

Question Paper

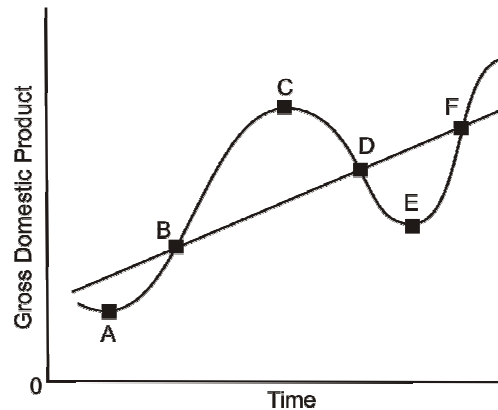
Economics – II (MB142): July 2008

- Answer all 79 questions.
- Marks are indicated against each question.

Total Marks : 100

[<Answer>](#)

1. Refer to the figure below:



During which of the following periods of the business cycle is the economy in a recession?

- (a) The period from A to B
 (b) The period from C to D
 (c) The period from B to C
 (d) The period from D to E
 (e) The period from D to F. (1 mark) [<Answer>](#)
2. Subhash Pvt. Ltd., an Indian company, has a fully owned subsidiary in the USA. The profits earned by the subsidiary in the USA is recorded in (1 mark) [<Answer>](#)
- (a) GDP of India and GNP of the USA
 (b) GNP of both India and the USA
 (c) Neither GDP nor GNP of India
 (d) GNP of India and GDP of the USA
 (e) GDP of both India and the USA. (1 mark) [<Answer>](#)
3. A higher price level _____ autonomous consumption, autonomous investment, and net exports which result in aggregate expenditure to _____. (1 mark) [<Answer>](#)
- (a) Increases; rise
 (b) Increases; fall
 (c) Decreases; rise
 (d) Decreases; fall
 (e) Decreases; remain constant. (1 mark) [<Answer>](#)
4. Which of the following is **not** a liability of Commercial Bank? (1 mark) [<Answer>](#)
- (a) Fixed Deposit
 (b) Demand Deposit
 (c) Bills Payable
 (d) Non-Residents Deposits
 (e) Loans and Advances. (1 mark) [<Answer>](#)
5. Suppose a drop in consumer confidence results in an economic contraction. In order to move the economy out of the recession, (1 mark)
- I. Government spending could be increased.
 II. Taxes could be lowered.
 III. Money supply could be increased.
 IV. Interest rate could be reduced.
- (a) Both (I) and (II) above
 (b) Both (II) and (III) above

- (c) Both (III) and (IV) above
- (d) Both (I) and (IV) above
- (e) All (I), (II), (III) and (IV) above.

6. The following information is given about an economy, calculate the value of profit in the economy:

[<Answer>](#)

Particulars	MUC
National Income	300
Wages and Salaries	180
Interest Income	45
Rental Income	30

- (a) 15 MUC
- (b) 25 MUC
- (c) 35 MUC
- (d) 45 MUC
- (e) 55 MUC.

(2marks)

[<Answer>](#)

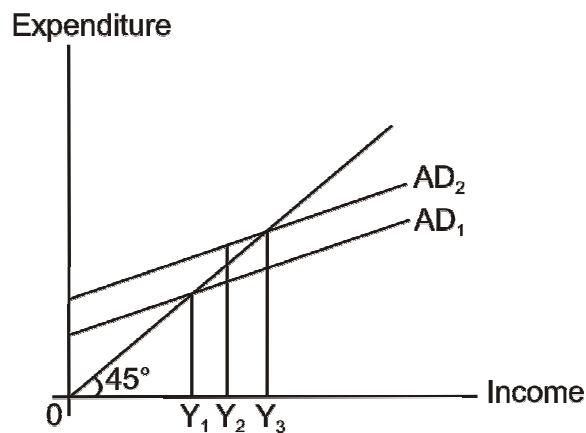
7. As on December 20, 2007, monetary liabilities of the Central Bank are 1,200 MUC and government money is 50 MUC. The currency deposit ratio is 0.2 while reserve ratio specified by the Central Bank is 5%. During the coming year, an additional flow of 50 MUC of foreign exchange assets is expected. If the Central Bank wants to maintain the money supply at the original level by resorting to open market operations, what would be the worth of government securities to be sold in the market?

- (a) 50 MUC
- (b) 250 MUC
- (c) 100 MUC
- (d) 225 MUC
- (e) 210 MUC.

(2marks)

[<Answer>](#)

8. The following figure shows expenditure and income in an economy without government and international trade:



If investment increases, this could cause

- (a) Recession
- (b) Boom
- (c) An increase in unemployment
- (d) Deflation
- (e) Stagflation.

(1 mark)

[<Answer>](#)

9. Consider the following information:

Particulars	MUC
NDP at market price	77,000
Net Factor Income From Abroad	-700
Depreciation	1,700
Subsidies	6,600
Indirect Taxes	7,700

The value of National Income is

(2marks)

- (b) 74,000 MUC
- (c) 75,200 MUC
- (d) 77,000 MUC
- (e) 89,000 MUC.

10. Which of the following is/are the economic indicator(s)?

[<Answer>](#)

- I. Gross Domestic Product.
- II. Inflation.
- III. Interest Rate.

- (a) Only (I) above
- (b) Only (II) above
- (c) Only (III) above
- (d) Both (I) and (II) above
- (e) All (I), (II) and (III) above.

(1 mark)

[<Answer>](#)

11. Which of the following is **not** a selective credit control method to regulate credit?

- (a) Rationing of credit
- (b) Direct action
- (c) Changes in margin requirements
- (d) Moral suasion
- (e) Bank rate.

(1 mark)

[<Answer>](#)

12. The term balance of trade implies

- (a) The amount of difference between current account and the capital account
- (b) The amount of difference between merchandise exports and imports
- (c) The ratio of exports to imports
- (d) The amount of balance in capital account
- (e) The ratio of imports to exports.

(1 mark)

[<Answer>](#)

13. A type of tariff in which a fixed amount of money is charged per unit of product traded is called

- (a) Ad Valorem duty
- (b) Specific duty
- (c) Quota
- (d) Excise duty
- (e) Estate duty.

(1 mark)

[<Answer>](#)

14. If the saving function $S = -20 + 0.4Y$, then the break even level of equilibrium income is

- (a) 50 MUC
- (b) 75 MUC
- (c) 87 MUC
- (d) 95 MUC
- (e) 100 MUC.

