

UPSC Prelims Test Series 2020
Test 3: Economy
Explanation

Answer Keys

Que	Ans	Que	Ans	Que	Ans	Que	Ans
1	D	26	A	51	B	76	B
2	C	27	C	52	C	77	C
3	B	28	D	53	B	78	A
4	C	29	B	54	B	79	B
5	B	30	A	55	C	80	A
6	D	31	C	56	B	81	B
7	C	32	D	57	C	82	C
8	D	33	A	58	C	83	D
9	C	34	D	59	D	84	A
10	B	35	A	60	C	85	B
11	D	36	A	61	B	86	C
12	D	37	C	62	C	87	B
13	D	38	A	63	C	88	D
14	C	39	B	64	D	89	C
15	D	40	A	65	B	90	B
16	D	41	A	66	B	91	D
17	A	42	A	67	D	92	C
18	C	43	A	68	A	93	A
19	C	44	C	69	A	94	D
20	D	45	B	70	A	95	D
21	B	46	D	71	D	96	D
22	C	47	C	72	A	97	D
23	B	48	A	73	D	98	A
24	C	49	A	74	A	99	B
25	A	50	A	75	D	100	C

ANSWER EXPLANATIONS:-

Q1] Ans: d

Adam Smith, the founding father of modern economics, had suggested that if the buyers and sellers in each market take their decisions following only their own self-interest, economists will not need to think of the wealth and welfare of the country as a whole separately.

Q2] Ans: c

Two nations with the same money supply can have different GDP

1.Circulation of the same money supply happens differently in both economies depending on nature of economy.

2.Labour productivity can be different in the two economies as result of different human capital.

Hence both statements are correct.

How the Money Supply Affects GDP?

According to standard macroeconomic theory, an increase in the supply of money should lower the interest rates in the economy, leading to more consumption and lending/borrowing. In the short run, this should, but does not always, correlate to an increase in total output and spending and, presumably, GDP.

The long-run effects of an increase in the money supply are much more difficult to predict. There is a strong historical tendency for asset prices, such as housing, stocks, etc., to artificially rise after too much liquidity enters the economy. This misallocation of capital leads to waste and speculative investments, often resulting in burst bubbles and recession. On the other hand, it is possible money is not misallocated, and the only long-term effect is higher prices than consumers normally would have faced.

How GDP Affects the Money Supply?

GDP is an imperfect representation of economic productivity and health, but generally speaking, higher GDP is more desired than lower. Rising economic productivity increases the value of money in circulation since each unit of currency can subsequently be traded for more valuable goods and services.

Thus, economic growth has a natural deflationary effect, even if the supply of money does not shrink. This phenomenon can still be seen in the technology sector, where innovations and productive advancements are growing faster than inflation; consumers enjoy falling prices of TVs, cellphones, and computers as a result.

Q3] Ans: b

Synergy Study point

The **GDP deflator** (implicit price deflator for GDP) is a **measure** of the level of prices of all new, domestically produced, final goods and services in an economy. It is a price index that **measures** price inflation or deflation, and is calculated using nominal **GDP** and **real GDP**.

Q4] Ans: c

Eligibility Criteria for grant of Maharatna status

CPSEs fulfilling the following criteria are eligible to be considered for grant of Maharatna status:

1. Having Navratna status
2. Listed on the Indian stock exchange, with a minimum prescribed public shareholding under SEBI regulations
3. An average annual turnover of more than Rs. 20,000 crore during the last three years
4. An average annual net worth of more than Rs.10,000 crore during the last three years
5. An average annual net profit of more than Rs. 2,500 crore during the last 3 years
6. Significant global presence or international operations.

Hence both statements are correct.

Impact of the grant of status:

1. This will impart greater operational and financial autonomy thus enhancing powers to their Boards to take financial decisions.
2. Boards of these PSUs can **make equity investments to undertake financial joint ventures (JV) and wholly owned subsidiaries and undertake mergers and acquisitions (M&A) in India as well as abroad.** This is however **subjected to a ceiling of 15% of net worth of concerned CPSE, limited to Rs 5,000 crore in one project.**
3. The Boards can also **structure and implement schemes relating to personnel as well as human resource management and training.**
4. Holding companies of a 'Maharatna' PSU are also **empowered to float fresh equity, transfer assets, divest shareholding in subsidiaries,** but are subjected to condition that the delegation will only be in respect of subsidiaries set up by holding company.

Following CPSEs have been identified as Maharatnas:

- BHARAT HEAVY ELECTRICALS LTD.
- BHARAT PETROLEUM CORP.LTD.
- COAL INDIA LTD.
- GAIL (INDIA) LTD.
- HINDUSTAN PETROLEUM CORP.LTD.
- INDIAN OIL CORP.LTD.
- NTPC LTD.
- OIL & NATURAL GAS CORP.LTD.
- POWER GRID CORP.OF INDIA LTD.
- STEEL AUTHORITY OF INDIA LTD.

Source: Department of Public Enterprises

Synergy Study point

Q5] Ans: b

Increase cash reserve ratio (CRR) leads lowering the loanable funds available with the banks. This, in turn, slows down investment and reduces the supply of **money** in the economy.

Increase the statutory liquidity ratio (SLR) reduces the supply of **money** in the economy.

Fiscal deficit by the government is financed by either borrowing from the market or by newly created money which leads to the rise in incomes of the people. This causes the aggregate demand of the community to rise to a greater extent than the actual amount of deficit financing undertaken through the operation of what Keynes called income multiplier.

Hence above three statements are correct.

