Nations meet to discuss the possibility of trade, with the goal of reaching a Trade Agreement.
b. The aim of both the nations is to reach mutual consciences and establish trade agreement and promote international trade.

Types of Trade Agreements

1. **Unilateral trade agreements** under which an importing country offers trade incentives in order to encourage the exporting country to engage in international economic activities that will improve the exporting country's economy. E.g. Generalized System of Preferences.
2. **Bilateral Agreements** are agreements which set rules of trade between two countries, two blocs or a bloc and a country. These may be limited to certain goods and services or certain types of market entry barriers. E.g. EU-South Africa Free Trade Agreement; ASEAN–India Free Trade Area
3. **Multilateral Trade agreement** are the trade agreement between Many nations at one time
4. **Pluri-lateral trade agreement**: Agreement between more than two countries, but not many.
5. **Regional Preferential Trade Agreements** among a group of countries reduce trade barriers on a reciprocal and preferential basis for only the members of the group. E.g. Global System of Trade Preferences among Developing Countries (GSTP)

General agreement on tariff and trade (GATT) 1948 to 1994

1. GATT is a Multilateral Trade Agreement created in January 1948 to achieve a broad, multilateral and free worldwide system of trading.
2. GATT governed international trade, working along with the **World Bank & International Monetary Fund.**
3. The Goods Council has **10 committees** dealing with specific subjects.

4. The GATT lost its relevance by 1980s because
   a. It was **obsolete** to the fast-evolving globalization.
   b. **International investments** had expanded substantially.
   c. **Intellectual property rights** and trade in services **were not covered by GATT**.
   d. The **ambiguities in the multilateral system** could be heavily exploited.
   e. Efforts at liberalizing **agricultural trade were not successful**.
   f. there were **inadequacies in institutional structure** and dispute settlement system
   g. It was not a treaty and therefore terms of **GATT were not fully binding**

World Trade Organisation (WTO) 1 July 1995.

Introduction of WTO - Uruguay Round

1. The Round started in Punta del Este in Uruguay in September 1986.The final act concluding the Uruguay Round establishing the WTO Regime was signed 15 April 1994, during the ministerial meeting at Marrakesh, Morocco, and hence is known as the Marrakesh Agreement.

WTO – Aim and Objectives

a. **The WTO has six key objectives:**
   (i) to **set and enforce rules** for international trade,
   (ii) to **provide a forum for negotiating** and monitoring further trade liberalization,
   (iii) to **resolve trade disputes**,
   (iv) to **increase the transparency** of decision-making processes,
   (v) to **cooperate with other major international economic** institutions involved in global economic management, and
   (vi) to **help developing countries** benefit fully from the global trading system.

The Structure of the WTO

a. The WTO activities are supported by a Secretariat located in Geneva, headed by a Director General.
b. The WTO accounting for about 95% of world trade currently has 164 members, of which 117 are developing countries.

MINISTERIAL CONFERENCE

1. It is the highest-Level Body, which can take decisions on all matters under any of the multilateral trade agreements.
2. It meets at-least once every two years.

GENERAL CONFERENCE:

1. It acts as the Trade Policy Review Body and the Dispute Settlement Body. It refers to the

Ministerial Conference. 2. It meets several times a year.
The Goods Council, Services Council, Intellectual Property 1. These councils oversee the implementation of WTO Agreements in Goods, Services and IPRs. 2. These councils report to the General Council.
Committees and Working Groups: 1. There are many Specialized Committees working under each council (eg. 11 committees under Goods Council) 2. These committees deal with individual agreements and specific areas, eg. Membership Application, Development etc.

Guiding principles of WTO

1. **Most-favoured-nation (MFN) Treatment**:

2. **National Treatment Principle (NTP)**

3. **Progressive Liberalization : Freer trade: gradually, through negotiation**

4. **Transparency**
   a. WTO members are required- i) to publish their Trade Regulations, ii) to maintain institutions allowing for the review of administrative, iii) to respond to requests for information by other members, and iv) to notify changes in trade policies to the WTO.
   b. These internal transparency requirements are supplemented and facilitated by periodic country- specific reports (Trade Policy reviews) through the Trade Policy review Mechanism (TPRM).

5. **No Quantitative Restrictions:**

6. **Protection of Domestic Industries** Trade control is permissible for protection of domestic industries, but only through Tariff Rates, which should be generally reduced through "reciprocal and mutually advantageous" negotiations.

7. **Market Access**:

8. **Protection of Health & Environment:**

9. **Dispute Settlement Mechanism**

WTO Agreement- An Overview of few

The WTO agreements cover goods, services and intellectual property and the permitted exceptions. These agreements are often called the WTO's trade rules, and the WTO is often described as "rules-based", a system based on rules.

1. **Agreement on Agriculture**
2. **Agreement on the Application of Sanitary and Phytosanitary (SPS)**
3. **Agreement on Textiles and Clothing (ATC) replaced the Multi-Fiber Arrangement (MFA)**

4. Agreement on Technical Barriers to Trade (TBT)
5. Agreement on Trade-Related Investment Measures (TRIMs) -
6. Anti-Dumping Agreement
7. Customs Valuation Agreement
8. Agreement on Pre-shipment Inspection (PSI)
9. Agreement on Rules of Origin
10. Agreement on Import Licensing Procedures
11. Agreement on Subsidies and Countervailing Measures
12. Agreement on Safeguards
13. General Agreement on Trade in Services (GATS)
14. Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS):
15. Trade Policy Review Mechanism (TPRM)

- The most controversial topic in the Doha Agenda was agriculture trade.

Concerns regarding WTO by Member countries

1. Real expansion of trade in the three key areas of **agriculture, textiles** and **services has been dismal.**
2. **Protectionism and lack of willingness** among developed countries **to provide market access.**
3. **Tariff escalation'**
4. Developing countries complain that they **face exceptionally high tariffs** on selected products
5. LDCs are hugely disadvantaged and vulnerable due to **lack of factor inputs, lack of capital, lack of infrastructure**, etc.
6. Significant issues like **Climate Change**, **high and volatile Food Prices**, and **energy production and consumption** are all issues that have not been effectively addressed.

International Capital Movement

Foreign Flow of Capital – This is far Wider than Foreign Investment

Foreign aid or assistance	Borrowings	Investments	Deposits from non-resident Indians (NRI)
Tied aid with strict mandates regarding the use of money	Direct inter government loans	Foreign direct investment (FDI)	
Untied aid where there are no such	External commercial borrowing		
voluntary transfer stipulations from institutions like IMF, WB	Soft Loans for e.g. from affiliates of World Bank such as IDA	Foreign portfolio investment (FPI) in bonds, stocks and securities	
Multilateral aid from many governments who pool funds to international organizations like the World Bank	Loans from international institutions (e.g. world bank, IMF)		

Bilateral or direct inter government grants.	Trade credit facilities		

Foreign Direct Investment (FDI)

1. Meaning - Foreign direct investment is defined as a process whereby the ***resident of one country*** (i.e. home country) ***acquires ownership of an asset in another country*** (i.e. the host country) and such movement of capital involves ***ownership, control as well as management*** of the asset in the host country.
2. Direct investments are ***real investments*** in factories, assets, land, inventories etc.
3. It Has a **long-term interest** and therefore remains invested for long.

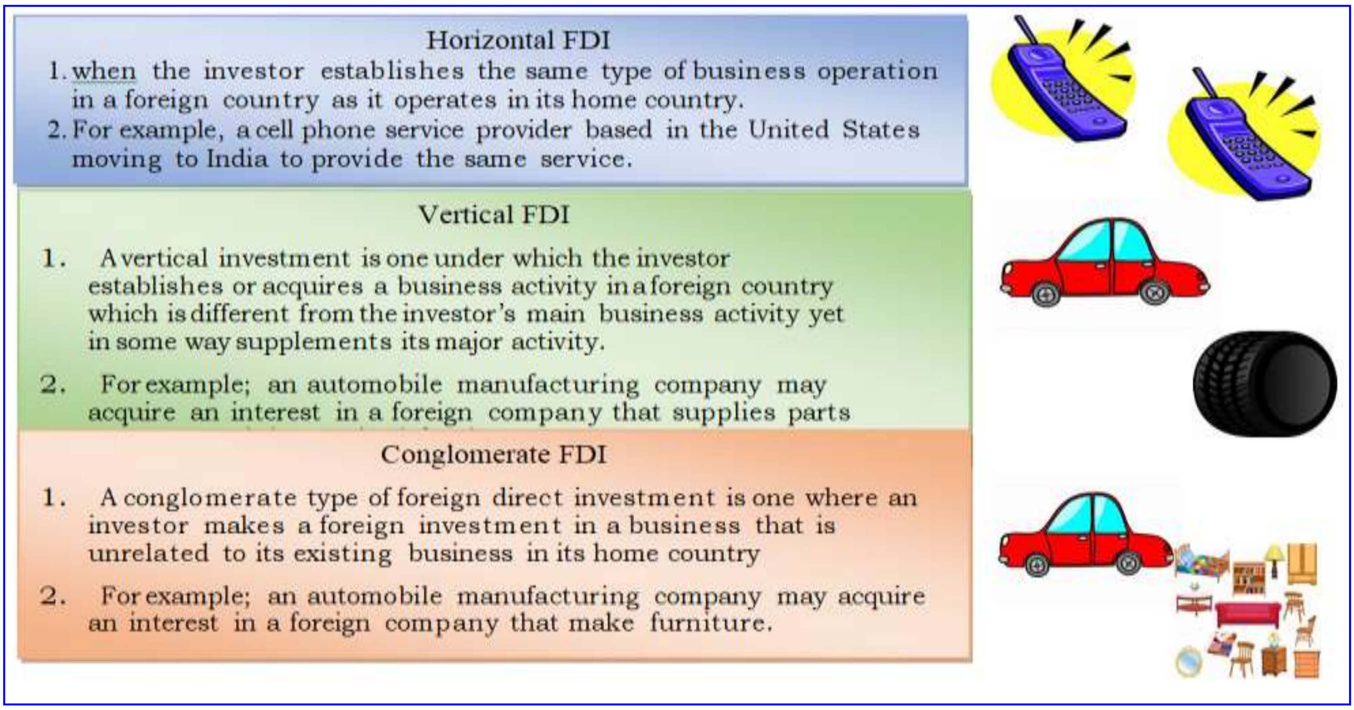
4. Control According to the IMF, the acquisition of **at least ten percent** of the ordinary shares or voting power in a public or private enterprise by non-resident investors makes it eligible to be categorized as foreign direct investment (FDI).

5. Components: FDI has three components-
    (a) Equity Capital,
    (b) Reinvested Earnings,
    (c) Other direct Capital in the form of intra-company loans between Direct Investors (Parent) and Affiliate Enterprises.

6. Who can be Foreign Direct Investors
    (a) Individuals,
    (b) Private and Public Enterprises, incorporated or unincorporated
    (c) Associated Groups of Individuals or Enterprises,
    (d) Governments or Government Agencies,
    (e) Estates, Trusts or other organizations, or
    (f) Any combination of the above-mentioned entities.

7. Modes or Forms of FDI
    (a) ***Opening of a subsidiary or associate*** company in a foreign country,
    (b) ***Equity injection*** into an overseas company,
    (c) ***Acquiring a controlling interest*** in an existing foreign company,
    (d) ***Mergers and acquisitions(***M&A)
    (e) ***Joint venture*** with a foreign company.
    (f) ***Green field investment*** (establishment of a new overseas affiliate for freshly starting production by a parent company).
    (g) ***Brownfield investments*** (a form of FDI which makes use of the existing infrastructure by merging, acquiring or leasing, instead of developing a completely new one . For e.g. in India 100% FDI under automatic route is allowed in Brownfield Airport projects.

Types of FDI



Horizontal FDI

1. when the investor establishes the same type of business operation in a foreign country as it operates in its home country.
2. For example, a cell phone service provider based in the United States moving to India to provide the same service.

Vertical FDI

1. A vertical investment is one under which the investor establishes or acquires a business activity in a foreign country which is different from the investor's main business activity yet in some way supplements its major activity.
2. For example; an automobile manufacturing company may acquire an interest in a foreign company that supplies parts

Conglomerate FDI

1. A conglomerate type of foreign direct investment is one where an investor makes a foreign investment in a business that is unrelated to its existing business in its home country
2. For example; an automobile manufacturing company may acquire an interest in a foreign company that make furniture.

Yet another category of investment is '**two- way direct foreign investments'** which are reciprocal investments between countries. These investments occur when some industries are more advanced in one nation (for example, the computer industry in the United States), while other industries are more efficient in other nations (such as the automobile industry in Japan).

Foreign Portfolio Investment (FPI)

1. Meaning- Foreign portfolio investment is the flow of **'financial capital'** rather than **'real capital'** and does not involve ownership, control, or management on the part of the investor.
2. Concept -FPI is a process in which the Resident of One Country (i.e Home Country) acquires ownership of **Financial Assets / Securities** in another country (i.e Host Company).
3. Example - European Citizen buying Bonds of Indian company in Indian Market.
4. Characteristics of FPI

(a) The singular intention of a foreign portfolio investor is to **earn a remunerative return through investment in foreign securities** and is primarily concerned about the safety of their capital, the likelihood of appreciation in its value, and the return generated.

(b) Such investors also **do not have any intention of exercising voting power or controlling or managing the affairs of the company** in whose securities they invest

(c) **Lower stake** in companies with their total stake in a firm **at below 10 percent**.

(d) FPI have **immediate impact on balance of payment** or exchange rate rather than on production or income generation.

(e) Portfolio investments are, to a large extent, expected to be speculative. Once investor confidence is shaken, such capital has a tendency to speedily shift from one country to another, occasionally creating financial crisis for the host country.

Reasons/factor for FDI and FPI	**Factors discouraging FDI in host Country**
1. **Higher rate of return:** 2. **Interdependency-** 3. **Economies of scale-** 4. **Desire to control-** 5. **Risk diversification** 6. **Desire to control IPR-** 7. **Penetration into the markets** (*'getting behind the tariff wall'*). 8. **Strategy to obtain control of strategic raw material** 9. **Labour cost advantage-** 10. **Tax differentials** 11. **Shared common language or common boundaries**	**General** ⇨ Political instability ⇨ Poor infrastructure ⇨ Small size of market with lack of growth potential. ⇨ Poor track-record of investments **Macro-Economic Factors** ⇨ High rates of inflation ⇨ Exchange rate volatility ⇨ Low income levels and lower demand **Labour related** ⇨ Poor literacy and low labour skills, ⇨ Dominance of labour unions ⇨ Language barriers **Law/ Governance related** ⇨ Higher degree of Non – Tariff barriers ⇨ Unfavorable tax regime ⇨ Law not favorable to IPR protection ⇨ Double taxation

FDI in Host Country- Advantages	FDI in Host Country- Disadvantages
1. *Labour*	1. *Labour class gets affected due to capital-intensive methods of production*
2. *International capital* supporting by domestic savings.	2. *Monopoly of foreign firm-*
3. *Technology up gradation*	3. *Domestic resources are ruthless exploited.*
4. *Domestic Industry becomes competitive*	4. *Transferring outdated technology.*
5. *Access to Global Market*	5. *Domestic Industry face stiff challenges -*
6. *Domestic resources are utilised more efficiently*	6. *FDI move towards regions or states which are well endowed in terms of natural resources, creating more regional disparity.*
7. *Consumer gets better goods at lower price*	7. *FDI may cause the domestic governments to slow down its efforts to generate more domestic savings and investment.*
8. *Competition among government to get FDI*	8. *Foreign firms may partly finance their domestic investments by borrowing funds in the host country's capital market. 'Crowding-out' effect.*
9. *Promotion of ancillary units/ support industries*	9. *FDI usually involves domestic companies 'off -shoring', or shifting jobs and operations abroad in pursuit of lower operating costs and consequent higher profits..*
10. *Promote the exports of developing countries*	10. *Foreign entities are usually accused of being*
11. *Act as a source of new tax revenue*	
12. *FDI reduces the established monopoly*	
13. *Favourable impact on the host country's balance of payment position*	
14. *Better work culture and higher productivity standards*	

	anti-ethical. 11. *Adverse impact on the host country's commodity terms of trade*

FDI in India

- Routes for FDI -An Indian Company can obtain FDI through-
  a. **Automatic Route-** i.e without any prior approval of the Government or RBI.
  b. **Approval Route**- i.e with prior approval of the Government

- Instruments - FDI can be obtained through issue of **"FDI – Compliant instruments"** viz **Equity Shares, fully and mandatorily Convertible Preference Shares and Debentures, Partly Paid Equity Shares and Warrants**, issued in accordance with the Companies Act 2013 and SEBI Guidelines, as applicable.
- Prohibition - In India, Foreign Investment is prohibited in the following sectors-
  (a) Lottery Business including Government/ private Lottery, Online Lotteries etc
  (b) Gambling and Betting including Casinos etc
  (c) Chit Funds
  (d) Nidhi Company
  (e) Trading in Transferable Development Rights (TDRs)
  (f) Real Estate Business or Construction of Farm Houses
  (g) Manufacturing of cigars, Cheroots, Cigarillos and Cigarettes, of Tobacco or of Tobacco substitutes
  (h) Activities / sectors not open to Private Sector Investment eg. Atomic Energy and Railway Operations (other than permitted activities)

Overseas Direct Investment by Indian Business

1. There has been progressive relaxation of the capital controls and simplification of procedures for outbound investments from India.
2. As a result, Outbound Foreign Direct Investments (OFDIs) from India have undergone substantial increase in terms of size, geographical spread and sectorial composition.

EXCHANGE RATE AND ITS ECONOMIC EFFECTS

A. **Currency –** Currency is the **legal tender** of any country within its national Frontier buy or sell goods. Major traded currencies in the world are- Dollar, Yen, Pound and Euro

B. **Home Currency** – A **country's own currency** is known as home currency / domestic currency.

C. **Foreign Currency** –any currency **other than home currency** is a foreign currency.

D. Foreign Exchange – A foreign currency transaction is a transaction that is denominated in or requires settlementin a foreign currency:

(a) buys or sells goods or services in a foreign currency.

(b) borrows or lends funds in aforeign currency.

(c) becomes a party to an unperformed forward exchange contract; or

(d) otherwise acquires or sells of assets, or incurs or settles liabilities, denominated in a foreign currency.

E. Foreign exchange Market –

a) The wide-reaching collection of markets and institutions **that handle the exchange of foreign currencies** is known as the foreign exchange market.

b) Foreign exchange market comprises of buyers and sellers of foreign currency.

F. Features of Foreign exchange Market –

a) It is ***a wide-reaching market*** and operates ***worldwide.***

b) It is ***largest market in the world*** in terms of cash value traded.

c) It is an ***Over-the-Counter market*** and not a physical place as such. (OTC)

d) There is ***no central trading location*** and ***no set hours*** of trading.

e) Market participants who demand and supply currencies represent themselves through their Banks and Key Forex Dealers.

f) Forex Market operates on ***very narrow spreads*** between buying & selling prices.

G. Vehicle Currency

a) A currency that is **widely used to denominate international contracts** made by parties even when it is not the national *currency* of either of the parties. Example – Dollar/ USD

H. Major Participants in Forex market and their role

a) **Central banks and Government-** To stabilize the excessive volatility in exchange rate

b) **Commercial banks - executing orders** from exporters, importers, investment institutions, insurance and retirement funds, hedgers, and private investors. Commercial banks also perform trading operations in their **own interests and at their own expense.**

c) **Foreign exchange Dealers-** Intermediaries between different dealers or banks.

d) **Arbitrageurs-** To earn profit by discovering price differences between pairs of currencies with different dealers or banks

e) **Speculators /Bulls or bears -** are deliberate risk-takers who participate in the market to make gains

f) ***MNCs that engage in international trade and investments*** -For normal trade

g) **Note:** Commercial Banks and Brokerage are also called market makers as they set their own exchange price too.

I. Spot Exchange rate

a) A spot exchange rate is the rate at which the currencies are being traded ***for delivery on the same day.***

J. Future Exchange rate

a) Contracts to buy or sell currencies for ***future delivery*** which are carried out in forward and/or futures markets.

b) The elements which get fixed on the date are- **rate of exchange, Amount and Date of execution**

K. Forward Premium and Forward Discount

a) **A forward premium** is said to occur when the forward exchange rate is more than a spot trade rate. E.g.- Spot rate Rs/Dollar = 63 and future rate 67

b) **Forward discount** is where the trade is quoted at a lower rate than the spot trade. E.g.- Spot rate Rs/Dollar = 63 and future rate 61

L. **Bid rate/ Buying rate:** It is the rate at which the **dealer is ready to buy the foreign currency** in exchange for domestic currency. Therefore, it is the buying rate.

M. **Ask rate/ Selling rate** : It is the rate at which the foreign dealer 'asks' its customers to pay in local currency in exchange of the foreign currency. Therefore, it is the **selling rate or offer rate** at which foreign currency can be purchase from the dealer.

Bid rate/Buying rate and Ask rate/selling rate is considered from banker's point

N. Spread or Bid-Ask Spread

- The **difference between bid price and the offer price** is called spread.

O. **Cross rate** :There may be two pairs of currencies with one currency being common between the two pairs and is called 'cross rate'

P. Base currency and Counter currency

a) In an expression Currency of one country/ Currency of Another country, the currency in denominator is Base currency and that in numerator is Counter currency

b) **Therefor in Direct Quote FC is base currency and HC is counter currency.**

c) **Therefor in Indirect Quote HC is base currency and FC is counter currency**

Difference between Direct and Indirect Quote

Point	Direct Quote	Indirect Quote
Meaning	A Direct Quote is the number of units of a Local Currency exchangeable for **one unit of a Foreign Currency.**	An Indirect Quote is the number of units of a Foreign Currency exchangeable for **one unit of local Currency.**
Also known as	European Currency Quotation	American Currency Quotation
Base Currency	Foreign Currency (i.e. Rupee in the above case)	Local Currency (i.e. US $ in the above case)
Counter Currency	Local Currency (i.e. US $ in the above case)	Foreign Currency (i.e. Rupee in the above case)
Relationship	Direct quote= 1/Indirect Quote	Indirect quote= 1/ Direct Quote
Example	Rs. 67/ US $ means 67 is required to buy 1	$ 0.0143 per Rupee means 1 is obtained by selling $ 0.0143

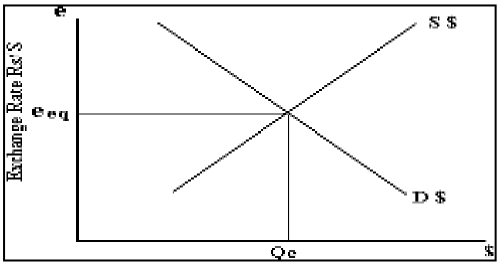
Arbitrage – Buy low sell high

Meaning

1. Arbitrage refers to the practice of making **risk-less profits** by intelligently exploiting price differences of an asset at different dealing places.
2. **Outcome of Arbitrage:** On account of arbitrage, regardless of physical location, at any given moment, all markets tend to have the same exchange rate for a given currency.