(2 marks)

[<Answer>](#)

15. The following data is taken from a balance sheet of the Central Bank:

Particulars	MUC
Net Worth	6,000
Credit to Government	10,000
Credit to Commercial bank	5,000
Government deposits	150
Credit to banks	4,000
Other non-monetary liabilities	3,000
Other deposits with the Central Bank	50
Other assets	100

The government money in the economy is 1,050 MUC and the money supply in the economy is 80,000 MUC. If the Central Bank imposes a reserve ratio of 10% and the currency deposit ratio is estimated to be 20%, net foreign exchange assets with the Central Bank are

(2 marks)

(e) 12,785 MUC.

16. Which of the following factor(s) is/are responsible for the increase in public expenditure?

[<Answer>](#)

- I. Increase in price level.
- II. Population growth.
- III. Lack of basic infrastructures.

- (a) Only (I) above
- (b) Only (II) above
- (c) Only (III) above
- (d) Both (I) and (II) above
- (e) All (I), (II) and (III) above.

(1 mark)

[<Answer>](#)

17. The cash reserve requirement for a Cooperative bank is 3%. If a cheque of Rs.10 lacs is drawn and cleared against the Janata Cooperative bank, the effect of this transaction is to

- I. Reduce demand deposits by Rs.10 lacs.
- II. Reduce reserves by Rs.30,000.
- III. Increase demand deposits by Rs.10 lacs.
- IV. Increase reserves by Rs.30,000.

- (a) Only (I) above
- (b) Only (II) above
- (c) Only (III) above
- (d) Both (I) and (II) above
- (e) Both (III) and (IV) above.

(1 mark)

[<Answer>](#)

18. The overall balance of payment of an economy for the year 2007 is given below:

(Rs. in million)

Items	Credit	Debit
Merchandise	53,000	65,474
Services	24,986	18,780
Transfer	15,225	367
Income	2,826	7,708
Foreign Direct Investment	4,790	1,179
Portfolio Investment	7,535	6,591
External Assistance	2,773	5,233
Commercial Borrowings (MT & LT)	2,737	4,435
Commercial Borrowings (Short Term)	8,189	7,210
Commercial Banks	16,926	8,973
Others	536	246
Rupee Debit Service	–	474
Other Capital	6,402	2,909
Errors and omissions	634	–

During the year 2007, trade deficit for the economy was

- (a) Rs.12,474 million
- (b) Rs.12,574 million
- (c) Rs.12,974 million
- (d) Rs.13,821 million
- (e) Rs.13,980 million.

(2 marks)

[<Answer>](#)

19. The balance sheet of Delta bank is given below:

Assets	MUC	Liabilities	MUC
Total Reserves	13,000	Deposit Liabilities	30,000
Loans	20,000	Borrowing from RBI	4,000
Securities	8,000	Savings Liabilities	12,000
Other Assets	9,000	Equity	4,000

If the reserve requirement is 10%, what amount can Delta bank still loan out?

- (a) 1,300 MUC
- (b) 8,400 MUC
- (c) 8,800 MUC
- (d) 10,000 MUC
- (e) 15,000 MUC.

(1 mark)

[<Answer>](#)

20. The following information is available from the consolidated balance sheet of the banking sector:

Item	Rs. Billion
Net Bank Credit to the Government	2,000
Bank Credit to the Commercial Sector	3,000
Net Foreign Exchange Assets of the Banking Sector	2,200
Net Non-Monetary Liabilities of the Banking Sector	1,200
Government Currency Liabilities to the Public	300

Money supply in the economy is

- (a) Rs. 200 billion
- (b) Rs.6,000 billion
- (c) Rs.6,300 billion
- (d) Rs.7,400 billion
- (e) Rs.7,600 billion.

(1 mark)

[<Answer>](#)

21. The school of "Rational expectations" believes that

- (a) Individuals make systematic forecasting errors
- (b) Individuals basically behave irrationally to maximize on the basis of available information
- (c) Individuals' guesses about future on an average are correct
- (d) Econometric models are very useful in policy analysis
- (e) Discretionary monetary policy can be used to stabilize the economy.

(1 mark)

[<Answer>](#)

22. The following particulars are available for an economy:

Particulars	Amount (Rs. in Crore)
Consumption	7,500
Investment	2,500
Government expenditure	10,000
Exports	15,000
Imports	20,000
Velocity of money	15

The money supply in the economy is

- (a) Rs.10,000 crore
- (b) Rs. 1,000 crore
- (c) Rs.20,000 crore
- (d) Rs.15,000 crore
- (e) Rs. 7,500 crore.

(2 marks)

[<Answer>](#)

23. The ultimate goal of monetary policy is to achieve

- (a) Economic growth with stable prices
- (b) Stable interest rates
- (c) A low bank rate
- (d) Steady growth in bank reserves
- (e) Low unemployment rate.

(1 mark)

[<Answer>](#)

24. Consider the following information of a country:

Particulars	MUC
Autonomous Consumption	200
Equilibrium Output	1100
Planned Investment	100
Government Purchases	200
Net Exports	50

Marginal Propensity to Consume for the country will be

- (a) 0.5
- (b) 0.7
- (c) 0.9
- (d) 1.5
- (e) 3.6.

(2 marks)

[<Answer>](#)

25. From the following information, calculate the money multiplier:

High powered money	Rs.8,800 Cr.
Currency deposit ratio in the economy	15%
Cash reserve requirement of the Central Bank	5%

(1 mark)

- (a) 5.75
- (b) 6.00
- (c) 7.25
- (d) 8.31
- (e) 9.25.

26. Which of the following factor(s) is/are responsible for demand pull inflation? [<Answer>](#)

- I. Increase in money supply.
- II. The government budget deficit.
- III. Increase in exports earnings.

- (a) Only (I) above
- (b) Only (II) above
- (c) Both (I) and (III) above
- (d) Both (II) and (III) above
- (e) All (I), (II) and (III) above.

(1 mark)

[<Answer>](#)

27. If the balance on current and capital accounts of the Balance of Payments (BoP) taken together is negative, then

- (a) It is a case of BoP surplus
- (b) It is a case of surplus in the official reserves
- (c) It is a case of BoP deficit
- (d) It is a case of BoP equilibrium
- (e) It is a case of a deficit in the official reserves.

(1 mark)

[<Answer>](#)

28. A recession is defined as

- (a) A fall in real GNP over two consecutive quarters
- (b) An increase in real GNP from one quarter to the next
- (c) Nominal GNP declines from one quarter to the next
- (d) No change in real GNP from one quarter to the next
- (e) A rise in both nominal and real GNP from one period to the next.

(1 mark)

[<Answer>](#)

29. The following information pertains to national income aggregates of a hypothetical economy:

Particulars	Rs. in Crore
Compensation to employees paid by the government	50
Profit distributed as dividends by the firms	70
Old age pensions, scholarships etc., distributed by government	21
Purchases made by the government sector	246
Indirect taxes paid by the firms	75
Value of exports	22
Factor income paid as dividends abroad	25
Corporate taxes	62
Personal savings	22
Undistributed profits of the firms	42
Income taxes	94
Factor incomes received by the household sector	632

The personal disposable income in the economy is

- (a) Rs.529 Crore
- (b) Rs.559 Crore
- (c) Rs.579 Crore
- (d) Rs.589 Crore
- (e) Rs.600 Crore.