Reverse repo rate is the interest offered by the RBI to banks who deposit funds into the treasury. For instance, when banks generate excess funds, they may deposit the money in the central bank. This is a much safer approach when compared to lending it to other companies or account holders. Reducing the reverse REPO rate may increase money supply in market. Hence this statement is not correct.

Q6] Ans: d

"GDP measures the monetary value of final goods and services—that are bought by the final user—**produced in a country in a given period of time** (say a quarter or a year)."

The expenditure approach calculates the spending by the different groups that participate in the economy using the following formula: $GDP = C + G + I + NX$, or (consumption + government spending + investment + net exports). All these activities contribute to the GDP of a country.

C is private consumption expenditures or consumer spending. Consumer spending is the biggest component of GDP,. Consumer confidence, therefore, has a very significant bearing on economic growth.

G represents government consumption expenditure and gross investment. Governments spend money on equipment, infrastructure, and payroll. Government pays salaries and pays for services at embassies and military establishments. **Due to this point Statement (3) and (4) are correct.**

I is for private domestic investment or capital expenditures. Businesses spend money to invest in their business activities (buying machinery, for instance).

NX is net exports, calculated as total exports minus total imports ($NX = \text{Exports} - \text{Imports}$).

Q7] Ans: c

To finance its expenditure, government likes to borrow from public rather than withdraw cash balances or borrow from RBI. The reason is found on the effects of money supply in the country. Borrowing from

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public has no effect on money supply in the country. when government borrows, money get transferred from the public to the government. The net effect of total money supply in country is nil.

On the other hand, withdrawal from cash balances held in RBI and borrowing from RBI leads to increase in money supply. This increase in money supply may lead to rise in prices and may create many problems in the economy. As such govt will like to use this source only when it is forced to do so when no other option of financing is left.

Q8] Ans: d

The net domestic product (NDP) equals the gross **domestic product (GDP)** minus depreciation on a country's capital goods. The Net Domestic Product is always less than or equal to Gross domestic product of the same year.

If a county has similar inflows and outflows of income from assets, then GNP and GDP will be very similar.

However, if a country has many multinationals who repatriate income from local production, then GNP will be lower than GDP & vice a versa.

Gross National Product of an economy may lesser than or more than or equal to its Gross Domestic Product of the same year.

Hence both statements are correct.

Q9] Ans: c

Currency deposit ratio is the ratio of money held by the public in currency to that they hold in bank deposit.

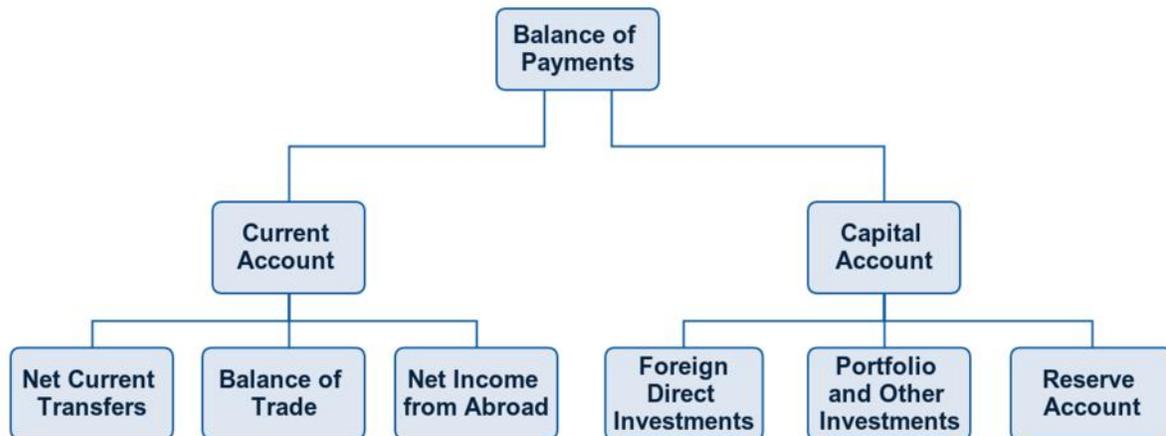
An increase in cash deposit rates leads to a decrease in money multiplier. An increase in deposit rates will induce depositors to deposit more, thereby leading to a decrease in cash to aggregate deposit ratio. This increases saving behaviour and decreases multiplier effect of money which is lying idle in banks.

Q10] Ans: b

A debenture is a type of debt instrument unsecured by collateral. Since debentures have no collateral backing, debentures must rely on the creditworthiness and reputation of the issuer for support. Both corporations and governments frequently issue debentures to raise capital or funds. Similar to most bonds, debentures may pay periodic interest payments called coupon payments.

Shares are units of ownership interest in a corporation or financial asset that provide for an equal distribution in any profits, if any are declared, in the form of dividends.

Q11] Ans: d



Q12] Ans: d

An agricultural subsidy (also called an agricultural incentive) is a government incentive paid to agribusinesses, agricultural organizations and farms to supplement their income, manage the supply of agricultural commodities, and influence the cost and supply of such commodities.

- 1.A substantial amount of fertilizer subsidy benefits not just the farmers(fertilizer at low prices as compared to its market prices) but also the fertilizer industry(it is protected from market competition by subsidies).
- 2.These agriculture subsidies have mainly benefited the farmers in the more prosperous regions like Haryana,Punjab etc.
- 3.Most farmers in India are very poor and they will not be able to afford the required inputs without subsidies.

Hence all statements are correct.

Q13] Ans: d

A repurchase agreement (repo) is a form of short-term borrowing for dealers in government securities. In the case of a repo, a dealer sells government securities to investors, usually on an overnight basis, and buys them back the following day at a slightly higher price. That small difference in price is the implicit overnight interest rate. Repos are typically used to raise short-term capital. They are also a common tool of central bank open market operations.