Determination of Exchange rate

Exchange rate is determined by ***equilibrium of Demand and Supply***. RBI intervenes the market only to stabilize the exchange rate and prevent wide fluctuations.



Demand for Foreign currency arises due to	Supply of Foreign currency arises due to
∂ ***Purchase of goods and services*** from another country- Import ∂ ***Unilateral transfers*** such as gifts, awards, grants, donations or endowments ∂ ***Make investment*** income payments abroad ∂ ***Purchase financial assets***, stocks or bonds abroad ∂ Open a ***foreign bank account*** and ∂ Acquire ***direct ownership*** of real capital ∂ for speculation and hedging activities related to risk-taking or risk-avoidance activity.	∂ ***Sale of goods and services*** from another country- Export ∂ Unilateral transfers **Inward** such as gifts, awards, grants, donations or endowments ∂ ***Receive investment income*** payments abroad ∂ ***Sale financial assets***, stocks or bonds abroad ∂ ***Sale direct ownership*** of real capital

Difference between HC appreciation and HC depreciation

The terms, 'currency appreciation' and 'currency depreciation' describe the movements of the exchange rate.

	Home Currency Depreciation (or Foreign currency appreciation)	**Home Currency Appreciation (or Foreign Currency Depreciation)**
Meaning	a. Currency depreciates when its value falls with respect to the value of another currency or a basket of other currencies. b. Home-currency depreciation takes place when there is an increase in the home currency price of the foreign currency (or, alternatively, a decrease in the foreign currency price of the home currency).	a. Currency appreciates when its value increases with respect to the value of another currency or a basket of other currencies. b. Home-currency appreciation takes place when there is a decrease in the home currency price of foreign currency (or alternatively, an increase in the foreign currency price of home currency).
Cause	1. This arises when the Demand Curve for Foreign Currency shifts to the right representing increased demand for Foreign Currency, and Supply Curve remains unchanged. 2. Where the DD curve remains same but the supply decreases	1. This arises when the Supply Curve for Foreign Currency shifts to the right representing increased supply for Foreign Currency, and Demand Curve remains unchanged. 2. Where the DD curve remains same but the supply increases

Impact on Exporters and importers by Appreciation/ depreciation of currency

Situation	Type	Impact	Good or Bad
When Foreign currency appreciates	Exporter		
When Home currency appreciates	Exporter		
When Home currency depreciates	Importer		
When Foreign currency Depreciates	Importer		

Devaluation Vs Depreciation

	Devaluation	Depreciation
Meaning	**Deliberate downward** adjustment in the value of a country's currency relative to another currency, group of currencies or standard.	Currency depreciates when its value falls with respect to the value of another currency or a basket of other currencies.
causes	Devaluation is caused by action of the Government/ central Bank/ Monetary authority/	Depreciation is caused when Demand increases with supply remaining constant or Where Demand is constant and Supply decreases
Regime	Applicable if **Fixed exchange rate Regime**	Applicable if **Floating exchange rate Regime**
Determinant	It is a monetary policy tool used by countries that have a fixed exchange rate or nearly fixed exchange rate regime	Determined by Market forces. Demand and supply forces determines the value of currency

Revaluation is the opposite of devaluation and the term refers to a discrete raising of the otherwise fixed par value of a nation's currency.

Impacts of exchange rate fluctuations on domestic economy

1. **Export:**
   (a) Home Currency Depreciates- Export Demand Increases.
   (b) Home Currency Appreciates- Export Demand decreases

2. **Imports:**
   (a) **Home Currency Depreciates- Imports decreases.**
   (b) **Home Currency Appreciates-** demand for Imports increases.

3. **Domestic Inflation: (relate with Import)**
   (a) **Home Currency Depreciates-** leads to Cost push Inflation.
   (b) **Home Currency Appreciates-** brings down Inflation.

4. **Domestic Demand:**
   (a) **Home Currency Depreciates-** increases the demand for Domestic goods.
   (b) **Home Currency Appreciates-** reduces the demand for Domestic goods.

5. **Foreign currency Debt**
   (a) **Home Currency Depreciates-** will lead to more HC outflow towards repayment of loan and

Principle.

(b) **Home Currency Appreciates-** will lead to lesser HC outflow towards repayment of loan and Principle.

6. **Inward remittance**
   - (a) **Home Currency Depreciates-** Depreciation increases such inflows.
   - (b) **Home Currency Appreciates-** Appreciation decreases such inflows

7. **Current account**
   - (a) **Home Currency Depreciates-** If Export earnings rise faster than the Import Spending, then Current Account will improve.
   - (b) **Home Currency Appreciates-** Increasing imports and declining Exports cause larger deficits and worsen the Current Account balance.

Exchange rate Regime

1. An exchange rate regime is the system by which a country manages its currency in respect to foreign currencies.
2. There are three broad categories of exchange rate systems.
   - (a) **Floating Exchange rate Regime:** In one system, exchange rates are set purely by private market forces with no government involvement. Values change constantly due to demand & supply of currencies.
   - (b) **Fixed Exchange rate Regime**: governments may seek to fix the values of their currencies, either through participation in the market or through regulatory policy
   - (c) **Managed Floating**: currency values are allowed to change, but governments participate in currency markets in an effort to influence those values.

Floating rate Regime

Meaning:

1. Determined by ***demand for and supply of currency*** relative to other currencies.
2. ***Self-regulating***.
3. There is ***no predetermined target rate***.
4. There is ***no interference on the part of the government or*** the ***central bank***, except to moderate the rate of change and preventing undue fluctuations.

Merits

1. Allows Central bank and /or government to pursue its ***own independent monetary policy***

2. Floating exchange rate regime allows exchange rate to be used as a ***policy tool***:

3. ***Not required to maintain a huge foreign exchange reserve.***

Demerits

1. Generate a ***lot of uncertainties*** in relation to international transactions.
2. Make international transactions riskier.
3. Contracts between buyers and sellers in different countries get affected by exchange rate changes in addition to business risk.

Fixed rate Regime

Concept

a) A fixed exchange rate is also referred as *pegged exchange rate*.

b) The Country's ***Central bank and / or Government announces or decrees the Rate***, i.e. what its currency will be worth in terms of –
   - i) either other country's currency,
   - ii) a basket of currencies,
   - iii) Another measure of value, e.g. Gold.

c) When a Government intervenes in the ***forex Market*** so that the Exchange Rate of its currency is different from what would have been determined by the free flow of market forces, it is said to have established a *"peg"* for its currency.

d) To maintain the Rate at that announced level (called "Parity Value"), the ***Central Bank and/or Government also regularly operates in the market*** by buying (or selling) Foreign Reserves.

Merits

(a) **Avoids currency fluctuations** and **eliminates exchange rate risks**

(b) **Greatly enhance international trade and investment**.

(c) A **reduction in speculation** on exchange rate.

(d) **Imposes discipline on a country's monetary authority**.

(e) The government **can encourage greater trade and investment**.

(f) **Exchange rate peg** can also enhance the credibility of the country's monetary-policy.

Demerits

a) The Central Bank and/or Government have to ***maintain large reserves***.

b) Market Forces of ***Demand and Supply have no role*** in determination of Equilibrium FX Rate.

Managed Float Systems

a) Exchange rates are still free to float, but governments try to influence their values. Government or central bank participation in a floating exchange rate system and intervene from time to time in the currency market to stabilize the fluctuations.

Hard Peg	The Central Bank sets a fixed and unchanging value for the Exchange Rate.
Soft Peg	The Exchange Rate is generally market determined, but if the Rates tend to be move speedily in one direction, the Central Bank will intervene in the market.
Floating Regime	Market determines the Exchange rate. Supply and Demand of Currency determines the rate of exchange

Real rate and Nominal rate of Exchange

(a) The 'real exchange rate' describes 'how many' of a good or service in one country can be traded for 'one' of that good or service in a foreign country. It is denoted by R.

(b) Trade flows are affected not by nominal exchange rates, but instead, by real exchange rates.

(c) A country's real exchange rate is a key determinant of its net exports of goods and services.

(d) The real exchange rate for single commodity is represented by the following equation:

$$\text{Real exchange rate (R)} = \text{nominal exchange rate} \times \frac{\text{domestic price}}{\text{Foreign Price}}.$$

(e) In contrast to the nominal exchange rate, the real exchange rate is always "floating", since even in the regime of a fixed nominal exchange rate E, the real exchange rate R can move via price-level changes.

(f) Rather than focusing on the nominal exchange rate, it is more sensible to monitor the real exchange rate when assessing the effect of exchange rates on international trade or export competitiveness of a country.

Nominal Effective Exchange rate (NEER) & Real effective exchange rate (REER):

(a) **Nominal Effective Exchange rate (NEER):** Unlike nominal and real exchange rates, NEER and REER are not determined for each foreign currency separately but against a whole basket of currencies.

(b) **Real effective exchange rate (REER):** A real effective exchange rate (REER) adjusts NEER by the appropriate foreign price level and deflates by the home country price level. The REER is NEER with price or labor cost inflation removed from it.

CHAPTER 10: INDIAN ECONOMY

STATUS OF INDIAN ECONOMY: PRE INDEPENDENCE PERIOD (1850 -1947)

India's Economic Position between 1st and 17th Century

1. India is the largest economy of the ancient and the medieval world.

2. It controlled between **one third and one fourth** of the world's wealth.

3. The Economy is a hub for commerce, pilgrimage and administration.

A. Handbook of Political Philosophy: Arthashastra - Period: 321-296 BCE

I. Features of the Book:

a) 'Arthashastra' is the work **Kautilya (Chanakya).**

b) It is believed to be a kind of **handbook for King Chandragupta Maurya,** the founder of Mauryan empire.

c) Arthashastra means **primarily, 'wealth' and, secondarily, 'the land'.**

d) The major focus of the work is on the means of fruitfully maintaining and using land.

e) Kautilya's writings relate to statecraft, political science, economic policy and military strategy.

f) It contains the directives as to how to reign over the kingdom and encouraging directaction in addressing political concerns without regard for ethical considerations.

g) Artha is **not** wealth alone; rather it encompasses all aspects of the **material well-being of individuals.**

h) Taxes, which were charged equal for private and state-owned businesses.

i) **True kingship:** The preservation and advancement of this good was comprised of seven vital elements, namely the **King, Ministers, Farmlands, Fortresses, Treasury, Military & the Allies.**

The period of British rule can be divided into two sub periods:

The rule of East India Company from 1757 to 1858

a) **Reversal of Indian Market** – From Exporter of Goods to exporter of RM

b) **Tariffs Discriminatory:** This made the exports of finished goods relatively costlier and the imports cheaper.

c) Hostile policy and Competition from Machine made goods:

d) Drop in Demand for Indian goods, Shift towards Western goods and Culture.

- Imbalance arose in Indian economy: this causes imbalance in the traditional village Economy.

e) **List of situations where waves of colonialism have impacted as follows**

  a) Large scale unemployment >> absence of alternate sources of employment >> dependency agriculture for livelihood >> sub division and fragmentation of land holdings >> subsistence farming >> reduced agricultural productivity and poverty >> imported goods made the survival of domestic industries more difficult >> Excessive pressure on land under tenancy >> zamindars got the opportunity to extract excessive rents >> low attention to productivity enhancing measures ledto a virtual collapse of Indian agriculture.

British government in India from 1858 to 1947

a) The 'Modern' industrial enterprises in colonial India started to grow in the mid-19th century.

b) **Cotton Mills:** With **9 million spindles** in the 1930s, India got **fifth position** globally.

c) **Jute Mills:** **Largest** in the world, expanding rapidly in and around **Calcutta**

d) **Iron Industry:** Ranking **eighth** in the world.

e) Just before the Great Depression, India was ranked as the 12th Largest Industrializedcountry measured by the value of manufactured products.

f) **Downturn in Producer goods Industries:**

  i. Policy formulation in favor of britishers

  ii. The share in the net domestic product (NDP) of the manufacturing sector had barely reached 7% even in 1946.

INDIAN ECONOMY: POST-INDEPENDENCE (1947- 1991)

1. **Feature of Indian Economy immediately after Independence:**

  a) **M**ajorly had rural inhabited >> mostly illiterate >> poor population >> literacy just 18 % >> barely 32 years of life expectancy.

2. Development Strategy - Nehruvian Model:

  a. The **Nehruvian model** supporting social and economic redistribution and industrialization.

  b. **Rapid industrialization** of the economy was the cornerstone of Nehru's development strategy. The concept of 'planned modernization'.

  c. **Centralized economic planning** and direction was at the core of India's development strategy supporting **equity and distributive justice.**

  d. **The Planning Commission of India** was established to particularly plan for the economic development of the nation in line with the **socialistic strategy.**

  e. This was carried throughthe **five-year plans.**

1948	a. Expanded role for the public sector b. Licensing to the private sector. c. Granted state monopoly for strategic areas such as atomic energy, arms & ammunition & railways. d. The rights to new investments in basic industries were exclusively given to the state.
1950	a. Two Economic philosophies: 1. PM Nehru's visualization - emphasis on heavy industry, and 2. The Gandhian philosophy - small scale and cottage industry and village republics.
1950- 1980	a. India's average annual rate of growth of GDP- often referred to as the **'Hindu growth rate'- was a modest 3.5 percent.** b. Green Revolution Initiative: i. The strategy for agricultural development till then **was reliance on institutional model.** ii. India then faced two severe and consecutive droughts struck in 1966 and 1967.. iii. The evolution of Green Revolution was successfully materialised. Green Revolution is called as Wheat Revolution, made us to overcome food problem. c. The economic performance during the period of 1965-81 is the worst because of-

- i. The license-raj, the autarchic policies in 1960s and 1970s,
- ii. the external shocks such as three wars (in 1962, 1965, and 1971),
- iii. major droughts (especially 1966 and 1967), and the oil shocks of 1973 and 1979
- iv. India being practically a closed economy missed out on the opportunities created by a rapidly growing world economy.

d. Consequence of Framing Interventionist policy

- i. The government nationalized 14 banks in 1969 and 6 in 1980.
- ii. The Monopolies and Restrictive Trade Practices (MRTP) Act, 1969 restricted the possibility of expansion of big business houses.

Evolution of Economic Reforms

1. **Around 1980** - The seeds of early Liberalization and Reforms were sown.
2. Between 1981-1989- This Period named as **early liberalization** were specifically aimed at changing the prevailing thrust on 'in-ward oriented' trade and investment practices.
3. The early reforms of 1980's broadly covered three areas, namely **industry**, **trade** and **taxation**.

a. List of Some Economic Reforms initiated before 1991:

- (a) **Delicensing of 25 broad categories** of industries.
- (b) **Broad-banding** - firms may switch production between different production lines.
- (c) The ceiling limit of MRTP Regulations have been increased from **20 crore to 100 crore**.
- (d) Establishment of SEBI.
- (e) The open general licence (OGL) list was steadily expande.
- (f) Based on the real effective exchange rate (REER), the rupee was depreciated by about 30.0 per cent from 1985-86 to 1989-90.

b. Challenges faced from Reforms:

- The private investments were affected due to **complicated licensing policies**, **public sector reservations** and **excessive government controls**.
- **Reservation of goods to small scale sector** discouraged private investments.
- Inefficiency in government controls and bureaucratic procedures.
- Foreign investments and foreign competition were not allowed for protection to domestic industries.

THE ECONOMIC REFORMS OF 1991

- India embarked on a bold set of economic reforms in **1991 under the Narsimha Rao government**.
- The causes attributed to the immediate need for such a drastic change are:

a. The fiscal initiatives of 1980s led fiscal deficit, making adverse balance of payments.

b. Persistent huge deficits led large government's expenditure towards interest payments.

c. The surge in oil prices triggered by the gulf war in 1990.

d. The foreign exchange reserves touched the lowest point with a reserve of only $1.2 billion which was barely sufficient for two weeks of imports.

e. India had to depend on external borrowing from the IMF.

f. The fragile political situation ballooned into what may be called a 'crisis of confidence'.

g. Collapse of the **Soviet Union and the spectacular success of China**, based on outward oriented policies were lessons for the Indian policy makers.

- The reforms, popularly known as liberalization, privatization & globalization had two major objectives:
  1. **Reorientation of the economy** from a centrally directed and highly controlled one to a 'market friendly' or market oriented economy.
  2. **Macroeconomic stabilization** by substantial reduction in fiscal deficit.

The policies can be broadly classified as :

1. **Stabilization measures** >>>> short term measures >>>to address the problems of inflation & adverse balance of payment
2. **Structural reform** >>>>> long term and of continuing nature>>>> aimed at bringing in productivity and competitiveness by removing the structural rigidities in different sectors of the economy.
4. The prominent industrial policy initiatives were:
   a. **Liberalisation:** Liberalisation refers to relaxation of previous Government restrictions usually in areas of social and economic policies.
   b. **Areas of Liberalisation:** **Liberalization** i.e. economic reforms were introduced in four major sectors viz. -
      - ✓ Industrial Sector,
      - ✓ Financial Sector,
      - ✓ Foreign Trade / External Sector, and
      - ✓ Fiscal Policy.

The Fiscal Reforms

Measures to this effect included:

1. Introduction of a **stable and transparent tax structure**,
2. Ensuring **better tax compliance**,
3. Thrust on **curbing government expenditure**
4. **Reduction** in subsidies and **abolition** of unnecessary subsidies
5. **Disinvestment of part of government's equity holdings** in select public sector undertakings and
6. Encouraging **private sector participation**.

Monetary and Financial Sector Reforms

- The focus was mostly on **reducing the burden of nonperforming assets**.These included many measures, important among them are:
  1. **Interest rate liberalization** and **reduction in controls on banks** by the RBI

2. **Opening of new private sector banks**.
3. Reduction in reserve requirements namely CRR and SLR.
4. **Liberalisation of bank branch licensing policy** and granting of freedom to banks in respect of opening, relocating or closure of branches

Reforms in Capital Markets

- The **Securities and Exchange Board of India (SEBI) which was set up in 1988 was given statutory recognition in 1992**.

The 'New Industrial Policy'

- The **'New Industrial Policy' was announced by the government on 24 July 1991**.

1. The New Economic **Policy put an end to the 'License Raj'** by removing licensing restrictions for all industries except for 18. Consequently, 80 percent of the industry was taken out of the licensing framework.
2. This is subsequently reduced to 5,namely, arms and ammunition, atomic substances, narcotic drugs and hazardous chemicals, distillation and brewing of alcoholic drinks and cigarettes and cigar.
3. The MRTP Act was restructured.
4. Many goods produced by small-scale industries have been de reserved enabling entry of large firms.
5. Foreign investment was also liberalised. The concept of automatic approval was introduced for foreign direct investments up to 51 %.
6. FDI is prohibited only in four sectors viz. retail trade, atomic energy, lottery business and betting and gambling.
7. External trade was further liberalised by substituting 'the positive list approach' of listing license-free items on the OGL list with **the negative list approach**..
8. In 1990-91, the highest tariff rate was 355% which came down to 10% with some exceptions such as automobile at 100%
9. Rupee was devalued by 18% against the dollar.

Trade Policy Reforms

- The trade policy reforms aimed at:
  - Dismantling of **quantitative restrictions** on imports and exports
- **Export duties were removed** to increase the competitive position of Indian goods.
- ***In 1991, India still had a fixed exchange rate system. In March 1992 the government decided to establish a dual exchange rate regime. From 1993 onwards, India has followed a managed floating exchange rate system.***
- India enjoys a solid cushion of foreign exchange reserves close to eight months of import cover. India has one of the largest holdings of international reserves in the world.

- Poverty has reduced substantially
- Value-added share of agriculture and allied activities has declined steadily over the past four decades.

NITI AAYOG: A BOLD STEP FOR TRANSFORMING INDIA

A. Background for NITI AAYOG:

a. On 1st January 2015, the apex policy-making body namely Planning Commission, was replaced by the National Institution for Transforming India (NITI) Aayog.

b. The major objective of such a move was to **'spur innovative thinking by objective 'experts' and promote 'co-operative federalism'** by enhancing the voice and influence of the states'.

c. NITI Aayog is expected to serve as a 'Think Tank' of the government. [and] a 'directional and policy dynamo'.

B. NITI Ayog will work towards the following objectives :

a. **To evolve a shared vision** of national development with the active involvement of states.

b. To foster **cooperative federalism**, recognizing that strong states make a strong nation.

c. **Formulate credible plans** at the village level & aggregate these progressively at higher levels.

d. To pay special **attention to the sections of our society**.

e. To **design strategic and long-term policy and programme** frameworks.

f. To provide **advice and encourage partnerships between key stakeholders** and national and international like-minded think tanks, as well as educational and policy research institutions.

g. To create a **knowledge, innovation and entrepreneuria**l support system.

h. To offer a **platform for the resolution of inter-sectoral and inter departmental issues**.

i. To maintain a **state-of-the-art resource centre**.

j. To **actively monitor and evaluate the implementation of programmes** and initiatives.

k. To focus on **technology up gradation and capacity building** for implementation of programmes.

C. The key initiatives of NITI Aayog are:

a. **'Life'** which envisions replacing the prevalent 'use-and-dispose' economy

b. The **National Data and Analytics Platform (NDAP)** facilitates and improves access to Indian government data

c. **Shoonya campaign** aims to improve air quality in India by accelerating the deployment of electric vehicles

d. **E-Amrit** is a one-stop destination for all information on electric vehicles

e. **India Policy Insights** (IPI)

f. **'Methanol Economy'** programme is aimed at reducing India's oil import bill, greenhouse gas (GHG) emissions, and converting coal reserves and municipal solid waste into methanol, and

g. **'Transforming India's Gold Market'** constituted by NITI Aayog to recommend measures for tapping into the potential of the sector and provide a stimulus to exports and economic growth

D. Weaknesses of NITI AAYOG:

a. NITI has a **limited role**

b. It **does not produce National Plans, Control Expenditures, or Review state plans**.

c. The major shortcoming of NITI is its **exclusion from the Budgeting Process**.

d. It also **lacks Autonomy and Balance of Power** within the policy making apparatus of the central government.