(2marks)

[<Answer>](#)

30. The European Union is an example of

- (a) Free Trade Area
- (b) Custom Union
- (c) Common Market
- (d) Economic Union
- (e) Political Union.

(1 mark)

[<Answer>](#)

31. Robert begins his job search soon after his Post-graduation in Computer Science. After two months of search, he is hired by a software company as a system administrator. The nature of unemployment (1 mark)

search, he is hired by a software company as a system administrator. The nature of unemployment encountered by Robert is

- (a) Structural
- (b) Frictional
- (c) Cyclical
- (d) Seasonal
- (e) Disguised.

32. Marginal Propensity to Consume for an economy is estimated to be 0.75. Beginning from a position of an equilibrium, investment rises by Rs.100 crore. The change in income that will bring back the economy to the equilibrium is

[<Answer>](#)

- (a) Rs.120 Crore
- (b) Rs.150 Crore
- (c) Rs.200 Crore
- (d) Rs.400 Crore
- (e) Rs.450 Crore.

(2 marks)

33. The relationship between aggregate consumption and aggregate income is known as the

[<Answer>](#)

- (a) Consumption function
- (b) Saving function
- (c) Production function
- (d) Demand function
- (e) Aggregate Supply function.

(1 mark)

34. In a two sector economy, if multiplier has a value of 3, it implies that

[<Answer>](#)

- (a) If income increases by Rs.3, investment will increase by Rs.9
- (b) If investment increases by Re.1, consumption will increase by Rs.2
- (c) If investment increases by Re.1, consumption will increase by Rs.3
- (d) If investment increases by Re.1, consumption will increase by Re.1
- (e) If investment increases by Rs.2, consumption will increase by Re.1.

(1 mark)

35. Dividends and corporate taxes are parts of

[<Answer>](#)

- I. Corporate profits.
 - II. National income.
 - III. Personal income.
 - IV. Personal disposable income.
- (a) Both (I) and (II) above
 - (b) Both (II) and (III) above
 - (c) Both (I) and (III) above
 - (d) (I), (II) and (III) above
 - (e) (I), (II) and (IV) above.

(1 mark)

36. If the Marginal Propensity to Consume is 0.8, a Rs.50 billion increase in investment spending will result in an increase in equilibrium output by

[<Answer>](#)

- (a) Rs. 50 billion
- (b) Rs.100 billion
- (c) Rs.200 billion
- (d) Rs.250 billion
- (e) Rs.500 billion.

(2 marks)

37. From the following information, compute personal savings:

[<Answer>](#)

Personal income	=	Rs.10,000
Personal taxes	=	Rs. 3,000
Dividends	=	Rs. 200
Depreciation	=	Rs. 1,250
Personal consumption =		Rs. 6,000

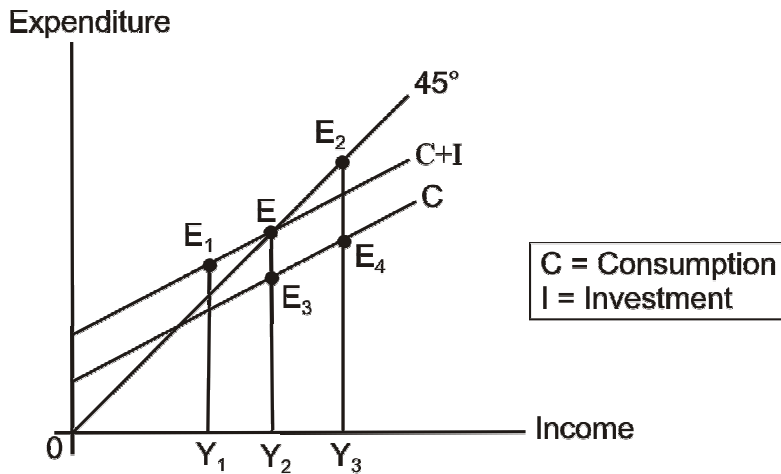
- (a) Rs.4,000
- (b) Rs.4,200
- (c) Rs.7,000
- (d) Rs.7,200
- (e) Rs.1,000.

(2 marks)

38. The following figure shows Keynesian' equilibrium of income and expenditure:

[<Answer>](#)

(1 mark)



Equilibrium income in the figure is shown by the point

- (a) E
- (b) E₁
- (c) E₂
- (d) E₃
- (e) E₄.

[<Answer>](#)

39. The following information is extracted from National Income Accounts of a country:

Particulars	Million Units of Currency
NDP at Market Prices	33,870
Net factor income from abroad	92
Depreciation	1,800
Subsidies	708
Indirect taxes	4,272

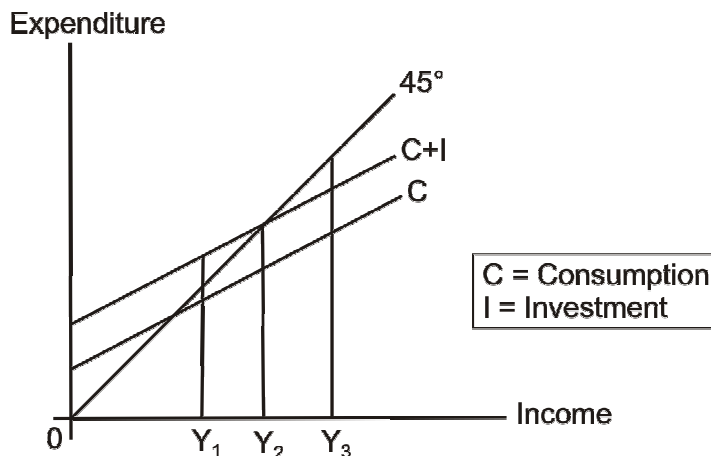
The NDP at Factor Cost is

- (a) 9,050 MUC
- (b) 11,560 MUC
- (c) 15,550 MUC
- (d) 30,306 MUC
- (e) 35,667 MUC.

(2 marks)

[<Answer>](#)

40. The following figure shows 'Keynesian' equilibrium of income and expenditure:



Which of the following situations is likely to happen at Y₃?

- (a) Income and expenditure are in equilibrium
- (b) Inventories are decreasing
- (c) Inventories are increasing
- (d) Production is increasing
- (e) Inventories remain constant.

(1 mark)

[<Answer>](#)

41. If the MPC = 0.6, then the multiplier is

(1 mark)

- (a) 1.67
- (b) 2.50
- (c) 5.00
- (d) 15.00
- (e) 60.00.