Open market operations is the sale and purchase of government securities and treasury bills by RBI or the central bank of the country. Open market operations are used to raise medium-term capital.

Cash Reserve Ratio (CRR) is a specified minimum fraction of the total deposits of customers, which commercial banks have to hold as reserves either in cash or as deposits with the central bank. CRR is a crucial monetary policy tool and is used for controlling money supply in an economy.

Synergy Study point

Q14] Ans: c

1. Bear markets are associated with declines in an overall market.
2. Investors Rush to SELL STOCKS instead of buying since the sentiments of the market is negative.
Hence statement 2 is incorrect.
3. Unemployment level may rise due to declines in an overall market

Q15] Ans: d

Self-explanatory

Q16] Ans: d

1. When the government levies tariffs on any foreign goods this **increases the prices of imported goods**. Due to this domestic consumers have to pay more to buy them or they may have to buy cheaper and poor quality indigenous goods.
Hence statement 1 is incorrect.
2. Due to high cost, the demand is reduced in the importing nation (domestically).
Hence statement 2 is incorrect.

Q17] Ans: a

Demand-pull inflation is the upward pressure on prices that follows a shortage in supply. Economists describe it as "too many dollars chasing too few goods".

1. Government spending. When the government spends more freely, prices go up.
2. Rising population and household consumption increase demand and this will lead to increased prices.
3. Buying and selling of real estate in urban areas leads to inflation in prices of real estate which is bought in hope of future price increase and sold to gain profit. This moves prices higher.

Cost-push inflation is the decrease in the aggregate supply of goods and services stemming from an increase in the cost of production.

4. Fluctuations in output and supply leads to shortage in production thereby increasing net cost of production.
5. Increased in administered prices increases cost of production.

Q18] Ans: c

Gross national product (GNP) is an estimate of total value of all the final products and services turned out in a given period by the means of production owned by a country's residents. GNP is commonly calculated by taking the sum of personal consumption expenditures, private domestic investment,

Synergy Study point

government expenditure, net exports and any income earned by residents from overseas investments, minus income earned within the domestic economy by foreign residents. Net exports represent the difference between what a country exports minus any imports of goods and services.

1. Income of Ambassadors of other countries in India forms part of GNP of other countries. Hence statement 1 is incorrect.
2. Women working at home does not contribute to gross national product. As it is an unpaid work. Hence statement 2 is incorrect.
3. Income of people working abroad also contributes to gross national product.

Q19] Ans: c

High powered money or **powerful money** refers to that **currency** that has been issued by the Government and RBI. The monetary base is called high-powered because the magnitude of changes in monetary base is greatly magnified by the money multiplier.

Source: Pg 41 macroeconomic NCERT

Q20] Ans: d

Social Infrastructure is a subset of the infrastructure sector and typically includes assets that accommodate social services. As examples of Social Infrastructure Assets include schools, universities, hospitals, prisons and community housing. Social Infrastructure does not typically extend to the provision of social services, such as the provision of teachers at a school or custodial services at a prison.

Q21] Ans: b

It is the revenue foregone by the government on account of exemptions on income and corporate tax. A **tax expenditure** program is government spending through the tax code. Tax expenditures alter the horizontal and vertical equity of the basic tax system by allowing exemptions, deductions, or credits to select groups or specific activities. For example, two people who earn exactly the same income can have different effective tax rates if one of the tax payers qualifies for certain tax expenditure programs by owning a home, having children, and receiving employer health care and pension insurance.

Q22] Ans: c

Marginal standing facility (MSF) is a window for banks to borrow from the RBI in an emergency situation when inter-bank liquidity dries up completely. Banks borrow from the central bank by pledging government securities at a rate higher than the repo rate under liquidity adjustment facility or LAF in short. Under MSF, banks can borrow funds up to one percentage of their net demand and time liabilities (NDTL).

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1. It affects the value of rupee in international market. As RBI hikes the MSF rate due to various reasons like to manage the surplus availability of the rupee in the Indian financial system or to put a hold on the devaluation of the rupee compared to the dollar. Hence statement 1 is correct.
2. The purpose of MSF is to reduce volatility in the overnight lending rates in the inter-bank market.
3. The MSF rate is **above** the repo rate. Hence statement 3 is incorrect.

Q23] Ans: b

Deficit financing, practice in which a government spends more money than it receives as revenue, the difference being made up by borrowing or minting new funds. The following development can occur

- The rise in inflation due to more money in hands of people.
- Increase in public debt. Hence statement 2 is incorrect
- Rupee may strengthen as High Fiscal Deficit means , India will require more money for carrying out other projects and for obtaining this , they either issue government bonds or take loans from other foreign bodies.
- When it happens, People try to buy this Government bonds as it is more valuable than any other bonds. When it comes to loan, Foreign currency comes in, but it cannot be used directly in India, so it has to be converted into Indian Rupees which creates a demand for Indian money as a conversion mechanism.
- Current account deficit may increase. Hence statement 4 is incorrect.

Q24] Ans: c

Securitization is the procedure where an issuer designs a marketable financial instrument by merging or pooling various financial assets into one group. The issuer then sells this group of repackaged assets to investors. Securitization offers opportunities for investors and frees up capital for originators, both of which promote liquidity in the marketplace. Hence

1. It improves the liquidity position of the owner of asset.
2. It improves both the efficiency of the financial markets and market liquidity.

Hence all statements are correct.

Source: Concept in NCERT and <https://www.investopedia.com/terms/s/securitization.asp>

Q25] Ans: a

1. Call money refers to borrowing / lending of funds on overnight basis.
- 2 If money is borrowed or lend for period between 2 days and 14 days it is known as **Notice Money**. Hence statement 2 is incorrect.