THE CURRENT STATE OF THE INDIAN ECONOMY: A BRIEF OVERVIEW

The Primary Sector

1. Agriculture, with its allied sectors, is largest source of livelihood in India.
2. According to the latest estimates, **47 per cent of India's population is directly dependent** on agriculture for living.
3. India is world's largest producer of **milk**, **pulses**, **jute** and **spices**. India has the **largest area planted** under **wheat**, **rice** and **cotton**.
4. India has the **world's largest cattle herd (buffaloes)**..
5. It is the **second-largest producer of fruits, vegetables, tea, farmed fish, cotton, sugarcane, wheat, rice, cotton, and sugar**.
6. Indian **food and grocery market is the world's sixth largest**.
7. India is among the **top ten exporters of agricultural** products in the world.
8. Although the share of agriculture has been declining in overall gross value added (GVA) of India, it continues to grow in absolute terms.
9. Gross Value Added by the agriculture and allied sector **was 18.8% in** 2021 -22 (until 31 January, 2022).
10. Ensure certainty of returns to the farmers through price support (The Minimum Support Price (MSP) of **all 23 mandated crops is fixed at 1.5 times** of all India weighted average cost of production)
11. Agricultural and Processed Food Export Development Authority (APEDA) is entrusted with the responsibility of export promotion of agri products.
12. The Government of India has allowed 100% FDI in marketing of food products and in food product E-commerce under the automatic route.
13. Large number of interventions is undertaken by different governments. A few such recent measures are:
    - Income support to farmers through PM KISAN
    - Launch of the **National Mission for Edible Oils**
    - **Pradhan Mantri Fasal Bima Yojana (PMFBY)**
    - **Mission for Integrated Development of Horticulture (MIDH)**
    - Provision of **Soil Health Cards**
    - **Parampara at Krishi Vikas Yojana (PKVY)** supporting and promoting organic farming, and improvement of soil health.
    - **Promotion of Farmer Producer Organisations (FPOs)** to ensure better income for the producers through an organization of their own.
    - **Per Drop More Crop (PDMC)** scheme to increase water use efficiency at the farm level

- Setting up of **E-NAM -a pan-India electronic trading portal** which networks the existing APMC mandis to create a unified national market for agricultural commodities.
- Introduction of **Kisan Rail** for improvement in farm produce logistics, and

14. Indian agriculture faces many issues such as:

1. Indian agriculture is dominated by **small and medium farmers with low farm productivity.** These also reduce their ability to participate in the **domestic as well as export market**.
2. Indian agriculture is **resource intensive**, **cereal centric** and **regionally biased**..
3. **Unscientific and wasteful agricultural practices**.
4. **Inadequate agro-processing infrastructure**
5. **Slow agricultural diversification**
6. Inadequate adoption of **environmentally sustainable** and **climate resistant** new farm technology
7. **Poor adoption of new agricultural technologies**
8. **Ineffective marketing, warehousing and credit delivery** of agricultural products.
9. High food **price volatility**
10. **Heavy dependence on monsoons** and loss of crops and livelihood due to vagaries of nature
11. **Inability to tap the full export potential** of primary as well as value added products
12. Inadequate **post-harvest infrastructure and management** practices
13. Incidence of **poverty and malnutrition**

10.7.1 The Secondary Sector

1. The Indian industry contributes about 30 % of total GVA by employing over 12.1 crores.
2. The industrial sector in India broadly comprises of manufacturing, heavy industries, fertilizers, pharmaceuticals, chemicals and petrochemicals, oil and natural gas, food processing, mining, defence products, textiles, retail, micro, small & medium enterprises, cottage industries and tourism. The share of informal sector in the economy is more than 50% of GVA.
3. The Department for Promotion of Industry and Internal Trade (DPIIT) has a role in the formulation and implementation of industrial policy and strategies for industrial development in conformity with the development needs and national objectives.

- Introduction of GST on 1 July 2017 replaced many indirect taxes in India such as the excise duty, VAT, services tax, etc.
- Reduction of corporate tax to domestic companies giving an option to pay income-tax at the rate of 22%.
- 'Make in India' is a 'Vocal for Local' initiative launched in 2014.
- Ease of Doing Business' - India ranks 63rdin the World Bank's annual Doing Business Report (DBR), 2020 as against 77thrank in 2019 registering a jump of 14 ranks.
- The National Single Window System is a one-stop-shop for investment related support.
- PM Gati Shakti - reducing logistics cost.
- National Logistics Policy (NLP) launched in September 2022, aims to lower the cost of logistics.

- The Production Linked Incentive (PLI) Scheme was initiated in March 2020 for 14 key sector.
- FAME-India Scheme (Faster Adoption and Manufacturing of Hybrid and Electric Vehicles)
- 'Udyami Bharat' aims at the empowerment of Micro Small and Medium Enterprises (MSMEs).
- PM Mega Integrated Textile Region and Apparel (PM MITRA):
- 100 per cent FDI under automatic route is permitted for the sale of coal, and coal mining activities, including associated processing infrastructure and for insurance intermediaries.
- Foreign Investment Promotion Board (FIPB) was abolished in May 2017, and a new regime namely Foreign Investment Facilitation Portal (FIF) has been put in place.
- Remission of Duties and Taxes on Export Products (RoDTEP) 2021 formed to replace the existing MEIS (Merchandise Exports from India Scheme) to boost exports.
- Start-up India Programme acts as the facilitator for ideas and innovation in the country. India's rank in the Global Innovation Index (GII) has improved from 81st in 2015 to 40th in 2022.
- The Emergency Credit Line Guarantee Scheme (ECLGS)is a fully guaranteed emergency credit line to monitor lending institutions.

There are many challenges to the industrial sector; a few of these are enumerated below:

- **Shortage of efficient infrastructure and manpower**.
- **Reliance on imports, exchange rate volatility** and associated time and cost overruns
- The **MSME sector is relatively less favorably placed** in terms of credit availability.
- **Industrial locations established** without reference to cost-effective points tend to experience unsustainable cost structure.
- **Heavy losses, inefficiencies, lower productivity** and unsustainable returns plaguing PSU.
- **Lower export competitiveness**, slowing external demand and imposition of non tariff barriers by other countries.
- **Inflation and associated macro economic developments** leading to input cost escalations and lower demand.
- **Global slowdown** and related negative sentiments affecting investment.
- **Aggressive tightening of monetary policy** and increases in cost of credit.
- **High and increasing fuel prices**, and Mounting presence of informal sector .

10.7.3 The Tertiary Sector

India has the unique experience of bypassing the secondary sector in the growth trajectory by a shift from agriculture to the services sector.

India's services sector covers a wide variety of activities.

	BOX 2. The broad classification of services as per the National Industrial Classification, 2008
1.	Wholesale and retail trade and repair of vehicles
2.	Transportation and storage
3.	Accommodation and food service activities

4.	Information and communication
5.	Financial and insurance activities
6.	Real estate activities
7.	Professional, scientific and technical activities
8.	Administrative and support services
9.	Public administration, defence and compulsory social security
10.	Education
11.	Human health and social work activities
12.	Arts, entertainments and recreation
13.	Other service activities
14.	Activities of households as employers, undifferentiated goods and servicesproducing activities of households for own use
15.	Activities of extra territorial organizations and bodies

1. The service sector refers to the industry producing intangible goods viz. services as output. The services sector is the largest sector of India and accounts for 53.89% of total India's GVA.
2. The production and consumption of information-intensive service activities such as computing, accounting, inventory management, quality control, personnel administration, marketing, advertising and legal services has increased manifold.
3. India is among the top 10 World Trade Organization (WTO) members in service exports and imports.
4. India's services exports have remained resilient during the Covid-19 pandemic. The reasons are the higher demand for digital support and need for digital infrastructure modernization.
5. The Indian services sector is the largest recipient of FDI inflows. FDI equity inflows into the services sector accounted for more than 60 per cent of the total FDI equity inflows into India.
6. India as the seventh largest recipient of FDI in the top 20 host countries in 2021. In 2021-22.
7. To ensure the liberalisation of investment in various industries, the government has permitted 100 per cent foreign participation in telecommunication services through the Automatic Route including all services and infrastructure providers.

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Chapter 1- Nature and Scope of Business Economics

Past Year & Most Frequent MCQ

Q.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

Q.2. The branch of economic theory that deals with the problem of allocation of resources is

(a) Micro economics (b) Macroeconomics
(c) Econometrics (d) None of these

Q.3. Capitalistic Economy uses __ as principal means of allocating Resources

(a) demand (b) supply
(c) price (d) all of the above

Q.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

Q.5. In which type of economy do consumers and producers make their choices based on the market forces demand and supply?

(a) Open Economy (b) Controlled Economy
(c) Command Economy (d) Market Economy

Q.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

Q.7. Which of the following falls under microeconomics?

(a) National income
(b) General price level
(c) Factor pricing
(d) National saving and investment

Q.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

Q.9. According to Robbins, 'means' are:

(a) Scarce (b) Unlimited
(c) Undefined (d) All of these

Q.10. 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

Q.11. 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

Q.12. Who defines Economics in terms of Dynamic Growth and Development?

(a) Robbins (b) Paul A Samuelson
(c) Adam Smith (d) None

Q.13. A Free Market economy, solves its Central Problems through

(a) planning authority
(b) market mechanism
(c) both
(d) none

Q.14. Normative aspect of Economics is given by :

(a) Marshall (b) Robbins
(c) Adam Smith (d) Samuelson

Q.15. Which one is not the characteristic of a capitalistic economy?

(a) Profit motive (b) Income inequality
(c) Free employment (d) Collective ownership

Q.16. 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

Q.17. Economic Problem arises when :

(a) Wants are unlimited

(b) Resources are limited

(c) Alternative uses of resources

(d) All of the above

Q.18. Micro economics is also known as

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

Q.19. A developed economy uses technique in production

(a) labour intensive	(b) capital intensive
(c) home-based	(d) traditional

Q.20. 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

Q.21. 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

Q.22. Micro Economics is concerned with:

(a) Consumer Behaviour	(b) Product pricing
(c) Factor Pricing	(d) All of the above

Q.23. Who gave the positive aspect of science?

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

Q.24. Which of these is a part of microeconomics?

(a) Factor pricing	(b) National Income
(c) Balance of payment	(d) None

Q.25. 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

Q.26. In a capitalist economy the allocation of resources is performed by:

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

Q.27. 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

Q.28. Inequalities of income do not perpetuate in

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

Q.29. 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.

Q.30. Normative Economics is based on:

(a) Ethical Considerations

(b) Facts and Generalization

(c) What is?

(d) All of the above

Q.31. The dual system of pricing exists in:

(a) Free market economy

(b) Socialistic economy

(c) Mixed economy

(d) None of the above

Q.32. A Capitalist Economy follows the policy of:

(a) Laissez-faire

(b) Regulated markets

(c) Promoting public sector
(d) None of the above.

Q.33. "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

Q.34. 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.

Q.35. 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

Q.36. 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

Q.37. "Economics is neutral between ends". The statement is given by:
(a) L. Robbins (b) Mrs. Joan
(c) Alfred Marshall (d) A.C. Pigou

Q.38. 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

Q.39. Where does the price mechanism exist?
(a) Capitalist Economy
(b) Socialist Economy
(c) Both types of economies
(d) None of the above

Q.40. Economics which is concerned with welfare propositions is called
(a) Socialistic economics
(b) Capitalistic economics
(c) Positive economics
(d) Normative economics

Q.41. In which among the following systems the right to property' exists
(a) Mixed economy (b) Capitalist economy
(c) Socialist economy (d) Traditional economy

Q.42. Positive science only explains
(a) What is?
(b) What ought to be?
(c) What is right or wrong
(d) None of the above

Q.43. Socialist Economy is also known as
(a) Mixed Economy (b) Planned Economy
(c) Capitalist Economy (d) None of the above

Q.44. Who has defined economics as "Science which deals with wealth"?
(a) Adam Smith (b) Canon
(c) J.B. Say (d) A.C. Pigou

Q.45. 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

Q.46. The most important function of an entrepreneur is to
a) innovate
(b) bear the sense of responsibility
(c) finance
(d) earn profit

Q.47. 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

Q.48. All wants of an individual are not of:

(a) Equal importance

(b) Immediate importance

(c) Fixed importance

(d) All of the above

Q.49. Micro economics does not study

(a) Consumer behavior (b) Factor pricing

(c) General price level (d) Firms equilibrium.

Q.50. 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

Q.51. 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

Q.52. 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

Q.53. 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

Q.54. 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, 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.

Q.55. Socialist Economy was propounded by:

(a) Karl Marx & Fredut Angles

(b) Samuelson

(c) A.C. Pigou

(d) Adam Smith

Q.56. Concept of Business Economics was given by:

(a) Joel Dean (b) Alfred Marshall

(c) Adam Smith (d) L. Robbins

Q.57. A business economy involves the theory of Business economics with

(a) Normative Economics (b) Business practices

(c) Micro Economics (d) Macro Economics

Q.58. Which is not included in Economics?

(a) Family Structure

(b) Managerial Economics

(c) Micro Economics

(d) Macro Economics

Q.59. In which economy market and government both play an important role?

(a) Mixed economy (b) Socialistic economy

(c) Capitalistic economy (d) Business economy

Q.60. 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

Q.61. 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

Q.62. Socialism ensures

(a) Rapid growth and balanced development

(b) Right to work

(c) Incentives for efficient economic decisions

(d) Both (a) and (b)

Q.63. Macroeconomics includes
(a) Product pricing
(b) Consumer behavior
c) External value of money
(d) Location of industry

Q.64. Exploitation and inequality will be more in
(a) Socialism (b) Capitalism
(c) Mixed (d) All of the above

Q.65. Shyam: This year due to heavy rainfall my anion 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

Q.66. 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

Q.67. Applied economics includes
(a) Regression analysis and mathematical linear programming
(b) Capital budgeting
(c) Both (a) and (b)
(d) None

Q.68. 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)

Q.69. Due to recession, employment rate and output
(a) Rises ; rises (b) Falls, falls
(c) Rises falls (d) Falls; rises

Q.70 ______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

Q.71. Socialist economy is
(a) Self-regulation
(b) Profit Oriented
(c) Command economy
(d) Allocation of resources as per market requirements
(1 mark)

Q.72. In a market economy all assets are held by:
(a) Investors (b) Privately
(c) Government (d) Jointly by government

Q.73. The branch of economic theory that deals with problem of allocating resources
(a) Micro economics (b) Marc economics
(c) Econometrics (d) None

Q.74. Larger production of goods would lead to higher production in future.
(a) consumer goods (b) capital goods
(c) agricultural goods (d) public goods

Q.75. Which of the following is not within the scope of business economics?
(a) Capital budgeting (b) Risk analysis
(c) Business cycle (d) Accounting Standards

Q.76. Which type of scarcity is referred to in economics
(a) Relative scarcity (b) Absolute scarcity
(c) Both (a) and (b) (d) None

Q.77. *Consumer sovereignty is which of the following characteristics?*

(a) Capitalist economy *(b) Mixed economy*

(c) Socialist economy *(d) Democracy*

Qn. no	Ans	Qn. no	Ans	Qn. no	Ans	Qn. no	Ans
1	C	21	A	41	B	61	C
2	A	22	D	42	A	62	D
3	C	23	D	43	B	63	C
4	A	24	A	44	A	64	B
5	D	25	D	45	B	65	D
6	B	26	D	46	A	66	B
7	C	27	A	47	C	67	C
8	A	28	A	48	D	68	A
9	A	29	D	49	C	69	B
10	C	30	A	50	B	70	B
11	D	31	C	51	A	71	C
12	B	32	A	52	B	72	B
13	B	33	B	53	C	73	A
14	A	34	D	54	B	74	B
15	D	35	B	55	A	75	D
16	C	36	A	56	A	76	A
17	D	37	A	57	B	77	A
18	B	38	B	58	A		
19	B	39	A	59	A		
20	C	40	A	60	D		

Chapter 2- Utility + Demand+ Supply

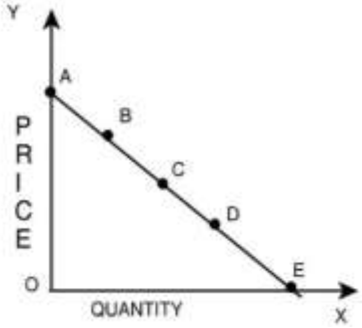
Past Year Exam + Most Repeated Question

Q.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

Q.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.

Q.3. Cardinal approach is related to:

(a) Indifference curve

(b) Equi marginal utility

(c) Law of diminishing returns

(d) None of these.

Q.4. An Increase in demand can result from:

(a) A decline in the market price

(b) An increase in income

(c) Reduction in the price of substitutes

(d) An increase in the price of complements.

Q.5. Cross elasticity of perfect substitutes is

(a) Zero (b) Negative

(c) One (d) Infinity

Q.6. Supply is a _______ concept

(a) Flow (b) Stock

(c) Flow and Stock, both (d) Qualitative

Q.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

Q.8. Which economist said that money is the measuring rod of utility?

(a) A.C Pigou (b) Marshall

(c) Adam Smith (d) Robbins

Q.9. Elasticity between two points:

(a) Point elasticity (b) Arc elasticity

(c) Cross elasticity (d) None.

Q.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

Q.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

Q.12. When supply curve shifts to the right there is:

(a) An increase (b) expansion

(c) Contraction (d) decrease

Q.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.

Q.14. When supply price increase in the short run, the profit of the producer _______.

(a) Increases (b) decreases

(c) Remains constant (d) decreases marginally

Q.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

Q.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

Q.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

Q.18. In case of necessaries, consumer surplus is?

(a) Infinite (b) Zero

(c) Equals to one (d) More than one

Q.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

Q.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

Q.21. Marginal utility of 3^{rd} unit is?

(a) 200 (b) 280

(c) 100 (d) 50

Q.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) $\frac{MUx}{MUy} \neq \frac{Px}{Py}$

Q.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

Q.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

Q.25. 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

Q.26. Method of demand forecasting does not include?

(a) Mathematical method

(b) Barometric method

(c) Expert opinion method

(d) Statistical method

Q.27. An IC shows MRS between the commodity?

(a) Increasing (b) Decreasing

(c) Constant (d) Zero

Q.28. 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.

Q.29. Addition made to total utility refers to?

(a) Total utility (b) Average utility

(c) Marginal utility (d) All of the above.

Q.30. The elasticity of supply is zero means?

a) Perfectly inelastic (b) Perfectly elastic

(c) Imperfectly elastic (d) All of the above.

Q.31. The Consumer is in equilibrium when the following condition is satisfied:

(a) Budget line is tangent to the Ic curve

(b) $\frac{MU_x}{Px} = \frac{MU_y}{P_y} = \frac{MU_z}{P_z}$

(c) Both (a) and (b)

(d) None of the above

Q.32. 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

Q.33. 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°

(d) Sloping upwards

Q.34. 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

Q.35. 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

Q.36. 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

Q.37. 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

Q.38. 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

Q.39. 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 mark demand curve to upper part

Q.40. Which of the following will affect the demand for non-durable goods?

(a) Disposable (b) Income Price

(c) Demography (d) All of the above

Q.41. 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

Q.42. 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

Q.43. 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 mark

(d) Increase in price of the good concerned

Q.44. Perishable commodities will have

(a) Perfectly elastic curve

(b) Perfectly inelastic curve

(c) Elastic

(d) Inelastic

Q.45. Budget line is also called

a) Price line (b) Iso cost line

(c) Iso-quant (d) None

Q.46. 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 given their period at a given price.

Q.47. Luxury goods have income elasticity

(a) Negative and less than 1

(b) Positive and greater than 1

(c) Zero

(d) None

Q.48. 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

Q.49. Elasticity for habitual goods is

(a) Perfectly elastic (b) Elastic

(c) Perfectly inelastic (d) Inelastic

Q.50. 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

Q.51. 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.

Q.52. Suppose the price of movies seen person to at a theatre rises from 120 per 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) 0.50 (b) 0.8

(c) 1.00 (d) None of these.

Q.53. In case of an inferior good, the income elasticity of demand is:

(a) Positive (b) Zero

(c) Negative (d) Infinite

Q.54. For what type of goods does demand fall with a rise in income levels of households?

(a) Inferior goods (b) Luxuries

(c) Substitutes (d) Necessities

Q.55. 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

Q.56. 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

Q.57. 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

Q.58. The quantity demanded does not respond to price change and so the elasticity is:

(a) Zero (c) Infinite

(b) One (d) None

Q.59. 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

Q.60. 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

Q.61. 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

Q.62. Compute income elasticity of demand increases by 5% and income by 1%.

(a) 5 (b) 1/5

(c) 0 (d) None

Q.63. 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

Q.64. 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

Q.65. 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

Q.66. Cross elasticity of demand in Monopoly market is :

(a) Elastic (b) Zero

(c)Infinite (d) One

Q.67. What is income elasticity of demand, when income changes by 20% and demand changes by 40%

(a) 1/2 (b) 2

(c) 0.33 (b) None

Q.68. 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

Q.69. Giffen Paradox is an exception of

(a) Demand (b) Supply Production Utility

(c) Production (d) Uitility

Q.70. Law of demand is a __________.

(a) Quantitative statement (b) qualitative statement

(c) Both (a) & (b) (d) Hypothetical

Q.71. 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

Q.72. 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)15

(c)-1.5 (b) 2

Q.73. 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

Q.74. The elasticity between two points:

(a) Point elasticity (b) Arc elasticity

(c) Cross elasticity (d) None

Q.75. 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

Q.76. cDemand of aommodity depends upon:

(a) Price (b) Income

(c) Price of related good (d)All of the above

Q.77. In case of substitute goods, cross elasticity Is________.

(a) Negative (b) Zero

(c) Positive (d) None of these

Q.78 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

Q.79. 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.

Q.80. 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

Q.81. 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

Q.82. 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

Q.83. 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

Q.84. 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

Q.85. 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

Q.86. 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

Q.87. 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

Q.88. 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

Q.89. Certain goods for which Quantity demanded decreases when Income Increases are called_______ goods.

(a) superior (b)inferior

(c) prestige (d) conspicuous

Q.90. 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

Q.91. Cross elasticity of complementary goods is :

(a)Positive (b) Negative

(c) Infinity (d) None of these.

Q.92. 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

Q.93. 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.

Q.94. Bricks for houses is an example of which kind of demand?

(a) Composite (b) Competitive
(c) Joint (d) Derived.

Q.95. Normal goods have

(a) zero income elasticity
(b) negative income elasticity
(c) positive income elasticity
(d) infinite income elasticity

Q.96. 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

Q.97. 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.

Q.98. If the price elasticity of demand is zero, the shape of the curve will be:

If the price elasticity of demand is zero, the shape of the curve will be:

Q.99. 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

Q.100. 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.

Q.101. Fall in the price of normal goods leads to:

(a) A shift in the demand curve
(b) Fall in demand
(c) Arise in consumers real income
(d) A fall in consumers real income.

Q.102. 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) 0.80

Q.103. 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

Q.104. 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) 15 (d) 1.0

Q.105. 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

Q.106. The demand for factors of production is —

(a) Fundamental demand
(b) Derived demand
(c) Market demand
(d) Joint demand.