[<Answer>](#)

42. Consider the following information:

Disposable income (Rs.)	Consumption (Rs.)
2,000	2,700
4,000	4,100
6,000	5,500
8,000	6,900
10,000	8,300

When disposable income is Rs.10,000, what is the average propensity to consume?

- (a) 0.92
- (b) 0.83
- (c) 0.86
- (d) 1.03
- (e) 1.35.

(1 mark)

[<Answer>](#)

43. Which of the following statements is **true**?

- (a) Open market operations are the least often used monetary policy tool
- (b) Changes in the reserve requirement ratio affect a bank's required reserves but not the money supply
- (c) Monetary policy influences the money supply primarily by altering the amount of excess reserves held by banks
- (d) Monetary policy affects the money supply but not interest rates
- (e) Bank rate is the rate at which the Commercial bank rediscounts approved bills of exchanges.

(1 mark)

[<Answer>](#)

44. Which of the following is a consequence of a reduction in the required reserve ratio?

- (a) Decrease in the credit creation and decrease in the money supply
- (b) Increase in the credit creation and decrease in the money supply
- (c) Increase in the credit creation and increase in the money supply
- (d) Decrease in credit creation and increase in the money supply
- (e) The money supply remains unaffected.

(1 mark)

[<Answer>](#)

45. If the country X enjoys a comparative advantage over the country Y in the production of coffee, then

- (a) The opportunity cost of producing coffee in X is higher than in Y
- (b) The opportunity cost of producing coffee in X is lower than in Y
- (c) Neither X nor Y should specialize in the production of coffee
- (d) Both the countries enjoy absolute advantage in the production of coffee
- (e) The opportunity cost of producing coffee is same in X and Y.

(1 mark)

[<Answer>](#)

46. Which of the following is a stock variable?

- (a) Investment
- (b) Exports
- (c) Gross domestic product
- (d) Consumption
- (e) Consumer price index.

(1 mark)

[<Answer>](#)

47. Cash reserve ratio refers to

- (a) Amount of money Commercial banks have to keep as reserve with the Consolidated Fund of India
- (b) Amount of money Commercial banks have to keep as reserves with other Commercial banks
- (c) Amount of money Commercial banks have to keep as reserves with the Central Bank
- (d) Amount of money the Central Banks have to keep as reserves with Commercial banks
- (e) Amount of deposits kept with Commercial banks by the public.

(1 mark)

[<Answer>](#)

48. The long run Phillips curve is vertical because

- (a) The unemployment rate decreases when the inflation rate increases
- (b) There is no trade-off between unemployment rate and the inflation rate in the long run

(1 mark)

- (b) There is no trade-off between unemployment rate and the inflation rate in the long run
- (c) The natural unemployment rate only depends on the inflation rate
- (d) Real GDP does not depend on the unemployment rate
- (e) There is a direct relationship between the natural unemployment rate and the inflation rate.

[<Answer>](#)

49. Which of the following is a “leakage” from the circular flow of income?

- (a) Mr. Ramesh bought an Indian made color television for Rs.15,000
- (b) Mr. Babu bought a second hand refrigerator from his friend Rajesh
- (c) Mr. Harsha imported a brand new Ferrari car from Germany for Rs.10 lakh
- (d) Mr. Sujit paid Rs.10,000 to his personal secretary towards salary
- (e) Mr. Anil bought toys made in Mumbai for his children.

(1 mark)

[<Answer>](#)

50. A reduction in the corporate tax that would encourage entrepreneurs to invest more as they would be exposed to lower entrepreneurial risks. This is advocated by

- (a) Keynesian economist
- (b) Monetarist
- (c) Supply-side economist
- (d) Classical economist
- (e) Rational expectation economist.

(1 mark)

[<Answer>](#)

51. Which of the following is **not** one of the basic postulates of the Keynesian Model?

- (a) Full employment occurs only by coincidence in an economy
- (b) Effective demand determines the level of employment and output
- (c) As full employment is not always possible, Government intervention is essential
- (d) Budget deficit is a tool to fight recession
- (e) Monetary policy is more effective than fiscal policy.

(1 mark)

[<Answer>](#)

52. Which of the following takes account of trade involving financial assets and international investment?

- (a) Unilateral transfers
- (b) Merchandise
- (c) Capital
- (d) Services
- (e) Errors and omissions.

(1 mark)

[<Answer>](#)

53. If the government spending increases by Rs.10,000 Cr. and tax collections also increase by Rs.10,000 Cr., the effect is termed as

- (a) Contractionary fiscal policy
- (b) Expansionary fiscal policy
- (c) Expansionary monetary policy
- (d) Contractionary monetary policy
- (e) Bank rate policy.

(1 mark)

[<Answer>](#)

54. The increase in the capital stock is known as

- (a) Depreciation
- (b) Interest
- (c) Saving
- (d) Investment
- (e) Income.

(1 mark)

[<Answer>](#)

55. Which of the following increases during a recession?

- (a) Sales
- (b) Unemployment
- (c) Corporate profits
- (d) Consumption
- (e) Investment.

(1 mark)

[<Answer>](#)

56. An underdeveloped country, due to lack of an effective Central Banking system, has to rely on fiscal policy alone to decide about its economic policies. Here, the term fiscal policy refers to

- (a) Changes in the quantity of money designed to affect interest rates
- (b) Policies related to quotas
- (c) Composition of money supply
- (d) Revenue and expenditure policies of the government to achieve full employment
- (e) Measures to control inflation.

(1 mark)