Term Money refers to borrowing/lending of funds for period between 15 days and one year.

Q26] Ans: a

1. Labour force participation rate is ratio of the number of persons in the labour force to the total population.
2. The unemployment rate as the number of persons who are unemployed as a percentage of the labour force (the total number of people employed plus unemployed) and not total population.

Hence statement 2 is incorrect.

Q27] Ans: c

1. **Quantitative easing (QE)**, also known as **large-scale asset purchases**, is a monetary policy whereby a central bank buys predetermined amounts of government bonds or other financial assets in order to inject liquidity directly into the economy. Hence statement 1 is incorrect
2. It is adopted to lower the interest rates and increase the money supply.
3. It can lead to higher rate of inflation.

An unconventional form of monetary policy, it is usually used when inflation is very low or negative, and standard expansionary monetary policy has become ineffective.

A central bank implements quantitative easing by buying specified amounts of financial assets from commercial banks and other financial institutions, thus raising the prices of those financial assets and lowering their yield, while simultaneously increasing the money supply. This differs from the more usual policy of buying or selling short-term government bonds to keep interbank interest rates at a specified target value.

Q28] Ans: d

Import substitution industrialization (ISI) is a trade and economic policy which advocates replacing foreign imports with domestic production. ISI is based on the premise that a country should attempt to reduce its foreign dependency through the local production of industrialized products.

It aims to increase domestic industries gain self-sufficiency. Import control and tariff are methods of import substitution. Defense indigenization in India is an example of import substitution. All statements are correct.

Q29] Ans: b

Fiscal policy, measures employed by governments to stabilize the economy, specifically by manipulating the levels and allocations of taxes and government expenditures. **Ex. increase in rates of income tax, decrease in expenditure on health care.**

Monetary policy is the macroeconomic policy laid down by the central bank. It involves management of money supply and interest rate and is the demand side economic policy used by the government of a

Synergy Study point

country to achieve macroeconomic objectives like inflation, consumption, growth and liquidity. **Ex. Increase in bank rate, open market operations by RBI.**

Q30] Ans: a

Self-explanatory.

Q31] Ans: c

Currency appreciation is an increase in the value of one currency in relation to another currency. Currencies appreciate against each other for a variety of reasons, including government policy, interest rates, trade balances and business cycles.

1. It may lead to decrease in export as exporting good become costlier. Hence statement 1 is incorrect
2. It may help in controlling inflation it increases purchasing power of currency.
3. Increase in NRI deposit leads to currency appreciation. It increases demand of currency at international market.

So statement 2 and 3 are correct.

Q32] Ans: d

1. Balance of payment is a sum total of balance of trade, factor income, cash transfers and invisibles
2. India is having a current account **deficit**. India's current account (CA) balance deficit grew to \$68 billion in 2018-19 from \$49 billion the previous year, according to the International Monetary Fund (IMF). Hence statement 2 is incorrect.
3. When rupee depreciates against the US dollars, the exports sector benefits. As US dollars' purchasing power increase. Hence statement 3 is correct.

Q33] Ans: a

Purchasing power parity (PPP) is a theory that measures prices at different locations using a common good or goods to contrast the real purchasing power between different currencies. In that case, PPP produces an exchange rate that equals the price of the basket of goods at one location over the price of the basket of goods at a different location. The PPP exchange rate may be different from the market exchange rate because of transportation costs, tariffs, and other frictions. PPP exchange rates are widely used when comparing GDP from different countries.

Q34] Ans: d

Full convertibility of the Indian Rupee is the ease with which a country's currency can be converted into gold or another currency through global exchanges. It indicates the extent to which the regulations allow inflow and outflow of capital to and from the country. Currencies that aren't fully convertible, on the other hand, are generally difficult to convert into other currencies.

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Currency convertibility is an important part of global commerce because it opens up trade with other countries. Having a convertible currency allows a government to pay for goods and services in a currency that may not be the buyer's own. Having a nonconvertible currency makes it harder for a government to participate in the international market because these transactions generally take longer to execute.

Here are some of the benefits:

- Sign of mature markets
- Increased Liquidity in Financial Markets
- Improved Employment and Business Opportunities
- It will attract more foreign capital inflow in India.
- Onshore Rupee Market Development
- Better Access to a Variety of Goods and Services
- Progress in Multiple Industry Sectors

Q35] Ans: a

Self-explanatory

Q36] Ans: a

A recession is when the economy experiences a marked slippage in economic activity. There's a drop in the following five economic indicators: **real gross domestic product, income, employment, manufacturing, and retail sales**. So option 1 is correct.

Q37] Ans: c

The Phillips curve shows the inverse relationship between inflation and unemployment: as unemployment decreases, inflation increases.

Q38] Ans: a

1. Inclusive growth implies that the poor not only benefit from growth but also become part of the growth process.
2. Trickle-down economics, or "trickle-down theory," states that tax breaks and benefits for corporations and the wealthy will trickle down to everyone else. It argues for income and capital gains tax breaks or other financial benefits to large businesses, investors, and entrepreneurs to stimulate economic growth. The argument hinges on two assumptions: All members of society benefit from growth, and growth is most likely to come from those with the resources and skills to increase productive output. Hence statement 2 is wrong.