Q.107. 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) 0.25
(b) 0.80
(c) 1.00
(d) None

Q.108. 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

Q.109. 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

Q.110. Demand curve parallel to the Y-axis implies:

(a) Ep = 0
(b) Ep = 1
(c) Ep < 1
(d) Ep > 1

Q.111. 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

Q.112. Which amongst the following is the right formula for calculating the price elasticity of demand using ratio method?

(a) (ΔQ/ΔP) x (P/Q)
(b) (ΔP/ΔQ) x (Q/P)
(c) (ΔQ/ΔP) x (Q/P)
(d) (ΔP/ΔQ) x (1/P)

Q.113. 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

Q.114. 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

Q.115. 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

Q.116. 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.

Q.117. When the price of a commodity increases from Z 8 to 9, its demand decreases by 10%. The price elasticity of demand for the commodity

(a) 0.8
(b) 0.9
(c) 1.0
(d) 1.1

Q.118. 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.

Q.119. 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

Q.120 Increase or Decrease in Supply means:

(a) Shift in Supply curve
(b) Movement along the same supply curve
(c) Both (a) and (b)
(d) Neither (a) or (b)

Q.121. When supply price increase in the short run, the profit of the producer ________.

(a) Increases
(b) Decreases
(c) Remains constant
(d)Decreases marginally

Q.122. 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

Q.123. What is the elasticity of supply, when price changes from ₹15 t0 ₹12 and supply change from 6 units to 5 units?

(a) 0.77	*(b) 0.87*
(c) 0.833	*(d) 0.58*

Q.124. 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

Q.125. 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

Q.126. 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

Q.127. If there is an improvement in the technology ______.

(a) The supply curve shifts to the left

(b) The supply curve shifts to

(c) The right quantity supplied increase

(d) Both (b) and (c)

Q.128. 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*

Q.129. 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 of the above

(d) None of the above

Q.130. When Supply Curve shifts to the right there is _______ in Supply.

(a) In increase	*(b) Expansion*
(c) Contraction	*(d) Decrease.*

Q.131. 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

Q.132. Supply of a commodity is a ______.

(a) Stock concept

(b) Flow concept

(c) Both stock and Flow concept

(d) Wholesale concept

Q.133. 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*

Q.134. 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*

Q.135. 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

Q.136. Short- run price is also called by the name of _______.

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

Q.137. 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

Q.138. 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

Q.139. As the price of a commodity increases, normally, its supply:

(a) Decreases (b) Remains unchanged
(c) Increases (d) Cannot be determined

Q.140. 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

Q.141. 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.

Q.142. 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

Q.143. 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.

Q.	Ans.	Q.	Ans.	Q.	Ans.	Q.	Ans.	Q.	Ans.
1	A	31	C	61	B	91	B	121	A
2	A	32	A	62	A	92	B	122	A
3	B	33	A	63	C	93	A	123	C
4	B	34	C	64	C	94	D	124	C
5	D	35	B	65	A	95	C	125	C
6	A	36	D	66	B	96	D	126	A
7	A	37	C	67	B	97	B	127	B
8	A	38	C	68	A	98	B	128	A
9	B	39	C	69	A	99	C	129	B
10	C	40	D	70	B	100	C	130	A
11	A	41	B	71	C	101	C	131	D
12	A	42	D	72	A	102	A	132	B
13	A	43	B	73	A	103	B	133	D
14	A	44	B	74	B	104	A	134	B
15	B	45	A	75	B	105	B	135	B
16	A	46	C	76	D	106	B	136	A
17	B	47	B	77	C	107	B	137	B
18	A	48	A	78	A	108	B	138	C
19	A	49	C	79	D	109	B	139	C
20	A	50	D	80	C	110	A	140	B
21	C	51	D	81	B	111	B	141	A
22	A	52	D	82	C	112	A	142	D
23	C	53	C	83	C	113	C	143	A
24	C	54	A	84	C	114	B		
25	A	55	B	85	D	115	C		
26	A	56	C	86	A	116	D		
27	B	57	A	87	C	117	A		
28	B	58	A	88	D	118	B		
29	C	59	B	89	B	119	D		
30	A	60	B	90	A	120	A		

Chapter 3- Production + Cost + Revenue Concepts

Q.1. _________ shows the overall output generated at a given level of input:
(a) Cost function
(b) Production function 0
(c) ISO cost
(d) Marginal rate of technical substitution

Q.2. If LAC curve falls as output expands, this is due to ________.
(a) Law of diminishing returns
(b) Economics of scale
(c) Law of variable proportion
(d) Dis-economics of scale

Q.3. Isoquants are equal to:
(a) Product Lines (b) Total utility lines
(c) Cost lines (d) Revenue lines

Q.4. The marginal product curve is above the average product curve when the average product is:
(a) Increasing (b) Decreasing
(c) Constant (d) None

Q.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

Q.6. [6] An isoquant is _______ to an isocost line at the equilibrium point:
(a) Convex (b) Concave
(c) Tangent (d)Perpendicular

Q.7. At the point of inflexion, the marginal product is:
(a) Increasing (b) Decreasing
(c) Maximum (d) Negative

Q.8. Diminishing marginal returns implies:
(a) Decreasing average variable costs
(b) Decreasing marginal costs
(c) Increasing marginal costs
(d) Decreasing average fixed costs

Q.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

Q.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

Q.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

Q.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

Q.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.

Q.14. During II^{nd} stage of law of diminishing returns:

(a) P and TP is maximum
(b) MP and AP are decreasing
(c) AP is negative
(d) TP is negative

Q.15. Who has given the concept of Innovative Entrepreneurship?

(a) Robbins	(b) Adam Smith
(c) Schumpeter	(d) Sweezy

Q.16. AT 10 units Total Cost — ₹200
20 units Total Cost — ₹600
Marginal Cost = ?

(a) 50	(b) 40
(c) 30	(d) 400

Q.17. 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

Q.18. What is Production in Economics:
(a) Creation / Addition of Utility
(b) Production of food grains
(c) Creation of services
(d) Manufacturing of goods

Q.19. External Economies of Scale are obtained by:

(a) A firm	(b) A group of firm
(c) Small Production	(d) Society

Q.20. 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

Q.21. 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

Q.22. 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

Q.23. Labour force wants more

(a) facility	(b) leisure
(c) benefit	(d) all of the above

Q.24. 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

Q.2 5. Increasing returns to scale occurs due to:

(a) Economies of scale	(b) Specialization
(c) Indivisibility of factors	(d) All of these

Q.26. 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 mark

Q.27. Law of increasing returns is applicable because of

(a) Indivisibility of factors	(b) Specialization
(c) Economies of scale	(d) Both (a) and (b)

Q.28. 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

Q.29. 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

Q.30. What will be the total product when two labourers are hired according to the table given below?

No. of labourers	MP	Total product
0	--	--
1	350	350
2	230	?

(a) 680	(b) 580
(c) 350	(d) 230

Q.31. Which function shows the relationship between input and output?
(a) Consumption fun ction
(b) Investment function
(c) Production function
(d) Cost function

Q.32. External economies are enjoyed:
(a) By large producers only
(b) As the firm expands
(c) Both (a) and (b)
(d) None of above

Q.33. 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

Q.34. The concept of Returns to Scale is related to:
(a) Very short period (b) Short period
(c) Long period (d) None of above

Q.35. The function of an entrepreneur is:
(a) Initiating an enterprise and resource coordination
(b) Risk bearing
(c) Introducing innovations
(d) All of the above

Q.36. Which of the following is not a characteristic 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.

Q.37. 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.

Q.38. 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.

Q.39. 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.

Q.40. External economies can be achieved through:
(a) Foreign trade only
(b) Superior managerial skill
(c) Extension of transport and credit facilities
(d) External assistance.

Q.41. External economies arise due to:
(a) Growth of ancillary industries
(b) High cost of technologies
(c) Increase in the price of factors of production
(b) None of the above.

Q.42. Innovation theory of entrepreneurship is propounded by:
(a) Knight (b) Schumpeter
(c) Max Weber (d) Peter Drucker

Q.43. 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.

Q.44. The concept of returns to scale is related with:
(a) Very short period (b) Short period
(c) Long period (d) None of the above

Q.45. In Cobb-Douglas production function, two inputs are:
(a) Land and Labour

(b) Labour and Capital mark
(c) Capital and Entrepreneur
(d) Entrepreneur and land

Q.46. 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.

Q.47. 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.

Q.48. 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.

Q.49. 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

Q.50. 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.

Q.51. Production is defined as:
(a) Creation of matter
(b) Creation of utility in matter
(c) Creation of infrastructural facilities
(d) None of the above.

Q.52. 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.

Q.53. 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.

Q.54. ISO quants are also known as:
(a) Production possibility curves
(b) Indifference curves
(c) Production indifference curves
(d) None of the above.

Q.55. Human capital refers to:
(a) Savings by individuals
(b) Mobilisation of savings
(c) Human skills and abilities
(d) Productive investment.

Q.56. 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.

Q.57. Which one of the following statements is not correct?
(a) Land has indestructible powers
(b) Labour is mobile
(c) Capital is nature's gift mark
(d) Land is a passive factor.

Q.58. 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

Q.59. 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

Q.60. 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

Q.61. 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

Q.62. 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.

Q.63. 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.

Q.64. Cobb Douglas function is given by Q = $KL^a\ C^b$
(a) If α + β > 1, increasing returns
(b) If α + β > 1, increasing returns to scale
(c) If α + β < 1, diminishing returns
(d) If «+ B = 1, decreasing returns to scale.

Q.65. Production is defined as:
(a) Creation of matter
(b) Creation of utility in matter
(c) Creation of infrastructural facilities
(d) None of the above.

Q.66. 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) $\frac{1^{th}}{2}$, $\frac{1^{th}}{2}$
(c) $\frac{1^{th}}{4}$, $\frac{3^{th}}{4}$ (d) None of the above.

Q.67. At the point of inflexion, the marginal product is:
(a) Increasing (b) Decreasing
(c) Maximum (d) Negative

Q.68. Isoquante's are equal to:
(a) Product lines (b) Total utility lines
(c) Cost lines (d) Revenue lines

Q.69. 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.

Q.70. According to Cobb-Douglas production function, will get returns to scale?
(a) Constant (b) Diminishing
(c) Increasing (d)Any of the above

Q.71. 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

Q.72. 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

Q.73. 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

Q.74. Supply of land is _______ in case of economy?

(a) Elastic (b) Inelastic

(c) Perfectly elastic (d) Perfectly inelastic

Q.75. MP is the slope of _______.

(a) TP (b) AP

(c) Both (d) None

For Questions [77] - [79] used the data table given below :

No of workers	Total output	Marginal output
0	0	0
1	10	-
2	-	8
3	24	-

Q.76. What will be total output for 2 workers?

(a) 6 (b) 18

(c) 12 (d) 17

Q.77. What will be marginal output for 3 workers?

(a) 6 (b) 12

(c) 7 (d) 8

Q.78. Average Product for three labour:

(a) 12 (b) 11

(c) 8 (d) None

Q.79. Opportunity cost is:

(a) Direct cost

(b) Total cost

(c) Accounting cost

(d) Cost of foregone opportunity

Q.80. As output increases, average fixed cost:

(a) Remains constant (b) Starts falling

(c) Start rising (d) None

Q.81. Average fixed cost can be obtained through :

(a) $AFC = \frac{TFC}{TS}$ (b) $AFC = \frac{EC}{TU}$

(c) $AFC = \frac{TC}{PC}$ (d) $AFC = \frac{TFC}{TU}$

Q.82. AFC curve is :

(a) Convex & downward sloping

(b) Concave & downward sloping

(c) Convex & upward sloping

(d) Concave & upward rising

Q.83. 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

Q.84. 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

Q.85. 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

Q.86. If total cost at 10 units is ₹600 and ₹640 for 11th unit. The marginal cost of 11th units :

(a) ₹20 (b) ₹30

(c) ₹40 (d) ₹50

Q.87. 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

Q.88. 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

Q.89. Suppose, the total cost of production of commodity X is ₹1,25,000. Out 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

Q.90. 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

Q.91. External economies accrue due to ________
(a) Increasing returns to scale
(b) Increasing returns to factor
(c) Law of variable proportion
(d) Low cost

Q.92. 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

Q.93. 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

Q.94. 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

Q.95. 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

Q.96. 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

Q.97. Which of the following is known as Envelope curve?
(a) MC curve (b) AFC curve
(c) LAC curve (d) TFC curve

Q.98. 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

Q.99. Firm's average fixed cost is ₹20 at 6 units of output. What will it be at units of output?
(a) ₹60 (b) ₹30
(c) ₹40 (d) ₹20

Q.100.

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

Q.101. Long run does not have:

(a) Average Cost (b) Total Cost
(c) Fixed Cost (d) Variable Cost

Q.102. Which of the following curve is not U shaped?
(a) AFC (b) AVC
(c) MC (d) TC.

Q.103. 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 mark
(c) ₹200 (d) ₹400

Q.104. 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

Q.105 Which one of the following is correct?
(a) AFC = AVC + ATC
(b) ATC = AFC - AVC
(c) AVC = AFC + ATC
(d) AFC = ATC - AVC.

Q.106. 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

Q.107. Find AFC of 3 units :

Unit	0	1	2	3
Total Cost	15	25	35	45

(a) 5 (b) 10
(c) 15 (d) 25

Q.108. What will be the TVC if we produce 2 units?

Unit	0	1	2
Total Cost	20	37	50

(a) 15 (b) 05
(c) 17 (d) 30

Q.109. 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

Q.110.

Unit	0	1	2	3	4
Total Cost	20	30	40	50	60

What will be the AFC at 4 units of output.
(a) 2 (b) 3
(c) 4 (d)5

Q.111. Payment made to outsiders for their goods and services are called:
(a) Opportunity cost (b)Real cost
(c) Explicit cost (d) Implicit cost

Q.112. Direct Cost is also known as:
(a) Indirect Cost (b) Traceable Cost
(c) Opportunity Cost (d) Accounting Cost.

Q.113. 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

Q.114. Long run price is also called by the name of _______.
(a) market price (b) normal price
(c) administered price (d) wholesale price

Q.115. What will be the AFC of 2 units according to the table given below:

Output	0	1	2
Total Cost	580	689	850

(a) 105 (b) 135
(c) 235 (d) 290

Q.116. Fixed cost is known as _______ cost
(a) Prime (b) Supplementary
(c) Overhead (d) Direct

Q.117. Average Revenue Curve is also known as ________.

(a) Profit curve (b) Demand curve
(c) Supply curve (d) Average cost curve

Q.118. Supply curve remaining unchanged, an increase in demand will lead to

(a) A fall in price (b) Rise in price
(c) No change in price (d) An increase in supply

Q.119. Find out AFC of 3 unit:

Unit	0	1	2	3
Total Cost	300	1000	2000	3000

(a) 100 (b) 200
(c) 300 (d) 400

Q.120.

Unit	0	1	2
Total Cost	580	1200	1500

Calculate AFC at 2nd unit of output

(a) 235 (b) 290
(c) 310 (d) 920.

Q.121. In the long run all factors are

(a) Fixed
(b) Variable
(c) All factors remain unchanged
(d) None.

Q.122. What is the total cost of production of 20 units, if fixed cost is T 5,000 and variable cost is x2/ - ?

a) 5,400 (b) 5,040
(c) 4,960 (d) 5,020

Q.123. Which of the following is known as Envelop Curve?

(a) Average variable cost curve
(b) Average total cost curve
(c) Long run average cost curve
(d) Short run average cost curve

Q.124. 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

Q.125. 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

Q.126. 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

Q.127. 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

Q.128. Cost in terms of pain, discomfort, disability involved in supplying the various factors of production by their owners are termed as _______.

(a) Aocial cost (b) Explicit cost
(c) Real cost (d) Implicit cost

Q.129. 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.

Q.130. 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.

Q.131. 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

Q.132. A firm's total cost is T 200 at 5 units of output and T 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.

Q.133. 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

Q.134 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

Q.135. When AC curve is rising, the MC curve must be _______ to it.

(a) Equal (b) Above

(c) Below (d) Parallel.

Q.136. 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

Q.137. 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.

Q.138. 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

Q.139. 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.

Q.140. Direct costs are also known as _______.

(a) Traceable costs (b) Indirect costs

(c) Opportunity costs (d) Real costs.

Q.141. 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.

Q.142. Marginal cost changes due to change in ______ cost.

(a) Total (b) Fixed

(c) Average (d) Variable

Q.143. 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

Q.144. 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) ₹340 (b) ₹540

(c) ₹840 (d) ₹1,040

Q.145. Average cost of producing 50 units of any commodity is T 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

Q.146. Company produces 10 units of output and incurs T 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

Q.147. 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 (₹)	240	330	410	480	540	610	690

(a) ₹133 (b) ₹75

(c) ₹80 (d) ₹450

Q.148. 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

Q.149. 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

Q.150. 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.

Q.151 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

Q.152. Diminishing marginal returns implies

(a) Decreasing average variable costs

(b) Decreasing marginal costs

(c) Increasing marginal costs

(d) Decreasing fixed costs.

Q.153. 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.

Q.154. 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.

Q.155. Fixed cost curve normally:

a) Starts from the origin (b) Is U shaped

(c) Is vertical line (d) Is horizontal line.

Q.156. 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.

Q.157. The vertical difference between TVC and TC curves is equal to:

(a) MC (b) AVC

(c) TFC (d) None of the above

Q.158. 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.

Q.159. 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.

Q.160. 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

Q.161. 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

Q.162. When average fixed cost is ₹20 at 6 units of output, what will it be at units of output?

(a) ₹60 (b) ₹30

(c) ₹40 (d) ₹20

Q.163. 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

Q.164. 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

Q.165. 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

Q.166. 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.

Q.167. 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

Q.168. What will be average variable cost of producing 5 units of blankets as per details given in the following table?

Blankets	1	2	3	4	5
Total Cost	2,575	3,800	4,500	5,300	6,000

(a) ₹500 (b) ₹750

(c) ₹900 (d) ₹1,000

Q.169. 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.

Q.170. Opportunity Cost is:

(a) Marginal cost (b) Variable cost

(c) Total fixed cost (d) None of these.

Q.171. 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

Q.172. 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.

Q.173. Which of the following curve is not U shaped?

(a) AFC (b) MC

(c) AVC (d) TC

Q.174. Unit TC 580 1200 1500 Calculated AFC at 2™ unit of output:

(a) 235 (b) 290

(c) 310 (d) 920

Q.175. 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

Q.176. External economies accrue due to ________.

(a) Increasing returns to scale

(b) Increasing returns to factor

(c) Law of variable proportions

(d) LOW cost

Q.177. A firms average fixed cost is ₹20 at 6 units of output what will be at 3 units of output?

(a) ₹60 (d) ₹30

(c) ₹40 (d) ₹20

Q.178. Which of the following is correct?

(a) AFC =AVC + ATC (b) ATC = AFC - AVC

(c) AVC =AFC + ATC (d) AFC = ATC - AVC

Q.179. The vertical difference between TVC and TC curves is equal to:

(a) MC (b) AVC

(c) TFC (d) None of the above.

Q.180. The cost of one thing in terms of alternative given up:

(a) Real cost (b) Production cost

(c) Opportunity cost (d) Physical cost

Q.181. 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

Q.182. The slope 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

Q.183. Price of a commodity is best expressed as

(a) Exchange value (b) Cost of goods sold

(c) Production cost (d) Nominal value

Q.184. Accounting cost is of Economic cost

(a) Equal to (b) Less than

(c) More than (d) Not Included

Q.185. 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

Q.186. Which of the following equation represents profit maximisation condition?

(a) MC = MR (b) MC > MR

(c) MC < MR (d) None.

Q.187. 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

Q.188. 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.

Q.189. 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

Q.190. 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) 80 (b) 50

(c) 125 (d) None of the above

Q.191. 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 from its lowest point.

Q.192. Diminishing marginal returns implies.

(a) Decreasing average fixed cost

(b) Decreasing average variable cost

(c) Decreasing marginal cost

(d) Increasing marginal cost

Q.193. Opportunity Cost is _______.

(a) Recorded in the book of accounts

(b) Sacrificed alternative

(c) Both (a) and

(d) None of the above

Q.194. Which of the following is true?

(a) TC=TFC+TVC (b) TC +TVC + TFC

(c) 2TC - TVC = TFC (d) None

Q.195. Total Economic Cost = Explicit Cost + Implicit Cost + _________.

(a) Normal Profit (b) Super Normal Profit

(c) Loss (d) None

Q.196. Economic cost of production differs from accounting cost of production

(a) Partially (b) True

(c) False (d) None

Q.197. Which curve is never U- shaped

(a) AFC (b) AVC

(c) AC (d) None

Q.	Ans	Q	Ans	Q	Ans	Q	Ans
1	B	52	B	103	B	154	D
2	B	53	A	104	B	155	D
3	A	54	C	105	D	156	C
4	A	55	C	106	C	157	C
5	A	56	A	107	A	158	B
6	C	57	C	108	D	159	B
7	C	58	D	109	B	160	C
8	C	59	A	110	D	161	D
9	C	60	B	111	C	162	C
10	A	61	C	112	B	163	B
11	A	62	A	113	B	164	C
12	B	63	B	114	B	165	B
13	C	64	B	115	D	166	A
14	B	65	B	116	C	167	B
15	C	66	A	117	B	168	C
16	B	67	C	118	B	169	D
17	A	68	A	119	A	170	D
18	A	69	A	120	B	171	A
19	B	70	A	121	B	172	C
20	C	71	D	122	B	173	A
21	D	72	D	123	C	174	B
22	D	73	A	124	B	175	C
23	B	74	D	125	D	176	A
24	C	75	A	126	B	177	C
25	D	76	B	127	A	178	D
26	D	77	A	128	A	179	C
27	D	78	C	129	C	180	C
28	D	79	D	130	B	181	C
29	B	80	B	131	B	182	A
30	B	81	D	132	A	183	A
31	C	82	A	133	A	184	B
32	B	83	B	134	A	185	B
33	D	84	D	135	B	186	A
34	C	85	C	136	B	187	B
35	D	86	C	137	D	188	D
36	B	87	A	138	B	189	D
37	A	88	D	139	A	190	C
38	A	89	B	140	A	191	B
39	D	90	B	141	D	192	D
40	C	91	A	142	D	193	B
41	A	92	B	143	C	194	A
42	B	93	D	144	D	195	A
43	A	94	A	145	A	196	B
44	C	95	B	146	D	197	A
45	B	96	C	147	C		
46	C	97	C	148	A		
47	D	98	D	149	A		
48	B	99	C	150	B		
49	C	100	A	151	C		
50	A	101	C	152	C		
51	B	102	A	153	B		

Chapter 4- Market & Its Forms

Q.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

Q.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

Q.3. Given the relation MR = $MR = P\left(1-\frac{1}{e}\right)$ if e > 1then:

(a) MR>0 (b) MR <0
(c) MR=0 (d) None

Q.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

Q.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

Q.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

Q.7. Firms in a monopolistic market are price ________.