57. Monetary liabilities of the Central Bank in an economy are 20,000 MUC and government money is 2,000 MUC. The currency-deposit ratio is estimated to be 0.25. If the Central Bank wants to set the money supply at 50,000 MUC, what should be the reserve ratio that the Central Bank should impose on banks to achieve the targeted money supply? [<Answer>](#)
- (a) 0.250
 (b) 0.300
 (c) 0.500
 (d) 0.425
 (e) 0.200. (2 marks)
58. Which of the following schools of thought advocates that money supply determines the short-run movements in nominal GDP? [<Answer>](#)
- (a) Keynesian economics
 (b) Classical economics
 (c) Monetarist economics
 (d) Neo-classical economics
 (e) Supply side economics. (1 mark)
59. Under the paper currency system, determination of the exchange rate usually takes into account [<Answer>](#)
- (a) Budget deficit
 (b) The purchasing power of a national currency
 (c) The inflation rate in the country
 (d) The money supply of the country
 (e) The unemployment rate in the country. (1 mark)
60. If the marginal propensity to consume is 0.80, the tax rate is 30% and the marginal propensity to import is 0.36, then the multiplier is [<Answer>](#)
- (a) 1.16
 (b) 1.25
 (c) 1.55
 (d) 2.50
 (e) 2.56. (2 marks)
61. The high-powered money in the economy is Rs.20,000 crore. If the currency-deposit ratio is 0.25, while the reserve ratio to be maintained with Central Bank is 0.05, what is the money supply? [<Answer>](#)
- (a) Rs. 80,000.00 crore
 (b) Rs. 66,666.66 crore
 (c) Rs. 83,333.33 crore
 (d) Rs.4,00,000.33 crore
 (e) Rs. 5,000.66 crore. (2 marks)
62. Which of the following is **not true**? [<Answer>](#)
- (a) Net investment equals gross investment less depreciation
 (b) Real GDP is gross domestic product as measured in current rupees divided by the GDP deflator
 (c) An unplanned inventory increase indicates that saving is greater than planned investment
 (d) In the equation, $C = a + bY$, “a” refers to the level of consumption (C) that is independent of Income level (Y)
 (e) Aggregate personal income is the market value of all final goods and services produced during a given period by the factors of production owned by residents of a country. (1 mark)
63. An economy is said to be facing inflation with respect to a base year if the price index for the current year is [<Answer>](#)
- (a) More than 0 and less than 50
 (b) More than 100
 (c) 100
 (d) Between 50 to 100
 (e) Less than 0 (i.e. negative). (1 mark)
64. The personal income of an individual is Rs.20,000. If the income tax paid is Rs.375, consumption expenditure is Rs.5,000, interest payments on loans are Rs.200 and savings amount to Rs.800, the disposable income of the individual is [<Answer>](#)
- (a) Rs.10,000
 (b) Rs.10,400
 (c) Rs. 9,600
 (d) Rs. 9,800 (2 marks)

(e) Rs.19,625.

65. The following information is available from the consolidated balance sheet of the banking sector:

[<Answer>](#)

Item	Rs. billion
Net Bank Credit to the Government	2,150
Bank Credit to the Commercial Sector	3,250
Net Foreign Exchange Assets of the Banking Sector	2,215
Net Non-Monetary Liabilities of the Banking Sector	1,200
Money supply in the economy	6,500

Government Currency Liabilities to the public is

- (a) Rs. 85 billion
- (b) Rs.6,000 billion
- (c) Rs.6,200 billion
- (d) Rs.7,400 billion
- (e) Rs.7,800 billion.

(2 marks)

[<Answer>](#)

66. When the government fixes the exchange rate, it is called as

- (a) Fixed rate
- (b) Hard peg
- (c) Soft peg
- (d) Low frequency pegging
- (e) Adjustable peg.

(1 mark)

[<Answer>](#)

67. The devaluation of rupee is aimed at

- (a) Increasing imports
- (b) Increasing exports
- (c) Decreasing exports
- (d) Decreasing national income
- (e) Decreasing rate of inflation.

(1 mark)

[<Answer>](#)

68. The production possibility curve illustrates that

- (a) An economy will automatically seek that level of output at which all of its resources are employed
- (b) An economy's capacity to produce increases in proportion to its population size
- (c) If all the resources of an economy are in use, more of one good can be produced only if less of another good is produced
- (d) Since human wants are limited and resources are unlimited, more of both goods can be produced
- (e) There is a direct relation between consumption and investment.

(1 mark)

[<Answer>](#)

69. Which of the following sequences expresses the relationship among money supply, nominal interest rate, investment and gross national product assuming demand for money to be constant?

- (a) When money supply decreases, nominal interest rate decreases, investment decreases and real gross national product decreases
- (b) When money supply decreases, nominal interest rate decreases, investment increases and nominal gross national product increases
- (c) When money supply decreases, nominal interest rate increases, investment increases and real gross national product increases
- (d) When money supply increases, nominal interest rate decreases, investment increases, nominal gross national product increases
- (e) When money supply increases, nominal interest rate, investment and real gross national product remains the same.

(1 mark)

[<Answer>](#)

70. Which of the following happens during recession?

- I. Workers are laid off.
 - II. Factories are idle.
 - III. Firms are unable to sell what they produce.
- (a) Only (I) above
 - (b) Only (II) above
 - (c) Both (I) and (II) above
 - (d) Both (II) and (III) above
 - (e) All (I), (II) and (III) above.

(1 mark)

[<Answer>](#)

71. Which of the following is an example of indirect tax?

(1 mark)

- (a) Wealth tax
- (b) Income tax
- (c) Excise duty
- (d) Estate duty
- (e) Gift tax.

72. Which of the following is classified as the cost-push factor of inflation?

[<Answer>](#)

- (a) Population growth
- (b) Hike in international prices of crude oil
- (c) Tax evasion by assesseees
- (d) Hoarding and speculative activities of middle men
- (e) Increase in supply of money.

(1 mark)

[<Answer>](#)

73. The change in foreign exchange reserves and reserves of gold held by the monetary authorities will be recorded in

- (a) Current account of the BoP statement
- (b) Capital account of the BoP statement
- (c) Errors and omissions account
- (d) Official reserves account
- (e) Invisible accounts.

(1 mark)

[<Answer>](#)

74. Which of the following is a regional grouping of countries that levies common external duties on imports from nonmember countries, but which eliminates tariffs, quotas and other miscellaneous government restrictions on trade among member countries?

- (a) Free trade area
- (b) Custom union
- (c) Political union
- (d) Economic union
- (e) Common market.

(2 marks)

[<Answer>](#)

75. In which of the following cases, people expect the price to increase and spend their money quickly so that they could consume to the maximum possible extent?

- (a) Creeping inflation
- (b) Running inflation
- (c) Galloping inflation
- (d) Deflation
- (e) Stagflation.

(1 mark)

[<Answer>](#)

76. If the real GDP is 5% and the inflation rate is 2%, the nominal GDP is

- (a) 4%
- (b) 3%
- (c) 1%
- (d) 5%
- (e) 7%.

(1 mark)

[<Answer>](#)

77. The following information is given about an economy:

Particulars	MUC
GDP at factor cost	8,000
Net factor income from abroad	2,150
Depreciation	1,050
Net indirect taxes	2,350

The amount of NNP at factor cost is

- (a) 10,000 MUC
- (b) 10,400 MUC
- (c) 9,100 MUC
- (d) 9,800 MUC
- (e) 19,625 MUC.

(2 marks)

[<Answer>](#)

78. Which of the following statements is **true**?

(1 mark)

- (a) There is a surplus output to the right of the Keynesian equilibrium output
- (b) At the Keynesian equilibrium, consumption is greater than disposable income
- (c) The Keynesian equilibrium output is necessarily at the full employment output
- (d) At the Keynesian equilibrium output, consumption is less than disposable income
- (e) At the Keynesian equilibrium, there will be unintended inventories.