Q39] Ans: b

1. White Revolution transformed India from a milk-deficient nation into the world's largest milk producer. **Operation Flood**, launched in 1970, was a landmark project of India's National Dairy

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Development Board (NDDDB), which was the world's biggest dairy development program. Hence statement 1 is incorrect

2. New agriculture policy of India aims at sustainable agriculture, which is popularly called '**second green revolution**'. Hence statement 2 is incorrect

3. Blue revolution in the field agriculture is associated with improvement in production of fish and marine products.

Q40] Ans: a

Monetary policy is the policy adopted by the monetary authority of a country that controls either the interest rate payable on very short-term borrowing or the money supply, often targeting inflation or the interest rate to ensure price stability and general trust in the currency. Ex bank rate.

Trade policy refers to the regulations and agreements that control imports and exports to foreign countries.

Credit Policy means Guidelines that spell out how to decide which customers are sold on open account, the exact payment terms, the limits set on outstanding balances and how to deal with delinquent accounts.

Fiscal policy is the use of government revenue collection (taxes or tax cuts) and expenditure (spending) to influence a country's economy.

Q41] Ans: a

Central Statistics Office (CSO)

The Central Statistics Office coordinates the statistical activities in the country and evolves statistical standards. It is headed by a Director General assisted by 5 Additional Director Generals. CSO has the following Divisions:

a. National Accounts Division (NAD): This Division is responsible for the preparation of national accounts, which includes Gross Domestic Product, Government and Private Final Consumption Expenditure, Fixed Capital Formation and other macro-economic aggregates. The Division brings out an annual publication, titled "National Accounts Statistics", containing these statistics.

b. Social Statistics Division (SSD): This Division is entrusted with Statistical monitoring of the Millennium Development Goals, Environmental Economic Accounting, Grant-in-aid for research, workshop/seminars/conferences in Official/Applied Statistics, National/International awards for Statisticians, National Data Bank (NDB) on socioreligious categories, Basic Statistics for Local Level Development (BSLLD) Pilot scheme, Time-use survey and release of regular and ad-hoc statistical publications

c. Economic Statistics Division (ESD): This Division conducts Economic Censuses, compiles All India Index of Industrial Production(IIP), Energy Statistics and Infrastructure Statistics, and develops classifications like, National Industrial Classification (NIC) and National Product Classification (NPC)

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d. Training Division: This Division is primarily responsible for the training manpower in theoretical and applied statistics to tackle the emerging challenges of data collection, collation, analysis and dissemination required for evidence based policy making as also for planning, monitoring and evaluation. The Division also looks after the National Statistical Systems Training Academy (NSSTA), which is a premier Institute fostering human resource development in official statistics in India as well as at international level, particularly amongst developing and SAARC countries.

e. Coordination and Publications Division (CAP): The Division looks after co-ordination work within CSO as well as with the line Ministries and State/UT Governments in statistical matters, organizes Conference of Central and State Statistical Organizations (COCSSO) and 'Statistics Day' every year, prepares Results Framework Document (RFD), Citizens'/Clients' Charter and Annual Action Plan, Outcome Budget and Annual Plan of the Ministry.

Q42] Ans: a

A Tobin tax was originally defined as a tax on all spot conversions of one currency into another. It was suggested by James Tobin, an economist who won the Nobel Memorial Prize in Economic Sciences. Tobin's tax was originally intended to penalize short-term financial round-trip excursions into another currency.

Q43] Ans: a

Self explanatory...

An **excise** or **excise tax** is any duty on manufactured goods which is levied at the moment of manufacture, rather than at sale.

An **anti-dumping duty** is a protectionist tariff that a domestic government imposes on foreign imports that it believes are priced below fair market value. **Dumping** is a process where a company exports a product at a price lower than the price it normally charges in its own home market.

Q44] Ans: c

1. Treasury Bills are issued by RBI on behalf of Government of India. Hence statement 1 is incorrect
- 2.They are mostly for short-term borrowing.
- 3.They are seek by investors due to their low risk & high security reasons. Hence statement 3 is incorrect

Q45] Ans: b

Increase in deposit rates leads to:

- 1.Higher savings in banks that increase money available for investment.
- 2.Increases in credit off takes as more fund with banks. Hence statement 2 is incorrect
- 3.increase in investment

Q46] Ans: d

Self-explanatory

A foreign direct investment (FDI) is an investment in the form of a controlling ownership in a business in one country by an entity based in another country. It is thus distinguished from a foreign portfolio investment by a notion of direct control.

Q47] Ans: c

International Monetary Foundation (not World Trade Organization) provides financial support to the countries having deficit balance of payment.

Q48] Ans: a

1. In mixed economies, government and the market together answer what and how to produce and how to re-distribute.
2. The market will provide whatever goods and services it can produce well. Hence statement 2 is incorrect
3. The government will produce to the goods and services the government fails to do. Hence statement 3 is incorrect.

Q49] Ans: a

Measures should be taken when an economy is going through inflationary pressure:

1. Direct taxes should be increased to minimize money availability in the hands of people.
2. Loan interest rate should be increased to restrict money supply in market. Hence statement 2 is incorrect.
3. Public spending should be reduced to restrict money supply in market. Hence statement 3 is incorrect.

Q50] Ans: a

Self-explanatory

Q51] Ans: b

Investment expenditure refers to the expenditure incurred either by an individual or a firm or the government for the creation of new capital assets like machinery, building etc.

Hence statement 2 is correct. All other statements are incorrect as expenditures in these will not result into productivity activities.

Q52] Ans: c

The gross fiscal deficit (GFD) is the excess of total expenditure including loans net of recovery over revenue receipts (including external grants) and non-debt capital receipts.

Options 1,3, and 4 are used by state governments in case of fiscal deficit. So are correct.

Printing of currency is sole prerogative of central government. Hence statement 2 is incorrect.