(a) Takers (b) Givers
(c) Makers (d) Acceptors

Q.8. Market which have two firms are known as

(a) Oligopoly (b) Duopoly
(c) Monopsony (d) Oligopsony

Q.9. Monopolist can determine :

(a) Price (b) Output
(c) Either price or output (d) None

Q.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

Q.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

Q.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

Q.13. Given the relation MR $= P\left(\frac{e-1}{e}\right)$, if e < 1, then:

(a) MR<0 (b) MR > 0
(c) MR = 0 (d) None of these.

Q.14. For a discriminating monopolist the condition for equilibrium is:

(a) MR >MC (b) MR, = MR,
(c) MR, = MR, = MC (d) All of the above.

Q.15. Average revenue curve is also known as:

(a) Profit curve (b) Demand curve
(c) Supply curve (d) Average cost curve.

Q.16. Given, AR = 5 and Elasticity of demand = 2 Find MR.

(a) + 2.5 (b)-2.5
(c) +1.5 (d) +2.0

Q.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

Q.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

Q.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 = $\frac{TR}{Q}$

Q.20. The market for ultimate consumer is known as:

(a) Wholesale market (b) Regulated market

(c) Unregulated market (d) Retail market

Q.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.

Q.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.

Q.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

Q.24. 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.

Q.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

Q.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

Q.27. Market consists of

(a) Buyer and Seller

(b) One price for one product at a given time

(c)Both (a) and

(d) None

Q.28. Demand for a product is unitary elastic then

(a) MR=0 (b) MR > 0

(c) MR < 0 (d) None of the above

Q.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

Q.30. When TR is at its peak then MR is equal to -

(a) Zero (b) Positive

(c) Negative (d) None of the above

Q.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

Q.32. Which of the following represents the supply curve in a perfect competitive market?

(a) MC curve (b) AC curve

(c) AR curve (d) R curve

Q.33. When TR is man, then MR is

(a) Zero (b) One

(c) Both (a) & (b) (d) None

Q.34. __________ is also called a free market as there are no stipulations on the transactions

(a) Unregulated (b) Regulated

(c) Retail (d) Spot

Q.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

Q.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.

Q.37. Demand of good increases from 15 units to 16 units if price decreases from T 40 to ¥ 38. What will be MR of 16" units.

(a) 8 (b) 16

(c) 38 (d) 15

Q.38. For maximum profit, the condition is :

(a) AR = AC (b) MR = MC

(c) MR = AR (d) MC = AR

Q.39. Equilibrium price may be determined through:

(a) Only demand (b) Only supply

(c) Both demand & supply (d) None

Q.40. 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)

Q.41. 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

Q.42. 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

Q.43. Condition for producer equilibrium is :

(a) TR=TVC (b) MC = MR

(c) TC=TAC (d) None of these

Q.44. 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.

Q.45. 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

Q.46. 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.

Q.47. If supply decreases and demand remains constant, then equilibrium price will be?

(a) Increases (b) Decreases

(c) No change (d) Become Negative

Q.48. According to pigou, first degree price discrimination charges price to;

(a) Individual capacity (b) Quantities sold

(c) Location (d) None of the above

Q.49. 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

Q.50. 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

Q.51. 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

Q.52. 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

Q.53. 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

Q.54. 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

Q.55. Under ________ market condition, firms make normal profits in the long run:

(a) Perfect competition (b) Monopoly
(c) Oligopoly (d) None

Q.56. 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

Q.57. Under which of the following market structure AR of the firm will be equal to MR?

(a) Monopoly
(b) Monopolistic Competition
(c) Oligopoly Perfect
(d) Competition

Q.58. 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

Q.59. When AR = ₹10 and AC = ₹8 the firm makes ________.

(a) Normal profit (b) Net profit
(c) Gross profit (d) Supernormal profit

Q.60. 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

Q.61. Kinked demand curve hypothesis is given by:

(a) Alfred marshal (b) A.C Pigou
(c) Sweezy (d) Hicks & Allen

Q.62. 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

Q.63. If under perfect competition, the price line lies below the average cost curve, the firm would : Incur losses

(a) Make only Normal profits
(b) Incur losses
(c) Make abnormal profit
(d) Profit cannot be determined

Q.64. 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

Q.65. Kinked demand curve is observed in ________.

(a) Duopoly market (b) Monopoly market
(c) Competitive market (d) Oligopoly market.

Q.66. Competitive firms in the long run earn:

(a) Super normal profit (b) Normal profit
(c) Losses (d) None

Q.67. For a monopolist, the necessary condition for equilibrium is: =

(a) P = MC (b) P= MR = AR

(c) MR = MC (d) None

Q.68. 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

Q.69. ________ 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

Q.70. OPEC is an example of :

(a) Monopolistic competition

(b) Monopoly

(c) Oligopoly

(d) Duopoly

Q.71 ________ is an ideal Market.

(a) Monopoly (b) Monopolistic

(c) Perfect Competition (d) Oligopoly

Q.72. Under which Market Situation demand curve is linear and parallel to X axis :

(a) Perfect Competition (b) Monopoly

(c) Monopolistic Competition (d) Oligopoly

Q.73 Which market have characteristic of product differentiation?

(a) Perfect Competition (b) Monopoly

(c) Monopolistic Competition (d) Oligopoly

Q.74. 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

Q.75. The demand curve of oligopoly is :

(a) Horizontal (b) Vertical

(c) Kinked (d) Rising left to right

Q.76. MR Curve = AR = Demand Curve is a feature of which kind of Market?

(a) Perfect Competition (b) Monopoly

(c) Monopolistic (d) Oligopoly

Q.77. 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.

Q.78. 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.

Q.79. Oligopoly having identical products is:

(a) Pure oligopoly (b) Imperfect oligopoly

(c) Price leadership (d) Collusion.

Q.80. The demand curve of oligopoly is :

(a) Horizontal (b) Vertical

(c) Kinked (d) Rising left to right

Q.81. Demand curve is equal to M. R. curve in which market?

(a) Oligopoly

(b) Monopoly

(c) Monopolistic Competition

(d) Perfect Competition

Q.82. 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

Q.83. Price discrimination can take place only in ________.

(a) Monopolistic competition

(b) Oligopoly

(c) Perfect competition

(d) Monopoly

Q.84. In oligopoly, the kink on the demand curve is more due to _______.

(a) Discontinuity in MR.

(b) Discontinuity in AR.

(c) Fulfilment 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.

Q.85. 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

Q.86. Which of the following is not the feature of an imperfect competition?

(a) Product differentiation (b) Few sellers

(c) Homogeneous products (d) Price wars

Q.87. 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

Q.88. Price rigidity is a situation found in which of the following market forms?

(a) Perfect competition

(b) Monopoly

(c) Monopolistic competition

(d) Oligopoly.

Q.89. 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

Q.90. 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.

Q.91. 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

Q.92. Tooth paste industry is an example of ______.

(a) Monopoly (b) Monopolistic Competition

(c) Oligopoly (d) Perfect Competition

Q.93. OPEC is an example of :

(a) Monopolistic competition (b) Monopoly

(c) Oligopoly (d) Duopoly

Q.94. 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)

Q.95. 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 1 mark

(d) The price elasticity of demand is uniform.

Q.96. Oligopoly having identical products is known as

(a) Pure oligopoly (b) Collusive oligopoly

(c) Independent oligopoly (d) None of these

Q.97. Which of these is the best example of oligopoly?

(a) OPEC (b) SAARC

(c) WTO (d) GATT

Q.98. Monopolist can fix him price of goods whose elasticity is

(a) Less than 1 (b) More than 1

(c) Elastic (d) Inelastic

Q.99. Kinked demand curve is observed in

(a) Duopoly market (b) Monopoly market

(c) Competitive market (d) Oligopoly market.

Q.100. Perfectly competitive firm faces:
(a) Perfectly elastic demand curve
(b) Perfectly inelastic demand curve
(c) Zero
(d) Negative

Q.101. 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

Q.102. "Price Discrimination" can be best exercised by the Seller in ________.
(a) Oligopoly
(b) Monopoly
(c) Monopolistic competition
(d) perfect competition

Q.103. In Oligopoly the kink in the demand curve is more due to _________
(a) Discontinuity in MR
(b) Discontinuity in AR
(c) Fulfilment 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

Q.104. 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

Q.105. Under which market Condition firms make only normal profits in the long run?
(a) Oligopoly
(d) Monopoly
(c) Monopolistic competition
(d) Duopoly

Q.106. In monopolistic competition excess capacity in the firm
(a) Always exists (b) Sometimes exists
(c) Never exists (d) None of the above

Q.107 Selling costs have to be incurred in case of:
(a) Perfect Competition
(b) Monopolistic Competition
(c) Monopoly
(d) None of these.

Q.108. 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.

Q.109. 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.

Q.110. 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.

Q.111. A monopolist can fix:
(a) Both price and output
(b) Either price or output
(c) Neither price nor output
(d) None of the above.

Q.112. In a perfectly competitive market, the demand curve of a firm is:
(a) Elastic (b) Perfectly elastic
(c) Inelastic (d) Perfectly inelastic

Q.113. 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.

Q.114. Price under perfect competition is determined by the

(a) Firm (b) Industry

(c) Government (d) Society.

Q.115. 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.

Q.116. Non price competition is very popular in:

(a) Monopoly market

(b) Monopolistic competition

(c) Oligopolistic market

(d) Perfect competition.

Q.117. In the 'kinked demand' curve model, the upper portion of the demand curve is:

(a) Elastic (b) Inelastic

(c) Perfectly Elastic (d) Unitary Elastic.

Q.118. 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.

Q.119. 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

Q.120. Kinked demand curve is related to which market structure

(a) Oligopoly (b) Monopoly

(c) Monopsony (d) Monopolistic competition.

Q.121. In the long run a monopolist always earns

(a) Normal profit (b) Abnormal profit

(c) Zero profit (d) Loss

Q.122. 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

Q.123. 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

Q.124. The demand curve of an oligopolist is :

(a) Determinate (b) Indeterminate

(c) Circular (d) Vertical

Q.125. Abnormal profits exist in the long run only under ______

(a) Perfect competition

(b) Monopoly

(c) Monopolistic competition

(d) Oligopoly

Q.126. 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

Q.127. Selling outlay is an essential part of which of the following market situations?

(a) Perfect Competition

(b) Monopoly

(c) Monopolistic Competition

(d) Pure Competition.

Q.128. The Kinked demand curve model explains the market situation

(a) Pure Oligopoly (b) Differentiated Oligopoly

(c) Collusive Oligopoly (d) Price Rigidity

Q.129. 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

Q.130. 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.

Q.131. 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

Q.132. 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

Q.133. Price discrimination will not be profitable, if the elasticity of demand is _________ in different markets

(a) Uniform (b) Different

(c) Less (d) Zero

Q.134. 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

Q.135. 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.

Q.136. 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.

Q.137. 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.

Q.138. Kinked demand curve under oligopoly is designed to show:

(a) Price and output determination

(b) Price rigidity

(c) Price leadership

(d) Collusion among rivals.

Q.139. "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.

Q.140. Kinked demand curve is the demand curve of

(a) Perfect Competition

(b) Monopoly

(c) Monopolistic Competition

(d) None of the above.

Q.141. Price discrimination M" be profitable only if the elasticity of demand in different markets is

(a) Uniform	(b) Different
(c) Less	(d) Zero

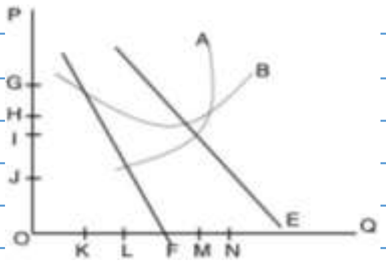
Q.142. Under which of the following form of market structure does a firm have no control over the price of its production?

(a) Monopoly	(b) Monopolistic Competition
(c) Oligopoly	(d) Perfect Competition.

Q.143. __________ 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.

Solve the question No. 91, 92 and 93 on the base of following figure:



Q.144. 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.

Q.145. Above figure represents a

(a) Monopolist

(b) Perfectly competition industry

(c) Perfectly competitive firm

(d) None of the above.

Q.146. In above figure, firms marginal revenue curve is curve

(a) E	(b) A
(c) F	(d) B

Q.147. The price elasticity of demand for a product is infinite under:

(a) Perfect competition

(b) Monopolistic competition

(c) Monopoly

(d) Oligopoly.

Q.148. 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.

Q.149. 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.

Q.150. 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.

Q.151. 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

Q.152. Who sets the price of the product under perfect competition?

(a) Government	(b) Consumers
(c) Sellers	(d) Both buyers and sellers

Q.153. 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

Q.154. Which market has the concept of 'group' equilibrium in the long run?

(a) Oligopoly
(b) Monopoly
(c) Monopolistic competition
(d) Perfect competition.

Q.155. 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.

Q.156. Average revenue curve is also known as:
(a) Profit Curve (b) Demand Curve
(c) Average Cost Curve (d) Indifference Curve

Q.157. 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.

Q.158. 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.

Q.159. 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.

Q.160. 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.

Q.161. 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.

Q.162. 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.

Q.163. 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.

Q.164. Condition for equilibrium of firm:
(a) MR = MC
(b) AR = AC
(c) MC curve cuts MR curve from below
(d) Both (a) and (c)

Q.165. 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

Q.166. 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.

Q.167. 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.

Q.168. In the long run monopolist
(a) Incur losses
(b) Must earn super normal profits

(c) Wants to shut down
(d) Earns only normal profits.

Q.169. 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

Q.170. Which of these is the best example of oligopoly?
(a) OPEC (b) SAARC
(c) WTO (d) GATT

Q.171. 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

Q.172. 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.

Q.173. 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 > AVG

Q.174. Market form in which there is only one buyer and one seller is:
(a) Oligopoly (b) Duopoly
(c) Bilateral Monopoly (d) Monopsony

Q.175. The structure of the Toothpaste Industry in India is best described as:
(a) Perfectly competitive
(b) Monopolistic
(c) Monopolistically competitive
(d) Oligopolistic

Q.176. Product differentiation is the main features of which market?
(a) Oligopoly
(b) Monopolistic
(c) Discriminating Monopoly
(d) Perfect competition

Q.177. Which market is having a single seller and single Buyer?
(a) Duopoly (b) Monopsony
(c) Bilateral Monopoly (d) None of the above

Q.178. In Long run perfect competitive market incurs
(a) Normal profit (b) Supernormal profit
(c) Losses (d) Constant Returns

Q.179. 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

Q.180. Price leadership is the characteristic of
(a) Oligopoly
(b) Monopoly
(c) Perfect competition
(d) Discriminating Monopoly

Q.181. 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

Q.182. 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

Q.183. Which out of these are not features of perfect competition?
(a) Homogeneous
(b) Large number of buyer and sellers
(c) Free entry and exit
(d) Selling cost.

Q.184. Which of the following statement is correct?
(a) Price rigidity is an important feature of monopoly

(b) Selling cost is possible under perfect competition
(c) An industry consists of many firms
(d) Under perfect competition factor of production do not move freely as these are legal restriction

Q.185. Which is the characteristic feature of monopoly?
(a) Homogeneous goods
(b) Strong barriers to entry
(c) Perfect competition
(d) Perfectly elastic demand curve

Q.186. 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

Q.187. Price discrimination is possible only in _______.
(a) Monopoly (b) Perfect Competition
(c) Oligopoly (d) Monopolistic Competition

Q.188. 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

Q.189. Demand curve is horizontal in the case of _________.
(a) Monopoly
(b) Perfect Competition
(c) Imperfect Competition
(d) Monopolistic Competition

Q.190. 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

Q.191. If a perfectly competitive firm earns super normal profits then _________
(a) AR > MR (b) AR < MR
(c) AR = MR (d) None of the above

Q.192. Live and let live is characteristics of which of the following market?
(a) Perfect Competition
(b) Monopoly Competition
(c) Imperfect Competition
(d) Oligopoly Competition

Q.193. 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

Q.194. The degree of elasticity in perfect competition market.
(a) Perfectly elastic (b) Inelastic
(c) Perfectly inelastic (d) Elastic

Q.195. A perfect competitive firm earns super normal profits when
(a) ATC < MC (b) ATC > MC
(c) MR < AR (d) MR > AR

Q.196. A firm is said to earn normal profit when
(a) AC = AR (b) MC = MR
(c) AR = NH (d) MC > MR

Q.197. 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

Q.198. Group Behaviour is a characteristics of ________.
(a) Oligopoly (b) Monopoly
(c) Perfect Competition (d) Monopolistic Competition

Q.199. Myth in Real world
(a) Oligopoly (b) Duopoly
(c) Perfect Competition (d) Monopoly

Q.200. _________ 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

Q.201. *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

Q.202. *Which Market has a downward demand curve?*

(a) Monopolistic competition

(b) Monopoly

(c) Perfect competition

(d) Both (a) and (b)

QUESTION	ANS	QUESTION	ANS	QUESTION	ANS	QUESTION	ANS
1	D	52	A	103	C	154	C
2	D	53	A	104	C	155	C
3	A	54	D	105	C	156	B
4	C	55	A	106	A	157	A
5	A	56	D	107	B	158	C
6	A	57	D	108	C	159	C
7	C	58	B	109	D	160	A
8	B	59	D	110	D	161	C
9	C	60	D	111	A	162	A
10	C	61	C	112	B	163	D
11	B	62	C	113	C	164	D
12	D	63	B	114	B	165	D
13	A	64	B	115	D	166	D
14	C	65	D	116	B	167	D
15	B	66	B	117	A	168	B
16	A	67	C	118	B	169	C
17	B	68	C	119	A	170	A
18	B	69	B	120	A	171	A
19	C	70	C	121	B	172	B
20	D	71	C	122	A	173	A
21	C	72	A	123	C	174	C
22	A	73	C	124	B	175	B
23	C	74	D	125	B	176	B
24	B	75	C	126	D	177	C
25	A	76	A	127	C	178	A
26	C	77	B	128	D	179	C
27	C	78	C	129	B	180	A
28	A	79	A	130	B	181	A
29	B	80	C	131	C	182	B
30	A	81	D	132	B	183	D
31	C	82	B	133	A	184	C
32	A	83	D	134	A	185	B
33	A	84	C	135	B	186	C
34	A	85	A	136	A	187	A
35	B	86	C	137	B	188	C
36	B	87	D	138	B	189	B
37	A	88	D	139	A	190	B
38	B	89	D	140	D	191	C
39	C	90	D	141	B	192	D
40	A	91	D	142	D	193	A
41	D	92	B	143	A	194	A
42	C	93	C	144	C	195	A
43	B	94	D	145	A	196	A
44	A	95	C	146	C	197	A
45	C	96	A	147	A	198	A
46	B	97	A	148	C	199	C
47	A	98	A	149	C	200	A
48	A	99	D	150	C	201	B
49	A	100	A	151	C	202	D
50	A	101	D	152	D		
51	B	102	B	153	C		

Chapter 5- Business Cycle

Q.1. Rampant unemployment is found in:
(a) Boom (b) Recovery
(c) Contraction (d) Depression

Q.2. According to which economist trade cycle is a purely monetary for phenomenon
(a) Schumpter (b) Pigou
(c) Hawtrey (d) Marshall

Q.3. Greatest depression suffered by economy in which year.
(a) 1924 (b) 1930
(c) 2008 (d) 2009

Q.4. Last stage of recession is called:
(a) Depression (b) Recovery
(c) Slowdown (d) All of these.

Q.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, tall (d) rise, rise.

Q.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

Q.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

Q.8. An economic variable that moves in the opposite direction as aggregate economic activity down in expansions, up in contractions is called.
(a) Pro cyclical (b) Counter cyclical
(c) A cyclical (d) A leading variable

Q.9. How many phases are there in business cycle?
(a) Four (b) Five
(c) One (d) Many

Q.10. The world economy suffered the longest, deepest and most widespread depression of the 20"1 century during?
(a) 1934 (b) 1928
(c) 1930 (d) 1932

Q.11. Business cycle is contagious and ________ in character?
(a) Local (b) Regional
(c) National (d) International

Q.12. Which External Factor affects the business cycle?
(a) Population growth
(b) Variation in government spending
(c) Money supply
(d) Macro economic policies

Q.13. Which internal factor affects the Business cycle?
(a) Fluctuations in investment
(b) Natural factors
(c) Technology shocks
(d) Population growth

Q.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"

Q.15. When once peak is reached, increase in demand is halted, then ________ phase begins?
(a) Trough (b) Contraction
(c) Expansion (d) Trend

Q.16. Fashion Retailer is business of?
(a) Cyclical business (b) Sun rise business
(c) Sluggish business (d) None of these

Q.17. Features of business cycles include?
(a) Discuss periodically
(b) Have four different phases

(c) Originate in free Market Economy
(d) All of the above.

Q.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

Q.19. The internal causes of business cycle is
(a) Fluctuation in effective demand
(b) Technology shocks
(c) Both (a) and (b)
(d) None

Q.20. Economics activities will be declining in the phase of ________.
(a) Expansion (b) Depression
(c) Contraction (d) Peak

Q.21. Business Cycle occurs
(a) Periodically (b) In different phases
(c) Both (a) and (b) (d) None of the above

Q.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

Q.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)

Q.24. Which of the following is not the phase of business cycles?
(a) Prosperity (b) Upswing
(c) Reconstruction (d) Depression

Q.25. Boom and depression in business cycle are
(a) Turning points (b) Equilibrium points
(c) Both (a) and (b) (d) None of the above

Q.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

Q.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

Q.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

Q.29. Excess capacity in capital industries leads to
(a) Peak (b) Trough
(c) Expansion (d) Recovery

Q.30. Here, growth moves in reverse direction
(a) Peak (b) Expansion
(c) Contraction (d) Recovery

Q.31. Frictional unemployment exists in
(a) Peak (b) Contraction
(c) Expansion (d) Recovery

Q.32. In which stage maximum production occurs.
(a) Peak (b) Expansion
(c) Boom or Expansion (d) Tough or boom

Q.33. Unemployment is caused due to structural changes is known as?
(a) Ethnic unemployment
(b) Involuntary unemployment
(c) Structural
(d) None

Q.34. At trough production is?
(a) High (b) Low
(c) Negative (d) None

Q.35. Stage at which actual demand is stagnated?
(a) Peak (b) Boom or Peak
(c) Contraction (d) Tough

Q.36. A change of reaction producer cancels their order in which, stage?
(a) Peak (b) Contraction
(c) Trough (d) None

Q.37. Which of the following is true?
(a) Depression is secure form trough
(b) Depreciation causes fall in interest rate.
(c) Both (a) and (b)
(d) None

Q.38. China's recent slovedow 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 fuelled the economic decline.