[<Answer>](#)

79. The following information is given for a hypothetical economy:

Particulars	MUC
NDP at factor cost	1,850
Depreciation	165
GNP at market price	2,425
Net factor income from abroad	100
Subsidies	255

The amount of indirect tax is

- (a) 310 MUC
- (b) 665 MUC
- (c) 565 MUC
- (d) 730 MUC
- (e) 365 MUC.

(2 marks)

END OF QUESTION PAPER

Suggested Answers

Economics – II (MB142): July 2008

Answer	Reason	
1. B	a. The period from A to B indicates recovery phase. b. The period from C to D indicates recession phase, hence is the answer. c. The period from B to C indicates expansion phase. d. The period from D to E indicates depression phase. e. The period from D to F indicates both depression and recovery phases.	< TOP
2. D	The profits of an Indian company which is established in USA will be recorded in GNP of India and GDP of USA. Therefore option (d) is the correct answer.	< TOP
3. D	A higher price level decreases autonomous consumption, autonomous investment, and net exports which result in aggregate expenditures to fall.	< TOP
4. E	Loans and advances are assets to the commercial bank. Therefore option e is the correct answer.	< TOP
5. E	If any economy is in recession, expansionary fiscal and policies can help increase the AD and revive economic activity. Statements (I) and (II) are expansionary fiscal policy tools and options (III) and (IV) are expansionary monetary policy tools. Therefore, all these things would be appropriate to help an economy in recession.	< TOP
6. D	National income (NNP at FC) = wages & salaries + interest income + rental income + profit Or, Profit = 300 – 180 – 45 – 30 = 45 MUC.	< TOP
7. A	Since foreign exchange inflows of 50 MUC increases the monetary liabilities by 50 MUC, the central bank can sell 50 MUC worth of government securities to bring back the monetary Liabilities to its original level to keep money supply at the same level.	< TOP
8. B	If investment increases, it does seem that the equilibrium shifts to the right results in an increase in production, which in turn causes boom.	< TOP
9. C	NI = NNP at factor cost = NDP at factor cost + Net factor income from abroad = NDP at market price – indirect taxes + subsidies + Net factor income from abroad = (77,000 – 7,700 + 6,600) + (-700) = 75,200 MUC.	< TOP
10. E	Since Gross Domestic Product, Interest rate and the inflation rate are used as the general economic indicators. Option (e) is the correct answer.	< TOP
11. E	Bank rate is not a selective credit control method to regulate credit.	< TOP
12. B	The term balance of trade is the differences between merchandise exports and imports.	< TOP
13. B	A type of tariff in which a fixed amount of money is charged per unit of product traded is called specific duty. Therefore option (b) is the correct answer.	< TOP

14. A At the break even level of income, savings are zero. [< TOP](#)
 Thus $-20 + 0.4Y = 0$
 or $-20 = -0.4Y$
 or $Y = 50$ MUC.
15. B Money supply = High powered money (H) x Money multiplier [< TOP](#)

$$\text{Money multiplier} = \frac{1 + \text{Currency Deposit Ratio}}{\text{Currency Deposit Ratio} + \text{Reserve Requirements}}$$

$$80,000 = H \times \frac{(1 + 0.2)}{(0.2 + 0.1)}$$
 Or $H = \frac{80,000}{4} = 20,000$
 Or, $H = 20,000$ MUC
 $H = \text{Monetary liabilities of the Central Bank} + \text{Government money} = \text{ML} + 1050$
 Or, $\text{ML} = 20,000 - 1,050 = 18,950$.
 Total assets = Total liabilities (= Non-ML + ML)
 Total liabilities = Net worth (6,000) + Government deposits (150) + Other non monetary liabilities (3,000) + Monetary liabilities (18,950) = 28,100.
 Thus, total assets = 28,100 = (10,000 + 4,000 + 5,000 + 100 + Net foreign exchange assets)
 Or, Net foreign exchange assets = 28,100 – 19,100 = 9,000 MUC.
16. E Increase in price level, Population growth and lack of Basic infrastructures are responsible for the increase in public expenditure. [< TOP](#)
17. D The cash reserve requirement for a cooperative bank is 3%. If a cheque for Rs.10 lacs is drawn and cleared against the Janata Cooperative bank, the demand deposits and reserves of the Janata Coop. Bank will be reduced by Rs.10 lacs and Rs.30,000 respectively. [< TOP](#)
18. A Trade deficit during the year 2007 = Merchandise (credit)- Merchandise (debit) [< TOP](#)
 = 53,000 – 65,474
 = Rs.12,474 million.
19. D The bank has 30,000 MUC in deposit liabilities and a reserve requirement of 10 percent. This means the bank must have 3000 MUC in reserves. Since the bank has 13,000 MUC in reserves, it has excess reserves of 10,000 MUC which it can lend out. [< TOP](#)
20. C Money Supply = Net bank credit to Government + Bank credit to commercial sector + Net foreign exchange assets of the banking sector – Net non-monetary liabilities of the banking sector + Government money [< TOP](#)
 = 2000 + 3000 + 2200 – 1200 + 300
 = Rs.6300 billion.
21. C According “Rational expectations”, on an average make correct guess about the future. [< TOP](#)
 (a) Individual’s do not make systematic forecasting errors and on average they are correct.
 (b) Individuals basically do behave rationally to maximize on the basis of available information.
 (c) Yes, this is the basic postulate of the “Rational expectations” school that the individuals on an average make correct guesses about the future. Hence this option is correct.
 (d) No, the econometric models have limited applicability.
 (e) Discretionary monetary policy is not effective because people expect the changes and make adjustments accordingly.

22. B
$$\text{Money Supply} = \frac{Y}{\text{Velocity of money}}$$
 [< TOP](#)
 Where $Y = C + I + G + E - M = 7,500 + 2,500 + 10,000 + 15,000 - 20,000 = 15,000$