Q53] Ans: b

A common market is a formal agreement where a group is formed among several countries in which each member country adopts a common external tariff. In a common market, countries also allow free trade and free movement of labor and capital among the members in the group. This trade arrangement is aimed at providing improved economic benefits to all the members of the common market.

An economic union is a type of trade bloc which is composed of a common market with a customs union. The participant countries have both common policies on product regulation, freedom of movement of goods, services and the factors of production (capital and labour) and a common external trade policy. When an economic union involves unifying currency it becomes an economic and monetary union.

A customs union is generally defined as a type of trade bloc which is composed of a free trade area with a common external tariff. Customs unions are established through trade pacts where the participant countries set up common external trade policy (in some cases they use different import quotas). Common competition policy is also helpful to avoid competition deficiency.

Q54] Ans: b

India's external debt comprises External commercial borrowings, short-term debt and rupees denominated non-resident Indian (NRI) deposits.

Money raised through bonds in the international markets, portfolio investors in share markets are not the components of India's external debt.

Q55] Ans: c

A rise in general level of prices may be caused by:

1. An increase in the monetary supply as it increases demand in the market.
2. A decrease in the aggregate level of output it causes supply side restrictions.

Hence all statements are correct.

Q56] Ans: b

Rupee depreciation is when rupee value decreases (becomes less expensive) and more rupees can buy one unit of foreign currency. This is also known as weakening of rupee as now INR worth is less than foreign currency.

Synergy Study point

Effect of depreciation of Rupee

1. Gold imports. Import becomes costlier. So will be negatively affected.
2. Indian students studying in the USA. Purchasing power of Indian rupees will decrease as compared to US dollars. So will be negatively affected.
3. Foreign tourist in India may increase as INR worth is less than foreign currency. So will not be negatively affected. Hence statement 3 is incorrect.
4. Receivers of remittances in India may increase. INR worth is less than foreign currency. Hence statement 4 is incorrect.

Q57] Ans: c

Self-explanatory...

The Lorenz curve is a graphical representation of the distribution of income or of wealth. It was developed by Max O. Lorenz in 1905 for representing inequality of the wealth distribution.

In economics, diminishing returns is the decrease in the marginal (incremental) output of a production process as the amount of a single factor of production is incrementally increased, while the amounts of all other factors of production stay constant.

In economics, the Laffer curve illustrates a theoretical relationship between rates of taxation and the resulting levels of government revenue. The curve illustrates the concept of taxable income elasticity – i.e., taxable income changes in response to changes in the rate of taxation.

Q58] Ans: c

Policy rates and reserve ratios determined by RBI are:

- Repo rate
- Reverse repo rate (RRR)
- Statutory liquidity ratio (SLR)
- Liquidity adjustment facility (LAF)
- Cash reserve ratio (CRR)
- Open market operation (OMO)
- Marginal standing facility (MSF)

Rates determine by banks:

- call money rate
- marginal cost of funds based lending rate
- base rate

Q59] Ans: d

Self-explanatory

Q60] Ans: c

Statement which are correct regarding Statutory Liquidity Ratio (SLR):

1. It effectively regulates the credit growth in Indian economy.
2. The reserve requirement that commercial banks are required to maintain in the form of cash, gold reserves, Reserve Bank of India (RBI)- approved securities before providing credit to the customers. Hence statement 2 is incorrect.
3. It is intended to make banks invest in government securities.
4. The chief driving force is increasing or decreasing liquidity which can result in a desired outcome. Hence statement 4 is incorrect.

Q61] Ans: b

Creeping or Mild Inflation: If the speed of upward thrust in prices is slow but small then we have creeping inflation. What speed of annual price rise is a creeping one has not been stated by the economists. To some, a creeping or mild inflation is one when annual price rise varies between 2 p.c. and 3 p.c.

Walking Inflation: If the rate of annual price increase lies between 3 p.c. and 4 p.c., then we have a situation of walking inflation. When mild inflation is allowed to fan out, walking inflation appears.

Galloping and Hyperinflation: Walking inflation may be converted into running inflation. Running inflation is dangerous. If it is not controlled, it may ultimately be converted to galloping or hyperinflation. It is an extreme form of inflation when an economy gets shattered. "Inflation in the double or triple digit range of 20, 100 or 200 p.c. a year is labeled "galloping inflation".

Q62] Ans: c

The tax-to-GDP ratio is a ratio of a nation's tax revenue relative to its gross domestic product (GDP), or the market value of goods and services a country produces. Some countries aim to increase the tax-to-GDP ratio to address deficiencies in their budgets.

Taxes and GDP are generally related. The higher the GDP, the more tax a nation collects. Conversely, countries with lower taxes produce a lower GDP. Analysts, economists, and government leaders can use this ratio to see the rate at which taxes fuel a nation's economy.

Result of poor tax - GDP in the country:

1. Lower GDP growth rate
2. High fiscal deficit as less resource available. Hence statement 2 is incorrect
3. Incentivize the low productivity sectors.
4. Encourage parallel economy.

Q63] Ans: c

The World Bank Group (WBG) is a family of five international organizations that make leveraged loans to developing countries. It is the largest and most well-known development bank in the world and is an observer at the United Nations Development Group.

The bank is headquartered in Washington, D.C. in the United States.

Synergy Study point

The World Bank Group consists of:

- the International Bank for Reconstruction and Development (IBRD), established in 1945, which provides debt financing on the basis of sovereign guarantees;
- the International Finance Corporation (IFC), established in 1956, which provides various forms of financing without sovereign guarantees, primarily to the private sector;
- the International Development Association (IDA), established in 1960, which provides concessional financing (interest-free loans or grants), usually with sovereign guarantees;
- the International Centre for Settlement of Investment Disputes (ICSID), established in 1965, which works with governments to reduce investment risk;
- The Multilateral Investment Guarantee Agency (MIGA), established in 1988, which provides insurance against certain types of risk, including political risk, primarily to the private sector.