Q.39. What of the following are not external causes?
(a) Past war reconstruction
(b) Population growth
(c) Technology factors
(d) Fluctuation in effective demand

Q.40. 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

Q.41. Great Depression occurred during:
(a) 1930 (b) 1947
(c) 1857 (d) 2000

Q.42. Internal causes of depression include:
(a) Fluctuation in investments
(b) Money supply
(c) Psychological factors
(d) All of these

Q.43. External factors for depression does not include:
(a) Population growth
(b) Technology shocks
(c) Macro economic policies
(d) Post war reconstruction

Q.44. ________ is the measurable economic factorthat changes before economy starts to follow a particular pattern or trend:
(a) Leading indicator
(b) Lagging indicator
(c) Concurrent indication
(d) Coincident indicators

Q.45. 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

Q.46. 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

Q.47. 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

Q.48. Variables that change after real output changes are:
(a) Leading indicators (b) Lagging indicators
(c) Coincident indicators (d) None of these

Q.49. Severe form of recession is called:
(a) Boom (b) Depression
(c) Trough (d) Recovery

Q.50. 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

Q.51. Peaks and troughs of the business cycles are known collectively as:

(a) Turning points (b) Indicators

(c) Equilibrium points (d) Contraction

Q.52. During recession output:

(a) Falls (b) Rises

(c) Expands (d) None of these.

Q.53. Business cycles generally originate in:

(a) Free market economies

(b) Imperfect economies

(c) Developed nations

(d) Low growth economies

Q.54. At the time of Great Depression of 1930, GDP fell around:

(a) 14% (b) 15%

(c) 20% (d) 25%

Q.55. The highest point of business cycle is known as:

(a) Trough (b) Peak

(c) Trend (d) Boom

Q.56. During the slowdown 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

Q.57. 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

Q.58. Which macro-economic variables are excluded from leading economic indicators:

(a) Industrial production

(b) Residential investment

(c) Money supply

(d) Inventory investment

Q.59. When aggregate economic activity is declining, is the phase of:

(a) Expansion (b) Contraction

(c) Recovery (d) Trough

Sr. No	Ans	Sr. no	Ans	Sr. No	Ans
1	D	28	D	55	B
2	C	29	B	56	B
3	B	30	A	57	D
4	A	31	C	58	A
5	A	32	A	59	B
6	D	33	C		
7	D	34	B		
8	B	35	A		
9	A	36	B		
10	C	37	C		
11	D	38	A		
12	A	39	D		
13	A	40	B		
14	C	41	A		
15	B	42	D		
16	A	43	C		
17	D	44	A		
18	A	45	C		
19	A	46	A		
20	C	47	D		
21	C	48	B		
22	B	49	B		
23	C	50	C		
24	C	51	A		
25	A	52	A		
26	B	53	A		
27	A	54	B		

CHAPTER 6 DETERMINATION OF NATIONAL INCOME

UNIT – 1 NATIONAL INCOME

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

2. 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

3. 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

4. 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

5. 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

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

7. 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

8. 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

9. 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

10. 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

11. 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

12. 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? Gross of depreciation.

(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

13. 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)₹3,250

(d) ₹ 4,000

Answer : C

14. 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

15. In a country, GNP MP 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)₹900billion

(b) ₹ 700 billion

(c)₹800billion

(d) ₹ 600 billion

Answer : B

16. In a country, the GDPMP for the year 2022 is ₹ 1,200 billion, and indirect taxes (only 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 : D

17. In a country, the 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

18. In a country, the Personal Income (PI) for the year 2021 is ₹ 800 billion. The direct taxes are 7 100 billion, and the social security contributions are ₹ 50 billion. Calculate the Disposable Personal Income (DI) for the year 202.

(a)₹650billion

(b) ₹ 750 billion

(c)₹700billion

(d) ₹ 600 billion

Answer : A

19. 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

20. 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 : D

21. 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

22. 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

23. 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

24. 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 : B

25. 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

26. 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

27. 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

28. 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

29. 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 : A

30. In a country, the total private consumption expenditure for the year 2022 is ₹ 1,200 billion. The gross private domestic investment for the year2022 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

31. 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

32. 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

33. 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

34. 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

35. 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

---

36. 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

---

37. 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

---

38. 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

---

39. 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

---

40. 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

Answer : C

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41. 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

Answer : B

---

42. 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

Answer : B

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43. The per capita income, derived from national income estimates, is useful for:

(a) Understanding the total population of a country

(b) Analysing the average income of individuals in the country

(c) Measuring the total number of employed people

(d) Evaluating the performance of the agricultural sector

Answer : B

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44. 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

Answer : B

---

45. 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

Answer : B

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46. Which of the following represents the broadest measure of a country's national income?

(a) GDP

(b) GNP

(c) NNP

(d) PI

Answer : B

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47. 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

Answer : A

---

48. 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

Answer : B

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49. 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

Answer : B

---

50 . 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)

Answer : D

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51. 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

Answer : C

---

52. 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

Answer : A

CHAPTER 6 DETERMINATION OF NATIONAL INCOME

Unit:2 The Keynesian Theory of Determination of National Income

53. 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 : C

54. 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

55. 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

56. 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

57. 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

58. 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

59. 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 : B

60. 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

61. 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 : A & D

62. 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

63. 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

64. 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

65. 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 : D

66. 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 : D

67. 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 : B

68. 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

69. 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

70. In an economy, the aggregate demand (A(d) function is represented as AD = 2,000 -10OP, 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

71. 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 : B

72. 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

73. 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

74. 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

75. 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

76. 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 : C

77. 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

78. 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

79. 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 & C

80. 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

81. 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

82. 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

83. 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

84. 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

85. 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

Answer : C

86. 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

Answer : C

87. 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

Answer : C

88. 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

Answer : C

89. Savings in the two-sector model is equal to:

(a) Investment

(b) Consumption

(c) Income earned by households

(d) Government spending

Answer : A

90. 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

Answer : B

91. 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

Answer : C

---

92. 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

Answer : D

---

93. 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

Answer : C

---

94. 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

Answer : A

---

95. 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)

Answer : B

---

96. 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

Answer : C

---

97. 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

Answer : B

---

98. 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

Answer : B

99. 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

Answer : C

---

100. 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

Answer : D

---

101. 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 : D

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102. The concept of 'resident unit' involved in the definition of GDP denotes

a) A business enterprise which belongs to a citizen of India with production units solely situated in India

b) The unit having predominant economic interest in the economic territory of the country for one year or more irrespective of the nationality or legal status

c) A citizen household which had been living in India during the accounting year and one whose economic interests are solely in India

d) Households and business enterprises composed of citizens of India alone living in India during the accounting year

Answer : B

---

103. Read the following statements and answer the following question.

Intermediate consumption consists of the value of the goods and services consumed as inputs by a process of production.

I. Intermediate consumption excludes fixed assets whose consumption is recorded as consumption of fixed capital.

(a) Only I is true

(b) Both I and II are true

(c) Only II is true

(d) Neither I nor II is true

Answer : B

---

104. Gross Domestic Product (GDP) of any nation

a) excludes capital consumption and intermediate consumption

b) is inclusive of capital consumption or depreciation

c) is inclusive of indirect taxes but excludes subsidies

d) None of the above

Answer : B

---

105. Read the following statements

I. 'Value added' refers to the difference between value of output and purchase of intermediate goods.

II. 'Value added' represents the contribution of labour and capital to the production process.

(a) Statements I and II are incorrect

(b) Statements I and II are correct

(c) Statement I is correct and II is incorrect

(d) Statement II is correct and I is incorrect

Answer : B

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106 .Non-economic activities are

a) Those activities whose value is excluded from national income calculation as it will involve double counting

b) Those which produce goods and services, but since these are not exchanged in a market transaction they do not command any market value

c) Those which do not involve production of goods and services as they are meant to provide hobbies and leisure time activities

d) Those which result in production for self consumption and therefore not included in national income calculation

Answer : B

---

107. Which of the following does not enter

in to the calculation of national income?

a) Exchange of previously produced goods

b) Exchange of second hand goods

c) Exchange of stocks and bonds

d) All the above

Answer : D

---

108. Which of the following enters in to the Calculation of national income?

a) The value of the services that accompany the sale

b) Additions to inventory stocks of final goods and materials

c) Stocks and bonds sold during eth current year

d) (a) and (b) above

Answer : D

---

109. Gross National Product at market prices GNP MP is

(a) GDP MP +Net Factor Income from Abroac

(b) GDP MP - Net Factor Income from Abroad

(c) GDP MP - Depreciation

(d) GDP MP + Net Indirect Taxes

Answer : A

---

110. Choose the correct statement

a. GNP includes earnings of Indian corporations overseas and Indian residents working overseas; but GDP does not include these

b. NNPFC =National Income = FID (factor income earned in domestic territory) – NFIA.

c. Capital goods and inventory investment are excluded from computation of GDP

d. NDP**MP** = GDP**MP** + Depreciation

Answer : A

111.The basis of distinction between market price and factor cost is

a. Net factor income from abroad

b. Net indirect taxes (i.e.,Indirect taxes-Subsidies)

c. Net indirect taxes (i.e., Indiret taxes + Subsidies)

d. Depreciation (consumption of fixed capital)

Answer : B

---

112. If net factor income from abroad is positive, then

a. National income will be greater than domestic factor incomes.

b. National income will be less than domestic factor incomes.

c. Net exports will be negative

d. domesticfactorincomeswillbegreaterthannationalincome

Answer : A

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113. The GDP per capita is

e. A measure of a country's economic output per person

f. Actual current income receipts of persons

g. National income divided by population

h. (a) and (c)above

Answer : D

---

114. Which of the following is an example of transfer payment?

i. Old age pensions and family pensions

j. Scholarships given to deserving diligent students.

k. Compensation given for loss of property due to floods

l. All the above

Answer : D

---

115. Mixed income of the self-employed means

(a) Net profits received by self -employed people

(b) Outside wages received by self-employed people

(c) Combined factor payments which are not distinguishable,

(d) Wages due to non- economic activities

Answer : C

1. Redistribution policies are likely to have efficiency costs because

(a) They will reduce the efficiency of governments

(b) They may create disincentives to work and save

© Governments have to forego taxes

(d) They are likely to make the poor people dependent on the rich

Answer :- B

2. Macroeconomic stabilization may be achieved through

(a) Free market economy

(b) Fiscal policy

(c) Monetary policy

(d) (b) and (c) above

Answer :- D

3. Which of the following policies of the government fulfils the redistribution function

(a) Parking the army on the northern borders of the country

(b) Supply of food grains at subsidized prices to the poor people

(c) Controlling the supply of money through monetary policy

(d) All of the above

Answer :- B

4. Choose the correct statement

(a) Fiscal policy involves the use of changes in taxation and government spending; while monetary policy involves the use of price and profit controls.

(b) Fiscal policy involves the use of price and profit controls; while monetary policy involves the use of taxation and government spending.

(c) Fiscal policy involves the use of changes in taxation and government spending; while monetary policy involves the use of changes in the supply of money and interest rates.

(d) Fiscal policy involves the use of changes in the supply of money and interest rates; while monetary policy involves the use of changes in taxation and government spending.

Answer :- C

5. The justification for government intervention is best described by

(a) The need to prevent recession and inflation in the economy

(b) The need to modify the outcomes of private market actions

(c) The need to bring in justice in distribution of income and wealth

(d) All the above

Answer :- D

6. Read the following statements:

1. The market-generated allocation of resources is usually imperfect and leads toinefficient allocation of resources in the economy

2. Market failures can at all times be corrected through government intervention

3. Public goods will not be produced in sufficient quantities in a market economyOf the three statements above:

(a) 1,2 and 3 are correct
(b) 1 and 3 are correct
(c) 2 and 3 are correct
(d) 3 alone is correct

Answer :- B

7. When a government offers unemployment benefits and also resorts to progressivetaxation which function does it seem to fulfill?

(a) It is trying to establish stability in an economy

(b) It is trying to redistribute income and wealth

(c) It is trying to allocate resources to their most efficient use

(d) It is creating a source of market failure

Answer :- B

8. Government of Emeline Land decides to provide most modern road infrastructurethroughout the nation. This can be classified as

(a) Distribution function

(b) Allocation function

(c) Stabilization function

(d) None of the above

Answer :- B

9. Which function does the government perform when it provides transfer payments to offersupport to the underprivileged

(a) Allocation

(b) Efficiency

(c) Distribution

(d) None of the above

Answer :- C

10. Which of the following is true in respect of centre and state government finances?

(a) The centre can tax agricultural income and mineral rights

(b) Finance commission recommends distribution of taxes between the centre andstates

(c) GST subsumes majority of direct taxes and a few indirect taxes

(d) IGST is collected by the state governments

Answer :- B

11. GST compensation is given to

(a) to the industries which have made losses due to the introduction of GST

(b) to compensate for the lower rates of GST on essential items

(c) o the states to compensate for the loss of revenue due to the introduction of GST

(d) to compensate for the loss of input tax credit in manufacturing

Answer :- C

12. Which of the following is true in respect of the role of Finance Commissions in India?

I. The distribution between the union and the states of the net proceeds of taxes

II. Allocation between the states of the respective shares of such proceeds.

III. Make Recommendations on integrated GST on inter-state movement of goodsand services

IV. To recommend expenditure decentralization among different states

(a) I and II are correct

(b) II and III are correct

(c) I, II and III are correct

(d) All the above are correct

Answer :- A

13. In a federal set up, the stabilization function can be effectively performed by

(a) Respective state governments

(b) Ministry of taxes

(c) The government at the centre

(d) None of the above

Answer :- C

14. Which of the following is concerned with division of economic responsibilities betweenthe central and state Government of India?

(a) NITI Aayog

(b) central bank

(c) Finance Commission

(d) Parliament

Answer :- C

15. Fiscal Federalism refers to________________ _.

(a) Organizing and implementing development plans

(b) Sharing of political power between centers and states

(c) The management of fiscal policy by a nation

(d) Division of economic functions and resources among different layers of thegovernment

Answer :- D

16. Which one of the following taxes is levied by the state government only?

(a) Corporation tax

(b) Wealth tax

(c) Income tax

(d) None of the above

Answer :-D

17. The percentage of share of states in central taxes for the period 2021-26 recommendedby the Fifteenth Finance Commission is

(a) 38 percent

(b) 41 percent

(c) 42 percent

(d) The commission has not submitted its report

Answer :- B

18. Which of the following is not a criterion for determining *distribution of central taxesamong states for 2021-26 period*

(a) Demographic performance

(b) Forest and ecology

(c) Infrastructure performance

(d) Tax and fiscal efforts

Answer :- C

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19. As per the supreme court verdict in May 2022

(a) The union has greater powers than the states for enacting GST laws

(b) The union and state legislatures have "equal, simultaneous powers "to make laws on Goods and Services Tax

(c) The union legislature's enactments will prevail in case of a conflict between thoseof union and states

(d) The state legislatures can make rules only with the permission of centralgovernment

Answer :- B

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20. Providing social sector services such as health and education is

(a) the responsibility of the central government

(b) the responsibility of the respective state governments

(c) the responsibility of local administrative bodies

(d) none of the above

Answer :- B

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21. 'Market failure' is a situation which occurs when

(a) private goods are not sufficiently provided by the market

(b) public goods are not sufficiently provided by public sector

(c) The market fail to form or they allocate resources efficiently

(d) (b) and (c) above

Answer :-C

---

22. Which of the following is an example of market failure?

(a) Prices of goods tend to rise because of shortages

(b) Merit goods are not sufficiently produced and supplied

(c) Prices fall leading to fall in profits and closure of firms

(d) None of the above

Answer :-B

---

23. Which of the following is an outcome of market power?

(a) makes price equal to marginal cost and produce a positive external benefit on others

(b) can cause markets to be efficient due to reduction in costs

(c) makes the firms price makers and restrict output so as to make allocation inefficient

(d) (b) and(c) above

Answer :-C

---

24. Markets do not exist

(a) for goods which have positive externalities

(b) for pure public goods

(c) for goods which have negative externalities

(d) none of the above

Answer :-B

---

25. Which of the following is the right argument for provision of public good by government?

(a) Governments have huge resources at their disposal

(b) Public goods will never cause any type of externality

(c) Markets are unlikely to produce sufficient quantity of public goods

(d) Provision of public goods are very profitable for any government

Answer :-C

---

26. Adequate amount of a pure public good will not be provided by the private market because of

(a) the possibility of free riding

(b) the existence of very low prices and low profits

(c) governments would any way produce them, so there will be overproduction

(d) there are restrictions as well as taxes on production of public goods

Answer :-A

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27. The free rider problem arises because of

(a) ability of participants to produce goods at zero marginal cost

(b) marginal benefit cannot be calculated due to externalities present

(c) the good or service is non excludable

(d) general poverty and unemployment of people

Answer :-C

28. A chemical factory has full information regarding the risks of a product, but continues to sell it. This is possible because of

(a) asymmetric information

(b) moral hazard

(c) free riding

(d) (a) and (c) above

Answer :-A

29. If an individual tends to drive his car in a dangerously high speed because he has a comprehensive insurance cover, it is a case of

(a) free riding

(b) moral hazard

(c) poor upbringing

(d) Inefficiency

Answer :-B

30. Smoking in public is a case of

(a) Negative consumption externality

(b) Negative production externality

(c) Internalising externality

(d) None of the above

Answer :-A

31. Read the following statements

I. The market-based approaches to control externalities operate through price mechanism

II. When externalities are present, the welfare loss would be eliminated

III. The key is to internalizing an externality is to ensure that those who create the externalities include them while making decisions Of the above statements

(a) II and III are correct

(b) I only is correct

(c) II only is correct

(d) I and III are correct

Answer :-D

32. Which of the following statements is false?

(a) Tradable permits provide incentive to innovate and reduce negative externalities

(b) A subsidy on a good which has substantial positive externalities would reduce its cost and consequently its price would be lower

(c) Substantial negative externalities are involved in the consumption of merit goods.

(d) Merit goods are likely to be under-produced and under consumed through the market mechanism

Answer :-C

33. Which one of the following would you suggest for reducing negative externality?

(a) Production subsidies

(b) Excise duty

(c) Pigouvian taxes

(d) All of the above

Answer :-C

34. A Pigouvian subsidy

(a) cannot be present when externalities are present

(b) is a good solution for negative externality as prices will increase

(c) is not measurable in terms of money and therefore not practical

(d) may help production to be socially optimal when positive externalities are present

Answer :-D

35. If governments make it compulsory to avail insurance protection, it is because

(a) Insurance companies need to be running profitably

(b) Insurance will generate moral hazard and adverse selection

(c) Insurance is a merit good and government wants people to consume it

(d) None of the above

Answer :-C

36. The Competition Act, 2002 aims to -

(a) protect monopoly positions of firms that have developed unique innovations

(b) to promote and sustain competition in markets

(c) to determine pricing under natural monopoly.

(d) None of the above

Answer :-B

37. Rules regarding product labelling

(a) Seeks to correct market failure due to externalities

(b) Is a method of solving the problem of public good

(c) May help solve market failure due to information failure

(d) Reduce the problem of monopolies in the product market

Answer :-C

38. Identify the incorrect statement

(a) A minimum support price for agricultural goods is a market intervention method to guarantee steady and assured incomes to farmers.

(b) An externality is internalised if the ones that generated the externality incorporate them into their private cost- benefit analysis

(c) The production and consumption of demerit goods are likely to be less than optimal under free markets

(d) Compared to pollution taxes, the cap and trade method is administratively cheap and simple to implement and ensures that pollution is minimised in the most cost-effective way.

Answer :-C

39. The incentive to let other people pay for a good or service, the benefits of which are enjoyed by an individual

(a) Is a case of negative externality

(b) Is a case of market efficiency

(c) Is a case of free riding

(d) Is inappropriate and warrant action

Answer :-C

40. A government subsidy

(a) is a market-based policy

(b) involves the government paying part of the cost to the firms in order to promote the production of goods having positive externalities

(c) is generally provided for merit goods

(d) all the above

Answer :-D

41. The production and consumption of demerit goods are

(a) likely to be more than optimal under free markets.

(b) likely to be less than optimal under free markets

(c) likely to be subjected to price intervention by government

(d) a) and c) above

Answer :-D

42. The argument for education subsidy is based on

(a) Education is costly

(b) the ground that education is merit good

(c) education creates positive externalities

(d) b) and c) above

Answer :- D

43. Read the following statements

I. Social costs are the total costs incurred by the society when a good is consumed or produced.

II. The external costs are not included in firms' income statements or consumers' Decisions

III. Each firm's cost which is considered for determining output would be only private cost or direct cost of production which does not include external costs

IV. Production and consumption decisions are efficient only when private costs are considered Of the above

(a) Statements I and III are correct

(b) Statements I,II and III are correct

(c) Statement I only is correct

(d) All the above are correct

Answer :- B

44. Government failure occurs when

(a) Government fails to implement its election promises on policies

(b) A government is unable to get reelected

(c) Government intervention is ineffective and produces fresh and more serious problems

(d) None of the above

Answer :- C

45. The difference between the budget deficit of a government and its debt service payments is

(a) Fiscal deficit

(b) Budget deficit

(c) Primary deficit

(d) None of the above

The following hypothetical figures relate to country A

` Crores

Revenue receipts	20,000
Recovery of loans	1,500
Borrowing	15,000
Other Receipts	5,000
Expenditure on revenue account	24,500
Expenditure on capital account	26,000
Interest payments	2,000

Answer :- C

46. The revenue deficit for country A is

(a) 5,000

(b) 24,000

(c) 4,500

(d) None of the above

Answer :- C

47. Fiscal deficit of country A is

(a) 14,000

(b) 24,000

(c) 23,500

(d) None of the above

Answer :- B

48. Primary deficit of Country A is

(a) 26,000

(b) 26,500

(c) 22,000

(d) 24,500

Answer :- C

49. In NITI Aayog, NITI stands for

(a) National Initiative for Transforming India

(b) National Institution for Transforming India

(c) National Institute for Technology and Innovation

(d) None of the above

Answer :- B

50. The Appropriation Bill is intended to

(a) reduce unnecessary expenditure on the part of the government

(b) give authority to government to incur expenditure from and out of the Consolidated Fund of India

(c) give authority to government to incur expenditure from the revenue receipts only

(d) be passed before the budget is taken for discussion

Answer :- B

51. Public debt management aims at

(a) An efficient budgetary policy to avail of domestic debt facilities

(b) Raising loans from international agencies at lower rates of interest

(c) Raising the required amount of funding at the desired risk and cost levels

(d) Management of public expenditure to reduce public debt

Answer :- C

52. The railway budget is

(a) Part of the general budget, but is presented by the railway minister

(b) Part of the general budget from the budget for financial year 2017-18.