$$\text{Money supply} = \frac{15,000}{15} = \text{Rs. 1,000 crore.}$$
23. A The monetary policy of any country refers to a regulatory policy, by the help of which monetary authority maintains its control over the supply of money for the realization of general economic objectives mainly to achieve higher economic growth with stable price. Therefore option (a) is the correct answer. [< TOP](#)
24. A $Y = C + I + G + NX$ [< TOP](#)
 $C = a + bY$
 $C = 200 + bY$
 $Y = C + I + G + NX$
 $1100 = 200 + bY + 100 + 200 + 50$
 $1100 = 200 + b(1100) + 100 + 200 + 50$
 $550 = 1,100b$
 $b = 0.5$
 So the value of marginal propensity to consume is 0.5.
25. A
$$\text{Money multiplier} = \frac{1+c}{c+r} = \frac{1+0.15}{0.15+0.05} = \frac{1.15}{0.20} = 5.75$$
 [< TOP](#)
26. E Inflation is the increase in the general price level of an economy it may be caused due to demand pull factors or cost pull factors. This demand pull inflation arises due to increase in money supply, government budget deficit and increase in export earnings. Therefore option (e) is the correct answer. [< TOP](#)
27. C If both the current and the capital accounts are in deficit, it is a case of a BoP deficit. [< TOP](#)
28. A A recession is defined as a fall in real GNP over two consecutive time periods. [< TOP](#)
29. B $\text{Personal Disposable Income} = \text{Personal income} - \text{Personal taxes}$ [< TOP](#)
 $= \text{Factor incomes received by the household sector} + \text{Transfer payments} - \text{Personal taxes}$
 $= 632 + 21 - 94 = \text{Rs. 559 Crore.}$
 Note: Compensation to employees paid by the Government and profit distributed as dividends by the firms are included in the factor income received by the household sector.
30. D The European Union is an example of Economic union. Therefore option d is the correct answer. [< TOP](#)
31. B (a) Structural unemployment arises when the regional or occupational pattern of the job vacancies does not match the pattern of workers availability and suitability. The above situation does not represent structural unemployment. [< TOP](#)
 (b) Unemployment that is caused by constant changes in the labor market is called frictional (natural) unemployment. It occurs on account of two reasons: (a) employers not fully aware of all available workers and their job qualifications; and (b) available workers are not fully aware of the jobs being offered by employers.
 Even though the suitable job is available for Mr. Robert it took him 2 months to find the job. Thus, the unemployment encountered by Robert is in the nature of frictional (natural) unemployment.
 (c) Unemployment that arises when there is general downturn in business activity is

called cyclical unemployment.

- (d) Unemployment that arises because of seasonal variations is called seasonal unemployment. For example, agricultural labors normally face unemployment during summer.
- (e) When marginal productivity becomes negative because of excess employment we call it as disguised unemployment. In less developed countries like India there is widespread disguised unemployment in agricultural sector.

32. D Multiplier is nothing but the ratio of percentage change in income to change in investment. That means multiplier = [< TOP](#)

$$\frac{1}{MPS} = \frac{1}{1-MPC} = \frac{1}{1-0.75} = \frac{1}{0.25} = 4$$

If investment increases to 100 crore the change in Y that will be bring back the economy to the equilibrium is $4 \times 100 = \text{Rs.}400$ crore.

33. A The relationship between aggregate consumption and aggregate income is known as the consumption function. Therefore option (a) is the correct answer. [< TOP](#)

34. B Multiplier = $1/1-MPC = 3$ [< TOP](#)
 $1-MPC = 1/3$
 $MPC = 2/3$

The larger the marginal propensity to consume the larger will be the multiplier. If the multiplier has a value of 3, it implies that if investment increases by Re.1 the output will increase by Rs.3. Since the MPC will be 2/3 a change in output of Rs.3 will result into an increase in consumption by Rs.2.

35. A By definition dividends and corporate taxes are part of corporate profits and national income. [< TOP](#)

National income refers to the factor income earned by the residents of a country and it includes profits earned by entrepreneurs. Profit includes dividends and corporate tax. Hence dividends and corporate tax are part of national income.

36. D [< TOP](#)
 $\Delta Y = k \Delta I$, where $k = \left(\frac{1}{1-MPC} \right)$. $\Delta I = \text{Rs } 50$ billion, $MPC = 0.8$

$$\text{Multiplier} = \frac{\Delta Y}{\Delta I} = \frac{1}{1-MPC}$$

$$\Delta Y = 50 \left(\frac{1}{1-0.8} \right) = \text{Rs } 250 \text{ billion.}$$

37. E Personal savings = Personal income – Personal tax – Personal consumption [< TOP](#)
 $= 10,000 - 3,000 - 6,000 = \text{Rs.}1,000$.

38. A At Y_2 , aggregate demand equals output and planned savings equal investment. So, the equilibrium income is shown by the point E. [< TOP](#)

39. D NDP at factor cost = NDP at market prices – indirect taxes + subsidies [< TOP](#)
 $= 33870 - 4272 + 708 = 30,306 \text{ MUC.}$

40. C At Y_3 , The level of inventory is higher than the equilibrium level, which is Y_2 . Hence there is unsold inventory. [< TOP](#)

41. B Multiplier = $\frac{1}{1-MPC} = \frac{1}{1-0.6} = \frac{1}{0.40} = 2.5$. [< TOP](#)

42. B [< TOP](#)

$$\text{Average Propensity to Consume} = \frac{\text{Consumption}}{\text{Disposal income}}$$

At a disposal income level of Rs, 10,000, the APC = $8300/10000 = 0.83$.

43. C By altering the amount of excess reserves held by banks, the Reserve Bank of India influences the ability of the banking system to increase the money supply through the process of loans and deposit expansion. The other four statements are all incorrect. [< TOP](#)
44. C When the reserve ratio is reduced, the money supply increases by the money multiplier given by $M = I + Cu/Cu + r$. A reduction in the reserve ratio will thus tend to increase the money supply, which will enable the banks to increase the loans. [< TOP](#)
45. B If the country called X enjoys a comparative advantage in the production of coffee over the country called Y, then the opportunity cost of production of coffee in X is lower than in Y. [< TOP](#)
46. E Consumer price index is a stock variable but others are flow variables. Therefore option (e) is the correct answer. [< TOP](#)
47. C Cash reserve ratio refers to the amount of the reserves that the commercial banks have to keep with the central bank. Therefore option c is the correct answer. [< TOP](#)
48. B In the long run, the economy is at full employment. So there is no long run trade-off between inflation and unemployment. As a result, the long run Phillips Curve is a vertical line above full employment. The long run Phillips curve, in contrast to the short run curve, does not hold the expected inflation rate constant (but does hold the natural unemployment rate constant). More specifically, the long run Phillips curve shows the relationship between inflation and unemployment when the actual inflation rate equals the expected inflation rate. This curve is vertical at the natural rate of unemployment: any anticipated (and actual) inflation rate is possible at the natural rate of unemployment. When inflation is accurately anticipated, real GDP equals potential GDP, and unemployment is at the natural rate. Expected inflation has no impact on the long run Phillips curve. [< TOP](#)
49. C Circular flow of income refers to money flow from households in return for goods and services produced by firms and money passes from firms to households in return for factor services provided by households. If any part of the income is not spent with in the flow and hence it represents leakage from the flow. [< TOP](#)
- Since Mr. Ramesh is spending his money on consumption of goods. Which would lead to flow of income from households to the firms and hence no leakage from the system.
 - In the process of buying second hand refrigerator income is transferred from Mr. Babu to Mr. Rajesh which represents consumption expenditure and hence income remains in the system.
 - As Mr. Harsha imported a new Ferrari car part of the income has gone out the flow in order to pay for commodity which is not produced within the country. Money spent on Ferrari becomes part of circular flow of exporting country and a leakage for the importing country. Hence the answer is option c.
 - Salary paid represents flow of income from Mr. Sujit to his personal secretary.
 - Mr. Anil bought toys made in Mumbai for his children is not a “leakage” from the circular flow of income. It is considered to be consumption.
50. C A reduction in the corporate tax that would encourage entrepreneurs to invest more as they would be exposed to lower entrepreneurial risks. This is advocated by Supply-side economist. [< TOP](#)
51. E (a) Is not the answer because Keynes considered the existence of full employment as a special case. The Keynesian underemployment equilibrium is reflecting real life situations. [< TOP](#)
- Is not the answer because aggregate demand or effective demand indicates the total quantity of goods and services that people want to buy. According to Keynes, effective aggregate demand determines the level of employment and output.
 - Is not the answer because Keynes argues that State intervention is essential as full employment is not possible in an economy.