Q64] Ans: d

A **regressive tax** is a tax imposed in such a manner that the tax rate decreases as the amount subject to taxation increases. "Regressive" describes a distribution effect on income or expenditure, referring to the way the rate progresses from high to low, so that the average tax rate exceeds the marginal tax rate. In terms of individual income and wealth, a regressive tax imposes a greater burden (relative to resources) on the poor than on the rich: there is an inverse relationship between the tax rate and the taxpayer's ability to pay, as measured by assets, consumption, or income. These taxes tend to reduce the tax burden of the people with a higher ability to pay, as they shift the relative burden increasingly to those with a lower ability to pay. **EX. Sales tax ,Goods and Services Tax ,Value Added Tax .**

A **progressive tax** is a **tax** that imposes a lower **tax** rate on low-income earners compared to those with a higher income, making it based on the taxpayer's ability to pay. That means it takes a larger percentage from high-income earners than it does from low-income individuals. Ex. **Income Tax .**

Q65] Ans: b

The Ministry of Environment, Forest and Climate Change (MoEFCC) has developed the criteria of categorization of industrial sectors based on the Pollution Index which is a function of the emissions (air pollutants), effluents (water pollutants), hazardous wastes generated and consumption of resources.

For this purpose the references are taken from the the Water (Prevention and Control of Pollution) Cess (Amendment) Act, 2003, Standards so far prescribed for various pollutants under Environment (Protection) Act, 1986 and Doon Valley Notification, 1989 issued by MoEFCC. The Pollution Index PI of any industrial sector is a number from 0 to 100 and the increasing value of PI denotes the increasing degree of pollution load from the industrial sector. The following are the criteria on 'Range of Pollution Index' for the purpose of categorization of industrial sectors.

- Industrial Sectors having Pollution Index score of 60 and above - Red category
- Industrial Sectors having Pollution Index score of 41 to 59 – Orange category
- Industrial Sectors having Pollution Index score of 21 to 40 – Green category

- **Industrial Sectors having Pollution Index score incl.& upto 20 - White category**

Q66] Ans: b

1. Depreciation is the decrease in the value of domestic currency against the foreign currency due to market forces.
2. Appreciation means increasing the exchange rate of domestic currency against foreign currency due to market forces. Hence statement 2 is incorrect.
3. Revaluation means increasing the exchange rate of domestic currency against foreign currency by the government. Hence statement 3 is incorrect.
4. Devaluation is the decrease in the value of domestic currency against the foreign currency by the government.

Q67] Ans: d

A trade deficit is an economic measure of international trade in which a country's imports exceed its exports. A trade deficit represents an outflow of domestic currency to foreign markets. It is also referred to as a negative balance of trade (BOT).

1. Domestic savings when savings translate into investments, capital is generated. And during trade deficits, this capital is of utmost importance as it drives economic growth..
2. Fiscal deficit may influence value of rupees in international market. That effects on trade deficit.
3. Investment in the economy. an increase in imports indicates a fast, growing economy. And a growing economy attracts more foreign investment.

Q68] Ans: a

Main Reasons for Economic Reforms in India

- Rise in Prices, high inflation: So statement 3 is correct.
- Rise in Fiscal Deficit: To cover the fiscal deficit, the Govt. has to raise loans and pay interest on it. Due to rise in fiscal deficit there was rise in public debt and interest. The Govt. caught in debt trap. So Govt. has to resort to economic reforms. So statement 1 is correct.
- Fall in Foreign Exchange Reserves: So Statement 2 is correct.
- Increase in Adverse Balance of Payments
- Iraq War
- Dismal Performance of PSU's (Public Sector Undertakings)

Bankruptcy is a legal process through which people or other entities who cannot repay debts to creditors may seek relief from some or all of their debts. Hence it was not the reason. Hence statement 3 is incorrect.

Q69] Ans: a

Collateral security is required to borrow from the capital market while it is not required in the money market.

Q70] Ans: a

A liquidity trap is a situation in which **interest rates are low** and savings rates are high, rendering monetary policy ineffective.

In a liquidity trap, consumers choose to avoid bonds and keep their funds in savings because of **the prevailing belief that interest rates will soon rise** (which would push bond prices down).

Hence statements 1&3 are correct & statement 2 is wrong.

Q71] Ans: d

Sources of demands in Indian economy:

1. Consumption stimulates demand in economy.
2. Government spending increases money supply in market. This leads to increase in demand.
3. Domestic investment helps employment generation that further increases demand in economy.
4. Exports earn foreign exchange.

Q72] Ans: a

On the basis of Purchasing Power Parity Theory, if Indian rupee is depreciating with respect to US Dollar, then India is facing higher inflation. The relative price of goods is linked to the exchange rate through the theory of purchasing power parity. As illustrated, PPP tells us that if a country has a relatively high inflation rate, then the value of its currency should decline...

Q73] Ans: d

Self-explanatory

Q74] Ans: a

The Human Development Index uses different measurements of a population:

- **Life expectancy at birth** This is used to see how healthy the people in one country are. It assumes that healthier people live longer on average.
- **Literacy** knowledge is measured by a combination of the adult literacy rate and the combined primary, secondary, and tertiary gross enrolment ratio

Synergy Study point

- **Standard of living** This is measured by calculating the Gross National Income (GNI) per capita

Q75] Ans: d

In simple words, Universal Banking means the financial entities – the commercial banks, Financial Institutions, NBFCs – that undertake multiple financial activities under one roof, thereby creating a financial supermarket...