(c) Part of the general budget from the budget for financial year 2021-22

(d) Part of the general budget but presented on the next day of the general budget

Answer :- B

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53. Outcome budgeting

(a) shares information about the money allocated for various purposes in a budget

(b) establishes a direct link between budgetary allocations and performance targets measured through output and outcome indicators

(c) establishes a direct link between budgetary performance targets and public account disbursals

(d) shares information about public policies and programmes under the budget

Answer :- B

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54. Corporate tax

(a) is collected by the union government and can be a capital receipt or revenue receipt

(b) may be collected by the respective states and fall under revenue receipts

(c) may be collected either by the centre or states and fall under revenue receipts

(d) is collected by the union government and is a revenue receipt

Answer :- D

---

55. Government borrowings from foreign governments and institutions

(a) Capital receipt

(b) Revenue receipt

(c) Accounts for fiscal deficit

(d) Any of the above depending on the purpose of borrowing

The following table relates to the revenue and expenditure figures of a hypothetical economy In ` lakh Crores

(a)	*Recovery of loans*	*5.1*
(b)	*Salaries of govt. servants*	*41.1*
(c)	*Capital Expenditure*	*45.0*
(d)	*Interest payments*	*1.3*
(e)	*Payments towards subsidies*	*3.2*
(f)	*Other receipts (mainly from disinvestment)*	*11.6*
(g)	*Tax revenue (net of states' share)*	*26.3*
(h)	*Non-tax revenue*	*12.3*
(i)	*Borrowings and other liabilities*	*6.8*
(j)	*States' share in tax revenue*	*11.9*

Answer :- A

56. The capital receipts are

(a) 23.5

(b) 19.7

(c) 11.3

(d) None of the above

Answer :- A

57. Revenue deficit is

(a) 23.6

(b) 13.0

(c) 7.0

(d) 2.6

Answer :- C

58. The non–debt capital receipts of this country is

(a) 45.1

(b) 16.7

(c) 15.8

(d) None of the above

Answer :- B

59. A budget is said to be unbalanced when

(a) when government's revenue exceeds government's expenditure

(b) when government's expenditure exceeds government's revenue

(c) either budget surplus of budget deficit occurs

(d) All the above

Answer :- D

60. Fiscal deficit refers to

(a) the excess of government's revenue expenditure over revenue receipts

(b) The excess of total expenditure over total receipts excluding borrowings

(c) Primary deficit - interest payments

(d) None of these

Answer :- D

61. Budget of the government generally impacts

(a) the resource allocation in the economy

(b) redistribution of income and enhance equity

(c) stability in the economy by measures to control price fluctuations

(d) all the above

Answer :- D

62. Which of the following is a statement submitted along with the budget as a requirement of FRBM Act

(a) Annual Financial Statement

(b) Macro -Economic Framework Statement

(c) Medium-Term Fiscal Policy cum Fiscal Policy Strategy Statement

(d) (b) and (c) above

Answer :- D

63. Government borrowing is treated as capital receipt because

(a) It is mainly used for creating assets by government

(b) It creates a liability for the government

(c) Both a) and b) above are correct

(d) None of the above is correct

Answer :- B

64. 'Retail Direct 'scheme is

(a) Initiated by the Reserve Bank of India

(b) facilitate investment in government securities by individual investors.

(c) Direct sale of goods and services by government departments

(d) Both (a) and (b) are correct

Answer :- D

65. Non-debt capital receipts

(a) do not add to the assets of the government and therefore not treated as capital receipts

(b) are those that do not create any future repayment burden for the government

(c) are those that create future liabilities for the government

(d) facilitate capital investments at low cost

Answer :- B

66. Which of the following is a capital receipt?

(a) Licence fee received

(b) Sale proceeds from disinvestment

(c) Assistance from Japan for covid vaccine

(d) Dividend from a public sector enterprise

Answer :- B

67. Grants given by the central government to state governments is

(a) A revenue expenditure as it is meant to meet the current expenditure of the states

(b) A revenue expenditure as it does neither creates any asset, nor reduces any liability of the government

(c) A capital expenditure because it increase the capital base of the states

(d) It is a grant and so does not come under revenue expenditure or capital expenditure.

Answer :- B

68. Short-term credit from the Reserve Bank to state governments to bridge temporary mismatches in cash flows is known as

(a) RBI credit to states

(b) Commercial credit of RBI

(c) Ways and Means Advances (WMA)

(d) Short term facility

Answer :- C

69. *Fiscal policy refers to the*

(a) use of government spending, taxation and borrowing to influence the level ofeconomic activity

(b) government activities related to use of government spending for supply ofessential goods

(c) use of government spending, taxation and borrowing for reducing the fiscaldeficits

(d) and (b) above

Answer :-A

70. *If real GDP is continuously declining and the rate of unemployment in the economy isincreasing, the appropriate policy should be to*

(a) Increase taxes and decrease government spending

(b) Decrease both taxes and government spending

(c) Decrease taxes and increase government spending

(d) Either (a) or (c)

Answer :-C

71. *Which of the following are likely to occur when an economy is in an expansionary phaseof a business cycle?*

(A) Rising unemployment rate

(B) Falling unemployment rate

(C) Rising inflation rate

(D) Deflation

(E) Falling or stagnant wage for workers

(F) Increasing tax revenue

(G) Falling tax revenue

(H) A, B and F are most likely to occur

(I) B, C and F are most likely to occur

(J) D, E and F are most likely to occur

(K) A, E and G are most likely to occur

Answer :-B

72. *During recession the fiscal policy of the government should be directed towards*

(a) Increasing the taxes and reducing the aggregate demand

(b) Decreasing taxes to ensure higher disposable income

(c) Increasing government expenditure and increasing taxes

(d) None of the above

Answer :- B

73. According to Keynesian economics, when we have inflation an effective fiscal policyshould not include

(a) increase corporate taxes.

(b) decrease aggregate demand.

(c) Increase government purchases.

(d) None of the above is correct

Answer :- C

74. Keynesian economists believe that

(a) fiscal policy can have very powerful effects in altering aggregate demand,employment and output in an economy

(b) when the economy is operating at less than full employment levels and whenthere is a need to offer stimulus to demand fiscal policy is of great use

(c) Wages are flexible and therefore business fluctuations would be automaticallyadjusted

(d) (a) and (b) above

Answer :- D

75. Which of the following may ensure a decrease in aggregate demand during inflation?

(a) decrease in all types of government spending and/ or an increase in taxes

(b) increase in government spending and/ or a decrease in taxes

(c) decrease in government spending and/ or a decrease in taxes

(d) All the above

Answer :- A

76. A recession is characterized by

(a) Declining prices and rising employment

(b) Declining unemployment and rising prices

(c) Declining real income and rising unemployment.

(d) Rising real income and rising prices

Answer :- C

77. Which one of the following is an example of fiscal policy?

(a) A tax cut aimed at increasing the disposable income and spending

(b) A reduction in government expenditure to contain inflation

(c) An increase in taxes and decrease in government expenditure to control inflation

(d) All the above

Answer :- D

78. Which of the following would illustrate a recognition lag?

(a) The time required to identify the appropriate policy

(b) The time required to identify to pass a legislation

(c) The time required to identify the need for a policy change

(d) The time required to establish the outcomes of fiscal policy

Answer :- C

79. An expansionary fiscal policy, taking everything else constant, would in the short-runhave the effect of

(a) a relative large increase in GDP and a smaller increase in price

(b) a relative large increase in price, a relatively smaller increase in GDP

(c) both GDP and price will be increasing in the same proportion

(d) both GDP and price will be increasing in a smaller proportion

Answer :- A

80. Which statement (s) is (are) correct about crowding out?

I. A decline in private spending may be partially or completely offset by the expansion of demand resulting from an increase in government expenditure.

II. Crowding out effect is the negative effect fiscal policy may generate when money from the private sector is 'crowded out' to the public sector.

III. When spending by government in an economy increases government spendingwould be crowded out.

IV. Private investments, especially the ones which are interest sensitive, will be reduced if interest rates rise due to increased spending by government

(a) I and III only

(b) I, II, and III

(c) I, II, and IV

(d) III only

Answer :- C

81. Which of the following policies is likely to shift an economy's aggregate demand curve to the right?

(a) Increase in government spending

(b) Decrease in taxes

(c) A tax cut along with increase in public expenditure

(d) All the above

Answer :- D

82. Identify the incorrect statement

(a) A progressive direct tax system ensures economic growth with stability becauseit distributes the burden of taxes unequally

(b) A carefully planned policy of public expenditure helps in redistributing incomefrom the rich to the poorer sections of the society.

(c) There are possible conflicts between different objectives of fiscal policy such thata policy designed to achieve one goal may adversely affect another

(d) An increase in the size of government spending during recessions may possibly 'crowd-out' private spending in an economy.

Answer :- A

83. Read the following statements

I. Fiscal policy is said to be contractionary when revenue is higher than spending i.e.,the government budget is in surplus

II. Other things constant, a fiscal expansion will raise interest rates and "crowd out" some private investment

III. During inflation new taxes can be levied and the rates of existing taxes are raised toreduce disposable incomes

IV. Classical economists advocated contractionary fiscal *policy to solve the problem ofinflation*

Of the above statements

(a) I and II are correct

(b) I, II and III are correct

(c) Only III is correct

(d) All are correct

Answer :- B

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84. While resorting to expansionary fiscal policy

(a) the government may possibly have a budget surplus as increased expenditure willbring more output and more tax revenue

(b) the government may run into budget deficits because tax cuts reduce governmentincome and the government expenditures exceed tax revenues in a given year

(c) it is important to have a balanced budget to avoid inflation and bring in stability

(d) None of the above will happen

Answer :- B

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85. Contractionary fiscal policy

(a) is resorted to when government expenditure is greater than tax revenues of anyparticular year

(b) increase the aggregate demand to sustain the economy

(c) to increase the disposable income of people through tax cuts and to enablegreater demand

(d) is designed to restrain the levels of economic activity of the economy during aninflationary phase

Answer :-D

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86. When government spending is deliberately reduced to bring in stability

(a) the government is resorting to contractionary fiscal policy

(b) the government is resorting to expansionary fiscal policy

(c) trying to limit aggregate demand to sustainable levels

(d) (a) and c) above

Answer :-D

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87. An increase in personal income taxes *(a) reduces disposable incomes leading to fall in consumption spending andaggregate demand*

(b) is desirable during inflation or when there is excessive levels of aggregate demand

(c) is to compensate the deficiency in effective demand by boosting aggregatespending

(d) both a) and b) are correct

Answer :- D

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88. While the government resorts to deliberate fiscal policy it may not attempt to manipulate

(a) Government expenditures on public works

(b) The rates of personal income taxes and corporate taxes

(c) Government expenditures on goods and services purchased by government

(d) The rate of interest prevailing in the economy

Answer :- D

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89. Which of the following fiscal remedy would you advice when an economy is facingrecession

(a) the government may cut interest rates to encourage consumption and investment

(b) the government may cut taxes to increase aggregate demand

(c) the government may follow a policy of balanced the budget.

(d) None of the above will work

Answer :- B

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90. While if governments compete with the private sector to borrow money for securingresources for expansionary fiscal policy

(a) it is likely that interest rates will go up and firms may not be willing to invest

(b) it is likely that interest rates will go up and the individuals too may be reluctantto borrow and spend

(c) it is likely that interest rates will go up and the desired increase in aggregatedemand may not be realized

(d) All the above are possible.

Answer :-D

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91. Choose the incorrect statement

(a) Anything that would act as a medium of exchange is money

(b) Money has generalized purchasing power and is generally acceptable in settlement of all transactions

(c) Money is a totally liquid asset and provides us with means to access goods and services

(d) Currency which represents money does not necessarily have intrinsic value.

Answer :- A

---

92. Money performs all of the three functions mentioned below, namely

(a) medium of exchange, price control, store of value

(b) unit of account, store of value , provide yields

(c) medium of exchange, unit of account, store of value

(d) medium of exchange, unit of account, income distribution

Answer :- C

---

93. Demand for money is

(a) Derived demand

(b) *Direct demand*

(c) *Real income demand*

(d) *Inverse demand*

Answer :-A

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94. Higher the ________________, higher would be _______________of holdin

(a) demand for money, opportunity cost, interest rate

(b) price level , opportunity cost, interest rate

(c) real income , opportunity cost, demand for money

(d) interest rate, opportunity cost, demand for money

Answer :- D

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95. The quantity theory of money holds that

(a) changes in the general level of commodity prices are caused by changes in the quantity of money

(b) there is strong relationship between money and price level and the quantity of money is the main determinant of the price

(c) changes in the value of money or purchasing power of money are determined first and foremost by

changes in the quantity of money in circulation

(d) All the above

Answer :- D

96. The Cambridge approach to quantity theory is also known as

(a) Cash balance approach

(b) Fisher's theory of money

(c) Classical approach

(d) Keynesian Approach

Answer :- A

97. Fisher's approach and the Cambridge approach to demand for money consider

(a) money's role in acting as a store of value and therefore, demand for money is for storing value temporarily.

(b) money as a means of exchange and therefore demand for money is termed as for liquidity preference

(c) money as a means of transactions and therefore, demand for money is only transaction demand for money.

(d) None of the above

Answer :- C

98. Real money is

(a) nominal money adjusted to the price level

(b) real national income

(c) money demanded at given rate of interest

(d) nominal GNP divided by price level

Answer :- A

99. The precautionary money balances people want to hold

(a) as income elastic and not very sensitive to rate of interest

(b) as income inelastic and very sensitive to rate of interest

(c) are determined primarily by the level of transactions they expect to make in the future.

(d) are determined primarily by the current level of transactions

Answer :- A

100. Speculative demand for money

(a) is not determined by interest rates

(b) is positively related to interest rates

(c) is negatively related to interest rates

(d) is determined by general price level

Answer :- C

101. According to Keynes, if the current interest rate is high

(a) people will demand more money because the capital gain on bonds would be less than return on money

(b) people will expect the interest rate to rise and bond price to fall in the future.

(c) people will expect the interest rate to fall and bond price to rise in the future.

(d) Either a) or b) will happen

Answer :- C

102. The inventory-theoretic approach to the transactions demand for money

(a) explains the negative relationship between money demand and the interest rate.

(b) explains the positive relationship between money demand and the interest rate.

(c) explains the positive relationship between money demand and general price level

(d) explains the nature of expectations of people with respect to interest rates and bond prices

Answer :- A

103. According to Baumol and Tobin's approach to demand for money, the optimal average money holding is:

(a) a positive function of income Y and the price level P

(b) a positive function of transactions costs c,

(c) a negative function of the nominal interest rate I

(d) All the above

Answer :- D

104. considered demand for money is as an application of a more general theory of demand for capital assets

(a) Baumol

(b) James Tobin

(c) J M Keynes

(d) Milton Friedman

Answer :- D

105. The nominal demand for money rises if

(a) the opportunity costs of money holdings – i.e. bonds and stock returns, r_B and r_E , respectively- decline and vice versa

(b) the opportunity costs of money holdings – i.e. bonds and stock returns, r_B and r_E , respectively- rises and vice versa

(c) the opportunity costs of money holdings – i.e. bonds and stock returns, r_B and r_E , respectively remain constant

(d) b) and c) above

Answer :- A

106. Reserve money is also known as

(a) central bank money

(b) base money

(c) high powered money

(d) all the above

Answer :- D

107. Choose the correct statement from the following

(a) Money is deemed as something held by the public and therefore only currency held by the public is included in money supply.

(b) Money is deemed as something held by the public and therefore inter-bank deposits are included in money supply.

(c) Since inter-bank deposits are not held by the public, therefore inter-bank deposits are excluded from the measure of money supply.

(d) Both (a) and (c) above.

Answer :- C

108. Reserve Money is composed of

(a) currency in circulation + demand deposits of banks (Current and Saving accounts) + Other deposits with the RBI.

(b) currency in circulation + Bankers' deposits with the RBI +

Other deposits with the RBI.

(c) currency in circulation + demand deposits of banks + Other deposits with the RBI.

(d) currency in circulation + demand and time deposits of banks + Other deposits with the RBI.

Answer :- B

109. M1 is the sum of

(a) currency and coins with the people + demand deposits of banks (Current and Saving accounts) + other deposits of the RBI.

(b) currency and coins with the people + demand and time deposits of banks (Current and Saving accounts) + other deposits of the RBI.

(c) currency in circulation + Bankers' deposits with the RBI + Other deposits with the RBI

(d) none of the above

Answer :-A

110. Under the' minimum reserve system' the central bank is

(a) empowered to issue currency to any extent by keeping an equivalent reserve of gold and foreign securities.

(b) empowered to issue currency to any extent by keeping only a certain minimum reserve of gold and foreign securities.

(c) empowered to issue currency in proportion to the reserve money by keeping only a minimum reserve of gold and foreign securities.

(d) empowered to issue currency to any extent by keeping a reserve of gold and foreign securities to the extent of ` 350 crores

Answer :- B

111. The primary source of money supply in all countries is

(a) the Reserve Bank of India

(b) the Central bank of the country

(c) the Bank of England

(d) the Federal Reserve

Answer :-B

112. The supply of money in an economy depends on

(a) the decision of the central bank based on the authority conferred on it.

(b) the decision of the central bank and the supply responses of the commercial banking system.

(c) the decision of the central bank in respect of high powered money.

(d) both a) and c) above.

Answer :-B

113. Banks in the country are required to maintain deposits with the central bank

(a) to provide the necessary reserves for the functioning of the central bank

(b) to meet the demand for money by the banking system

(c) to meet the central bank prescribed reserve requirements and to meet settlement obligations.

(d) to meet the money needs for the day to day working of the commercial banks

Answer :-C

114. If the behaviour of the public and the commercial banks is constant, then

(a) the total supply of nominal money in the economy will vary directly with the supply of the nominal high-powered money issued by the central bank

(b) the total supply of nominal money in the economy will vary directly with the rate of interest and inversely with reserve money

(c) the total supply of nominal money in the economy will vary inversely with the supply of high powered money

(d) all the above are possible

Answer :-A

115. Under the fractional reserve system

(a) the money supply is an increasing function of reserve money (or high powered money) and the money multiplier.

(b) the money supply is an decreasing function of reserve money (or high powered money) and the money

multiplier.

(c) the money supply is an increasing function of reserve money (or high powered money) and a decreasing function of money multiplier.

(d) none of the above as the determinants of money supply are different

Answer :-A

116. The money multiplier and the money supply are

(a) positively related to the excess reserves ratio ***e****.*

(b) negatively related to the excess reserves ratio ***e****.*

(c) not related to the excess reserves ratio ***e****.*

(d) proportional to the excess reserves ratio e.

Answer :-B

117. The currency ratio represents

(a) the behaviour of central bank in the issue of currency.

(b) the behaviour of central bank in respect cash reserve ratio.

(c) the behaviour of the public.

(d) the behaviour of commercial banks in the country.

Answer :-C

118. The size of the money multiplier is determined by

(a) the currency ratio (c) of the public,

(b) the required reserve ratio (r) at the central bank, and

(c) the excess reserve ratio (e) of commercial banks.

(d) all the above

Answer :-D

119. tells us how much new money will be created by the banking system for a given increase in the high-powered money.

(a) The currency ratio

(b) The excess reserve ratio €

(c) The credit multiplier

(d) The currency ratio (c)

Answer :-C

120. The money multiplier will be large *(a) for higher currency ratio (c), lower required reserve ratio (r) and lower excess reserve ratio €*

(b) for constant currency ratio (c), higher required reserve ratio (r) and lower excess reserve ratio €

(c) for lower currency ratio (c), lower required reserve ratio (r) and lower excess reserve ratio €

(d) None of the above

Answer :-C

121. The ratio that relates the change in the money supply to a given change in the monetary base is called the

(a) required reserve ratio.

(b) money multiplier.

(c) deposit ratio.

(d) discount rate.

Answer :-B

122. For a given level of the monetary base, an increase in the required reserve ratio will denote

(a) a decrease in the money supply.

(b) an increase in the money supply.

(c) an increase in demand deposits.

(d) Nothing precise can be said

Answer :-A

123. For a given level of the monetary base, an increase in the currency ratio causes the money multiplier to and the money supply to .

(a) decrease; increase

(b) increase; decrease

(c) decrease; decrease

(d) increase; increase

Answer :-C

124. If commercial banks reduce their holdings of excess reserves

(a) the monetary base increases.

(b) the monetary base falls.

(c) the money supply increases.

(d) the money supply falls.

Answer :-C

125. Which of the following is the function of monetary policy?

(a) regulate the exchange rate and keep it stable

(b) regulate the movement of credit to the corporate sector

(c) regulate the level of production and prices

(d) regulate the availability, cost and use of money and credit

Answer :-D

126. The main objective of monetary policy in India is ______:

(a) reduce food shortages to achieve stability

(b) economic growth with price stability

(c) overall monetary stability in the banking system

(d) reduction of poverty and unemployment

Answer :-B

127. The monetary transmission mechanism refers to

(a) how money gets circulated in different sectors of the economy post monetarypolicy

(b) the ratio of nominal interest and real interest rates consequent on a monetarypolicy

(c) the process or channels through which the evolution of monetary aggregatesaffects the level of product and prices

(d) none of the above

Answer :-C

128. A contractionary monetary policy-induced increase in interest rates

(a) increases the cost of capital and the real cost of borrowing for firms

(b) increases the cost of capital and the real cost of borrowing for firms and households

(c) decreases the cost of capital and the real cost of borrowing for firms

(d) has no interest rate effect on firms and households

Answer :-B

129. During deflation

(a) the RBI reduces the CRR in order to enable the banks to expand credit andincrease the supply of money available in the economy

(b) the RBI increases the CRR in order to enable the banks to expand credit andincrease the supply of money available in the economy

(c) the RBI reduces the CRR in order to enable the banks to contract credit andincrease the supply of money available in the economy

(d) the RBI reduces the CRR but increase SLR in order to enable the banks to contractcredit and increase the supply of money available in the economy

Answer :-A

130. Which of the following statements is correct?

(a) The governor of the RBI in consultation with the Ministry of Finance decides thepolicy rate and implements the same

(b) While CRR has to be maintained by banks as cash with the RBI, the SLR requiresholding of approved assets by the bank itself

(c) When repo rates increase, it means that banks can now borrow money throughopen market operations (OMO)

(d) None of the above

Answer :-B

131. RBI provides financial accommodation to the commercial banks through repos/reverserepos under

(a) Market Stabilisation Scheme (MSS)

(b) The Marginal Standing Facility (MSF)

(c) Liquidity Adjustment Facility (LAF).