- (d) Is not the answer because Keynes argues that an economy facing recession, budget deficit is an important tool to overcome recession.
- (e) Is the answer because in the Keynesian model, monetary policy is not effective as compared to fiscal policy. Rather it is the fiscal policy, which is very effective and powerful. Keynes argues that government should maintain an active stance with a combination of tax and expenditure policies to maintain the desired levels of output and employment through manipulation of effective demand.
52. C Capital account records the trade involving financial assets and international investment. [< TOP](#)
53. B If the government spending increases by Rs. 10,000 Cr and tax collections also increase by 10,000 Cr, the effect is expansionary. Because increased government spending have a multiplier effect in the economy. [< TOP](#)
54. D The increase in the capital stock is known as investment. [< TOP](#)
55. B Unemployment typically rises during a recession. [< TOP](#)
56. D Fiscal policy refers to revenue and expenditure policies to achieve full employment. Therefore option d is the correct answer. [< TOP](#)
57. B High-powered money (H) = Government money + Monetary liabilities of the Central Bank
 = 20,000 + 2000 = 22,000 MUC.
 Money supply, Ms = H x $\{(1 + Cu)/(Cu + r)\}$
 Or, 22,000 x $\{(1.25/0.25 + r)\} = 50,000$
 $0.55 = 0.25 + r$
 Or, r = 0.3. [< TOP](#)
58. C Monetarist advocates that money supply determines the short-run movements in nominal GDP. [< TOP](#)
59. B Under the paper currency system, determination of the exchange rate usually takes into account the purchasing power of a national currency. [< TOP](#)
60. B
$$\text{Multiplier} = \frac{\Delta Y}{\Delta G} = \frac{1}{1 - b(1 - t) + m} = \frac{1}{1 - 0.8(1 - 0.30) + 0.36}$$

$$= \frac{1}{1 - 0.8 \times 0.7 + 0.36} = \frac{1}{0.80} = 1.25$$
 [< TOP](#)
61. C Money Supply = H $\left[\frac{1 + Cu}{Cu + r} \right] = 20,000 \times \left[\frac{1 + 0.25}{0.25 + 0.05} \right] = \text{Rs.}83,333.33 \text{ Cr.}$ [< TOP](#)
62. E The market value of all final goods and services produced during a given period by factors of production owned by residents of a country is Gross Domestic Product. All other options are true [< TOP](#)
63. B The value of price index in base year is 100. A country is said to be facing inflation when the price index increases from the base year. Thus, a country having a price index of more than 100 is said to be facing inflation. [< TOP](#)
64. E Disposable income = personal income – personal taxes = 20,000 – 375 = Rs.19,625. [< TOP](#)
65. A Money Supply = Net bank credit to Government + Bank credit to commercial sector + Net foreign exchange assets of the banking sector – Net non-monetary liabilities of the [< TOP](#)

banking sector + Government money

Rs.6500 billion = 2,150 + 3,250 + 2,215 – 1,200 + Government money

Government money = Rs.85 billion.

66. A When the government fixes the exchange rate it is called as Fixed rate. [< TOP](#)
67. B The devaluation in the value of rupee is aimed at increasing exports. For example when the rupee depreciates, it becomes cheaper in terms of the foreign currencies and hence imports from India will be more attractive. In other words, our exports will become more attractive. [< TOP](#)
68. C Since resources are limited and human wants are unlimited, the economy in order to satisfy the wants of the people needs the help of production possibility curve which stays if all the resources of an economy are in use, more of one good can be produced only if less of another good is produced. Therefore option (c) is the correct answer. [< TOP](#)
69. D When the money supply increases the interest rate decreases. This will increase the investment Demand which will increase GNP. [< TOP](#)
70. E Recession is one of the most important stage of business cycle and following are the features of recession stage: [< TOP](#)
- I. Workers are laid off.
 - II. Factories are idle.
 - III. Firms are unable to sell what they produce.
- So, option (e) is the correct answer.
71. C Excise duty is an indirect tax. An indirect tax is imposed on one person but paid wholly or partly by another person. [< TOP](#)
72. B Option (b) is classified as cost-push factor of inflation. Options (a), (c), (d) and (e) are classified as demand-pull factors of inflation. [< TOP](#)
73. D Inventories of foreign countries and gold that could be sold for dollars are held under the official reserves account with the central bank that they would sell in the market when there is an excess demand for dollars. Conversely when there is an excess supply of dollars, they would buy up the dollars. [< TOP](#)
74. E Common market is a regional grouping of countries that levies common external duties on imports from nonmember countries, but which eliminates tariffs, quotas and other miscellaneous government restrictions on trade among member countries. [< TOP](#)
75. C In Galloping inflation, people expect the price to increase and spend their money quickly so that they could consume to the maximum extent possible. [< TOP](#)
76. E If the real GDP is 5% and the inflation rate is 2%, it means that nominal GDP must be 7%. [< TOP](#)
- Nominal GDP = real GDP + inflation
(e) is the answer.
77. C As we know NNP at factor cost [< TOP](#)
- = GDP at factor cost – Depreciation + Net Factor Income from abroad
= 8,000 – 1,050 + 2,150 = 9,100 MUC.
78. A When the economy is producing to the right of the equilibrium output determined by the Keynesian cross, there will be unsold inventories or there will be over production. At the equilibrium point, consumption is equal to disposable income. [< TOP](#)
79. C Indirect taxes = GNP at market price – NDP at factor cost – Depreciation – NFIA + Subsidies [< TOP](#)
- = 2425 – 1850 – 165 – 100 + 255 = 565 MUC.

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