(d) Statutory Liquidity Ratio (SLR)

Answer :-C

132. ____________is a money market instrument, which enables collateralised short termborrowing and *lending through sale/purchase operations in debt instruments.*

(a) OMO

(b) CRR

(c) SLR

(d) Repo

Answer :-D

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133. In India, the term 'Policy rate' refers to

(a) The bank rate prescribed by the RBI in its half yearly monetary policy statement

(b) The CRR and SLR prescribed by RBI in its monetary policy statement

(c) the fixed repo rate quoted for sovereign securities in the overnight segment ofLiquidity Adjustment Facility (LAF)

(d) the fixed repo rate quoted for sovereign securities in the overnight segment ofMarginal Standing Facility (MSF)

Answer :-C

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134. Reverse repo operation takes place when

(a) RBI borrows money from banks by giving them securities

(b) banks borrow money from RBI by giving them securities

(c) banks borrow money in the overnight segment of the money market

(d) RBI borrows money from the central government

Answer :-A

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135. The Monetary Policy Framework Agreement is on

(a) the maximum repo rate that RBI can charge from government

(b) the maximum tolerable inflation rate that RBI should target to achieve pricestability.

(c) the maximum repo rate that RBI can charge from the commercial banks

(d) the maximum reverse repo rate that RBI can charge from the commercial banks

Answer :-B

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136. An open market operation is an instrument of monetary policy which involves buying orselling of ________________ from or to the public and banks

(a) bonds and bills of exchange

(b) debentures and shares

(c) government securities

(d) none of these

Answer :-C

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137. Which statement (s) is (are) true about Monetary Policy Committee?

I. The Reserve Bank of India (RBI) Act, 1934 was amended on June 27, 2016, for giving a statutory backing to the Monetary Policy Framework Agreement and for setting up a Monetary Policy Committee

II. The Monetary Policy Committee shall determine the policy rate through debate and majority vote by a panel of experts required to achieve the inflation target.

III. The Monetary Policy Committee shall determine the policy rate throughconsensus from the governor of RBI

IV. The Monetary Policy Committee shall determine the policy rate through debate and majority vote by a panel of bankers chosen for eth purpose

(a) I only

(b) I and II only

(c) III and IV

(d) III only

Answer :-B

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138. Which of the following does not represent a differenc between internal trade andinternational trade?

(a) Transactions in multiple currencies

(b) homogeneity of customers and currencies

(c) differences in legal systems

(d) none of the above

Answer :-B

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139. The theory of absolute advantage states that

(a) national wealth and power are best served by increasing exports and decreasingimports

(b) nations can increase their economic well-being by specializing in the production of goods they produce more efficiently than anyone else.

(c) that the value or price of a commodity depends exclusively on the amount of labour going into its production and therefore factor prices will be the same

(d) differences in absolute advantage explains differences in factor endowments indifferent countries

Answer :-B

140. Which of the following theories advocates that countries should produce those goods for which it has the greatest relative advantage?

(a) Modern theory of international trade

(b) The factor endowment theory

(c) The Heckscher-Ohlin Theory

(d) None of the above

Answer :-B

141. Which of the following holds that a country can increase its wealth by encouraging exports and discouraging imports

(a) Capitalism

(b) Socialism

(c) Mercantilism

(d) Laissez faire

Answer :-C

142. Given the number of labour hours to produce cloth and grain in two countries, which country should produce grain?

Labour cost (hours) for production of one unit

	Country A	**Country B**
Cloth	40	80
Grain	80	40

(a) Country A

(b) Country B

(c) Neither A nor B

(d) Both A and B

Answer :-B

143. According to the theory of comparative advantage

(a) trade is a zero-sum game so that the net change in wealth or benefits among theparticipants is zero.

(b) trade is not a zero-sum game so that the net change in wealth or benefits amongthe participants is positive

(c) nothing definite can be said about the gains from trade

(d) gains from trade depends upon factor endowment and utilization

Answer :-B

144. Given the number of labour hours to produce wheat and rice in two countries and that these countries specialise and engage in trade at a relative price of 1:1 what will be the gain of country X?

Labour cost (hours) for production of one unit

	Wheat	**Rice**
Country X	10	20
Country Y	20	10

(a) 20 labour hours

(b) 10 labour hours

(c) 30 labour hours

(d) Does not gain anything

Answer :-B

145. Assume India and Bangladesh have the unit labour requirements for producing tables and mats shown in the table below. It follows that:

Labour cost (hours) for production of one unit

	India	**Bangladesh**
Tables	3	8
Mats	2	1

(a) Bangladesh has a comparative advantage in mats

(b) India has a comparative advantage in tables

(c) Bangladesh has an absolute advantage in mats

(d) All the above are true

Answer :-D

146. Comparative advantage refers to

(a) country's ability to produce some good or service at the lowest possible cost compared to other countries

(b) a country's ability to produce some good or service at a lower opportunity cost than other countries.

(c) Choosing a productive method which uses minimum of the abundant factor

(d) (a) and (b) above

Answer :-B

147. Ricardo explained the law of comparative advantage on the basis of

(a) opportunity costs

(b) the law of diminishing returns

(c) economies of scale

(d) the labour theory of value

Answer :-D

148. A specific tariff is

(a) a tax on a set of specified imported good

(b) an import tax that is common to all goods imported during a given period

(c) a specified fraction of the economic value of an imported good

(d) a tax on imports defined as an amount of currency per unit of the good

Answer :-D

149. A tariff on imports is beneficial to domestic producers of the imported good because

(a) they get a part of the tariff revenue

(b) it raises the price for which they can sell their product in the domestic market

(c) it determines the quantity that can be imported to the country

(d) it reduces their producer surplus, making them more efficient

Answer :-B

150. A tax applied as a percentage of the value of an imported good is known as

(a) preferential tariff

(b) ad valorem tariff

(c) specific tariff

(d) mixed or compound tariff

Answer :-B

151. Escalated tariff refers to

(a) nominal tariff rates on raw materials which are greater than tariffs onmanufactured products

(b) nominal tariff rates on manufactured products which are greater than tariffs onraw materials

(c) a tariff which is escalated to prohibit imports of a particular good to protect domestic industries

(d) none of the above

Answer :-B

152. Voluntary export restraints involve:

(a) an importing country voluntarily restraining the quantity goods that can be exported into the country during a specif period of time

(b) domestic firms agreeing to limit the quantity foreign produ sold in their domestic markets

(c) an exporting country voluntarily restraining the quantity goods that can be exported out of a country during a specif period of time

(d) quantitative restrictions imposed by the importing countr government.

Answer :-C

153. Anti-dumping duties are

(a) additional import duties so as to offset the effects of exporting firm's unfair charging of prices in the foreign market which are lower than production costs.

(b) additional import duties so as to offset the effects of exporting firm's increased competitiveness due to subsidies by government

(c) additional import duties so as to offset the effects of exporting firm's unfair charging of lower prices in the foreign market

(d) Both (a) and (c) above

Answer :-D

154. A countervailing duty is

(a) a tariff that aim to offset artificially low prices charged by exporters who enjoy export subsidies and tax concessions in their home country

(b) charged by importing countries to ensure fair and market-oriented pricing of imported products

(c) charged by importing countries to protect domestic industries and firms from unfair price advantage arising from subsidies

(d) All the above

Answer :-D

155. Which of the following is an outcome of tariff?

(a) create obstacles to trade and increase the volume of imports and exports

(b) domestic consumers enjoy consumer surplus because consumers must now payonly a lower price for the good

(c) discourage domestic consumers from consuming imported foreign goods and encourage consumption of domestically produced import substitutes

(d) increase government revenues of the importing country by more than value ofthe total tariff it charges

Answer :-C

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156. SPS measures and TBTs are

(a) permissible under WTO to protect the interests of countries

(b) may result in loss of competitive advantage of developing countries

(c) increases the costs of compliance to the exporting countries

(d) All the above

Answer :-D

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157. Which of the following is not a non-tariff barrier.

(a) Complex documentation requirements

(b) Import quotas on specific goods

(c) Countervailing duties charged by importing country

(d) Pre shipment product inspection and certification requirements

Answer :-C

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158. Under tariff rate quota

(a) countries promise to impose tariffs on imports from members other than those who are part of a preferential trade agreement

(b) a country permits an import of limited quantities at low rates of duty but subjects an excess amount to a much higher rate

(c) lower tariff is charged from goods imported from a country which is givenpreferential treatment

(d) none of the above

Answer :-B

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159. Non -tariff barriers (NTBs) include all of the following except:

(a) import quotas

(b) Tariffs

(c) export subsidies

(d) technical standards of products

Answer :-B

160. Which of the following culminated in the establishment of the World TradeOrganization?

(a) The Doha Round

(b) The Tokyo Round

(c) The Uruguay Round

(d) The Kennedy Round

Answer :-C

161. Choose the correct statement

(a) The GATT was meant to prevent exploitation of poor countries by richer countries

(b) The GATT dealt with trade in goods only, while, the WTO covers services as wellas intellectual property.

(c) All members of the World Trade Organization are required to avoid tariffs of alltypes

(d) All the above

Answer :-B

162. The 'National treatment' principle stands for

(a) the procedures within the WTO for resolving disagreements about trade policyamong countries

(b) the principle that imported products are to be treated no worse in the domesticmarket than the local ones

(c) exported products are to be treated no worse in the domestic market than thelocal ones

(d) imported products should have the same tariff, no matter where they areimported from

Answer :-B

163. 'Bound tariff' refers to

(a) clubbing of tariffs of different commodities into one common measure

(b) the lower limit of the tariff below which a nation cannot be taxing its imports

(c) the upper limit on the tariff that a country can levy on a particular good, according to its commitments under the GATT and WTO.

(d) the limit within which the country's export duty should fall so that there are cheaper exports

Answer :-C

164. The essence of 'MFN principle' is

(a) equality of treatment of all member countries of WTO in respect of matters related to trade

(b) favour one, country, you need to favour all in the same manner

(c) every WTO member will treat all its trading partners equally without any prejudice and discrimination

(d) all the above

Answer :-D

165. The World Trade Organization (WTO)

(a) has now been replaced by the GATT

(b) has an inbuilt mechanism to settle disputes among members

(c) was established to ensure free and fair trade internationally.

(d) (b) and c) above

Answer :-D

166. The Agreement on Agriculture includes explicit and binding commitments made by WTO Member governments

(a) on increasing agricultural productivity and rural development

(b) market access and agricultural credit support

(c) market access, domestic support and export subsidies

(d) market access, import subsidies and export subsidies

Answer :-C

167. The Agreement on Textiles and Clothing

(a) provides that textile trade should be deregulated gradually and the tariffs should be increased

(b) replaced the Multi-Fiber Arrangement (MFA) which was prevalent since 1974

(c) granted rights of textile exporting countries to increase tariffs to protect their domestic textile industries

(d) stipulated that tariffs in all countries should be the same

Answer :-B

168. The Agreement on Trade-Related Aspects of Intellectual Property Rights

(a) stipulates to administer a system of enforcement of intellectual property rights.

(b) provides for most-favoured-nation treatment and national treatment for intellectual properties

(c) mandates to maintain high levels of intellectual property protection by all members

(d) all the above

Answer :-D

169. The most controversial topic in the yet to conclude Doha Agenda is

(a) trade in manufactured goods

(b) trade in intellectual property rights-based goods

(c) trade in agricultural goods

(d) market access to goods from developed countries

Answer :-C

170. The WTO commitments

(a) affect developed countries adversely because they have comparatively lessagricultural goods

(b) affect developing countries more because they need to make radical adjustments

(c) affect both developed and developing countries equally

(d) affect none as they increase world trade and ensure prosperity to all

Answer :-B

171. Based on the supply and demand model of determination of exchange rate, which of the following ought to cause the domestic currency of Country X to appreciate against dollar?

(a) The US decides not to import from Country X

(b) An increase in remittances from the employees who are employed abroad to theirfamilies in the home country

(c) Increased imports by consumers of Country X

(d) Repayment of foreign debts by Country X

Answer :-B

172. All else equal, which of the following is true if consumers of India develop taste for imported commodities and decide to buy more from the US?

(a) The demand curve for dollars shifts to the right and Indian Rupee appreciates

(b) The supply of US dollars shrinks and, therefore, import prices decrease

(c) The demand curve for dollars shifts to the right and Indian Rupee depreciates

(d) The demand curve for dollars shifts to the left and leads to an increase inexchange rate

Answer :-C

173. 'The nominal exchange rate is expressed in units of one

currency per unit of the other currency. A real exchange rate adjusts this for changes in price levels'. The statements are

(a) wholly correct

(b) partially correct

(c) wholly incorrect

(d) None of the above

Answer :-A

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174. Match the following by choosing the term which has the same meaning

i) floating exchange rate
ii) fixed exchange rate
iii) pegged exchange rate
iv) devaluation
v) appreciation

A. Deprecation
B. Revolution
C. Flexible exchange rate

(a) (i c); (ii d); (iii b); (iv a))

(b) (i b); (ii a); (iii d); (iv c)

(c) (i a); (ii d) ; (iii b); (iv c)

(d) (i d); (ii a); (iii b); (iv c)

Answer :-D

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175. Choose the correct statement

(a) An indirect quote is the number of units of a local currenc exchangeable for oneunit of a foreign currency

(b) the fixed exchange rate regime is said to be efficient and highl transparent.

(c) A direct quote is the number of units of a local currenc exchangeable for oneunit of a foreign currency

(d) Exchange rates are generally fixed by the central bank of th country

Answer :-C

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176. Which of the following statements is true?

(a) Home-currency appreciation or foreign-currency depreciation takes place when there is a decrease in the home currency price of foreign currency

(b) Home-currency depreciation takes place when there is an increase in the home currency price of the foreign currency

(c) Home-currency depreciation is the same as foreign-currency appreciation and implies that the home currency has become relatively less valuable.

(d) All the above

Answer :-D

177. An increase in the supply of foreign exchange

(a) shifts the supply curve to the right and as a consequence, the exchange ratedeclines

(b) shifts the supply curve to the right and as a consequence, the exchange rateincreases

(c) more units of domestic currency are required to buy a unit of foreign exchange

(d) the domestic currency depreciates and the foreign currency appreciates

Answer :-A

178. Currency devaluation

(a) may increase the price of imported commodities and, therefore, reduce the international competitiveness of domestic industries

(b) may reduce export prices and increase the international competitiveness ofdomestic industries

(c) may cause a fall in the volume of exports and promote consumer welfare through increased availability of goods and services

(d) (a) and (c) above

Answer :-B

179. At any point of time, all markets tend to have the sam exchange rate for a givencurrency due to

(a) Hedging

(b) Speculation

(c) Arbitrage

(d) Currency futures

Answer :-C

180. 'Vehicle Currency' refers to

(a) a currency that is widely used to denominate international contracts made by parties because it is the national currency of either of the parties

(b) a currency that is traded internationally and, therefore, is in high demand

(c) a type of currency used in euro area for synchronization of exchange rates

(d) a currency that is widely used to denominate international contracts made by parties even when it is not the national currency of either of the parties

Answer :-D

181. .Which of the following statements is incorrect?

(a) Direct investments are real investments in factories, assets, land, inventories etc. and involve foreign ownership of production facilities.

(b) Foreign portfolio investments involve flow of 'financial capital'.

(c) Foreign direct investment (FDI) is not concerned with either manufacture of goodsor with provision of services.

(d) Portfolio capital moves to a recipient country which has revealed its potential forhigher returns and profitability.

Answer :-C

182. Which of the following is a component of foreign capital?

(a) Direct inter government loans

(b) Loans from international institutions

(e.g. World Bank, IMF, ADB)

(c) Soft loans for e.g. from affiliates of World Bank such as IDA

(d) All the above

Answer :-D

183. Which of the following would be an example of foreign direct investment fromCountry X?

(a) A firm in Country X buys bonds issued by a Chinese computer manufacturer.

(b) A computer firm in Country X enters into a contract with a Malaysian firm for the latter to make and sell to it processors

(c) Mr. Z a citizen of Country X buys a controlling share in an Italian electronics firm

(d) None of the above

Answer :-C

184. Which of the following types of FDI includes creation of fresh assets and productionfacilities in the host country?

(a) Brownfield investment

(b) Merger and acquisition

(c) Greenfield investment

(d) Strategic alliances

Answer :-C

185. Which is the leading country in respect of inflow of FDI to India?

(a) Mauritius

(b) USA

(c) Japan

(d) USA

Answer :-A

186. An argument in favour of direct foreign investment is that it tends to

(a) promote rural development

(b) increase access to modern technology

(c) protect domestic industries

(d) keep inflation under control

Answer :-B

187. Which of the following is a reason for foreign direct investment?

(a) secure access to minerals or raw materials

(b) desire to capture of large and rapidly growing emerging markets

(c) desire to influence home country industries

(d) (a) and (b) above

Answer :-D

188. A foreign direct investor

(a) May enter India only through automatic route

(b) May enter India only through government route

(c) May enter India only through equity in domestic enterprises

(d) Any of the above

Answer :-D

189. Foreign investment are prohibited in

(a) Power generation and distribution

(b) Highways and waterways

(c) Chit funds and Nidhi company

(d) Airports and air transport

Answer :-C

190. Which of the following statement is false in respect of FPI?

(a) portfolio capital in general, moves to investment in financial stocks, bonds andother financial instruments

(b) is effected largely by individuals and institutions through the mechanism ofcapital market

(c) is difficult to recover as it involves purely long-term investments and the investorshave controlling interest

(d) investors also do not have any intention of exercising voting power or controlling or managing the affairs of the company.

Answer :-C

191. The Indian industry stagnated under the colonial rule because

(a) Indians were keen on building huge structures and monuments only

(b) Deterioration was caused by high prices of inputs due to draught

(c) The Indian manufactures could not compete with the imports of cheap machinemade goods

(d) None of the above

Answer :-C

192. The first wave of liberalization starts in India

(a) In 1951

(b) In 1980's

(c) In 1990

(d) In 1966

Answer :-B

193. The sequence of growth and structural change in Indian economy is characterized by

(a) The historical pattern of prominence of sectors as agriculture, industry, services

(b) The historical pattern of prominence of sectors as industry, services, agriculture

(c) Unique experience of the sequence as agriculture, services, industry

(d) All the above are correct

Answer :-C

194. Merchandise Exports from India Scheme was replaced by -

(a) Remission of Duties and Taxes on Export Products (RoDTEP) in 2021

(b) National Logistics Policy (NLP) in 2020

(c) Remission of Duties and Taxes on Export Products (RoDTEP) in 2019

(d) None of the above

Answer :-A

195. The Foreign Investment Promotion Board (FIPB)

(a) a government entity through which inward investment proposals were routed toobtain required government approvals

(b) no more exists as the same is replaced by a new regime namely ForeignInvestment Facilitation Portal

(c) no more exists as all inward investments are through automatic route and needno approval

(d) is the body which connects different ministries in respect of foreign portfolioinvestments

Answer :-B

196. FAME-India Scheme aims to

(a) Enhance faster industrialization through private participation

(b) to promote manufacturing of electric and hybrid vehicle technology

(c) to spread India's fame among its trading partners

(d) None of the above

Answer :-B

197. In terms of Ease of Doing Business in 2020 India ranks

(a) 63

(b) 77

(c) 45

(d) None of the above

Answer :-A

198. E-NAM is -

(a) An electronic name card given to citizens of India

(b) National Agriculture Market with the objective of creating a unified nationalmarket for agricultural commodities.

(c) a pan-India electronic trading portal which networks the existing APMC mandis

(d) b) and c) above

Answer :-D

199. Which of the following is not a policy reform included in the new economic policy of1991 -

(a) removing licensing requirements for all industries

(b) Foreign investment was liberalized

(c) Liberalisation of international trade

(d) The disinvestment of government holdings of equity share capital of public sectorenterprises

Answer :-A

200. Imports of foreign goods and entry of foreign investments were restricted in Indiabecause -

(a) The government wanted people to follow the policy of' Be Indian; Buy Indian'

(b) Because foreign goods were costly and meant loss of precious foreign exchange

(c) Government policy was directed towards protection of domestic industries fromforeign competition

(d) Government wanted to preserve Indian culture and to avoid influence of foreignculture

Answer :-C

201. The 'Hindu growth rate' is a term used to refer to -

(a) the high rate of growth achieved after the new economic policy of 1991

(b) the low rate of economic growth of India from the 1950s to the 1980s, whichaveraged around 3.5 per cent per year

(c) the low growth of the economy during British period marked by an average of 3.5 percent

(d) the growth rate of the country because India is referred to as 'Hindustan'

Answer :-B

202. In the context of the new economic policy of 1991, the term 'disinvestment' stands for -

(a) A policy whereby government investments are reduced to correct fiscal deficit

(b) The policy of sale of portion of the government shareholding of a public sectorenterprise

(c) The policy of public partnership in private enterprise

(d) A policy of opening up government monopoly to the privates sector

Answer :-B

203. The objective of introducing Monopolies and Restrictive Trade Practices Act 1969 was -

(a) to ensure that the operation of the economic system does not result in theconcentration of economic power in hands of a few

(b) to provide for the control of monopolies

(c) to prohibit monopolistic and restrictive trade practice

(d) all the above

Answer :-D

204. Which one of the following is a feature of green revolution -

(a) use of soil friendly green manure to preserve fertility of soil

(b) grow more crops by redistributing land to landless people

(c) High yielding varieties of seeds and scientific cultivation

(d) Diversification to horticulture

Answer :-C

205. The strategy of agricultural development in India before green revolution was -

(a) High yielding varieties of seeds and chemical fertilizers to boost productivity

(b) Institutional reforms such as land reforms

(c) Technological up gradation of agriculture

(d) All the above

Answer :-B

206. The Industrial Policy Resolution (1948) aimed at -

(a) Market oriented economic reforms and opening up of economy

(b) A shift from state led industrialization to private sector led

industrialisation

(c) an expanded role for the public sector and licensing to the private sector

(d) an expanded role of private sector a limited role of public sector

Answer :-C

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207. The new economic policy of 1991 manifest in -

(a) State led industrialization and import substitution

(b) Rethinking the role of markets versus the state

(c) Emphasized the role of good governance

(d) Bringing about reduction in poverty and redistributive justice

Answer :-B

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208. The post independence economic policy was rooted in -

(a) A capitalist mode of production with heavy industrialization

(b) social and economic redistribution and industrialization directed by the state

(c) social and economic redistribution through private sector initiatives

(d) Industrialization led by private entrepreneurs and redistribution by state

Answer :-B