Q76] Ans: b

Small finance banks are a type of niche banks in India. Banks with a small finance bank license can provide basic banking service of acceptance of deposits and lending. The aim behind these to provide financial inclusion to sections of the economy not being served by other banks, such as small business units, small and marginal farmers, micro and small industries and unorganised sector entities. Hence statement 1 is wrong.

Existing non-banking financial companies (NBFC), microfinance institutions (MFI) and local area banks (LAB) can apply to become small finance banks. They can be promoted either by individuals, corporate, trusts or societies. It cannot set up subsidiaries to undertake non-banking financial services activities. Hence statement 2 is correct.

It cannot be business correspondent (BC) of any Bank. So statement 3 is wrong.

Q77] Ans: c

A shadow banking system is the group of financial intermediaries facilitating the creation of credit across the global financial system but whose members are not subject to regulatory oversight. The shadow banking system also refers to unregulated activities by regulated institutions.

Examples of intermediaries not subject to regulation include hedge funds, unlisted derivatives, and other unlisted instruments, while examples of unregulated activities by regulated institutions include credit default swaps.

Q78] Ans: a

Hot money signifies currency that quickly and regularly moves between financial markets, that ensures investors lock in the highest available short-term interest rates. Hot money continuously shifts from countries with low-interest rates to those with higher rates. These financial transfers affect the exchange rate and potentially impact a country's balance of payments. Hot money can also refer to stolen money that has been especially marked, so that it may be traced and identified.

Q79] Ans: b

Macroeconomics is the branch of economics that studies the behavior and performance of an economy as a whole. It focuses on the aggregate changes in the economy such as **unemployment**, growth rate, gross domestic product and **inflation**.

Synergy Study point

Microeconomics is the study of individuals, households and firms' behavior in decision making and allocation of resources. It generally applies to markets of goods and services and deals with **individual and economic issues**.

Q80] Ans: a

Refer detailed explanation of Q 63.

Q81] Ans: b

A budget deficit occurs when expenses exceed revenue and indicate the financial health of a country. The government generally uses the term budget deficit when referring to spending rather than businesses or individuals. Accrued deficits form national debt. One of the primary dangers of a budget deficit is inflation, which is the continuous increase of price levels. That may increase in interest rate. When government creates a budget deficit with some combination of tax cuts or spending increases, it will increase aggregate demand in the economy, and some of that increase in aggregate demand will result in a higher level of imports. Hence statements 1& 3 are correct.

The real exchange rate – the ratio of foreign to domestic prices, measured in the same currency. Deficit reduction through tax increases tends to weaken the exchange rate of countries with good records on inflation and debt, while deficit reduction through spending cuts tends to strengthen the exchange rate of countries with poor records on inflation and debt. Hence statement 2 is incorrect.

Q82] Ans: c

1. Fiscal deficit arises when a government's total expenditures exceed the income that it generates (excluding borrowings). Hence statement 1 is incorrect.
2. Effective Revenue Deficit is the difference between revenue deficit and grants for creation of capital assets. Effective Revenue Deficit signifies that amount of capital receipts that are being used for actual consumption expenditure of the Government. Hence statement 2 is incorrect.
3. Primary deficit is the difference between fiscal deficit and revenue expenditure.

Q83] Ans: d

1. Current account convertibility facilitates trade related payments and remittances.
 2. Capital account convertibility deals with creation and liquidation of assets by other countries in local market.
- Hence both statements are incorrect.

Q84] Ans: a

Disposable income, also known as disposable personal income (DPI), is the amount of money that households have available for spending and saving after income taxes have been accounted for. Disposable personal income is often monitored as one of the many key economic indicators used to gauge the overall state of the economy.

DPI=Personal Income–Personal Income Taxes

Q85] Ans: b

1. Cash Reserve Ratio (CRR) is a specified minimum fraction of the total deposits of customers, which commercial banks have to hold as reserves either in cash or as deposits with the central bank. Hence statement 1 is incorrect.

2. When the RBI lowers CRR it is said to follow expansionary monetary policy.

Q86] Ans: c

Dear Money Policy a policy of the economy where government restricts the money supply in the market making it expensive to borrow by raising interest rates. This would have an adverse impact on growth in the economy because the investment would reduce when the rate of interest is high.

1. RBI raises the bank rate commercial banks can get the money at the higher rate of interest

2. RBI starts raising the CRR and sells the securities to commercial banks

Q87] Ans: b

The Gross Domestic Product (GDP) deflator is a measure of general price inflation. It is calculated by dividing nominal GDP by real GDP and then multiplying by 100. Nominal GDP is the market value of goods and services produced in an economy, unadjusted for inflation (It is the GDP measured at current prices). Real GDP is nominal GDP, adjusted for inflation to reflect changes in real output (It is the GDP measured at constant prices).

GDP Deflator = (Nominal GDP/ Real GDP) x 100

1. GDP deflator is more comprehensive measure of inflation than consumer price index and wholesale price index

2. Unlike WPI and CPI, monthly change inflation cannot be tracked using GDP deflator

3. GDP deflator value of **one** implies no change in price levels from the base year. Hence statement 3 is incorrect.

Synergy Study point

Q88] Ans: d

In business and accounting, net income (also total comprehensive income, net earnings, net profit, bottom line, sales profit, or credit sales) is a measure of the profitability of a venture. It is an entity's income minus cost of goods sold, expenses (e.g., SG&A), depreciation and amortization, interest, and taxes for an accounting period. It is computed as the residual of all revenues and gains over all expenses and losses for the period, and has also been defined as the net increase in shareholders' equity that results from a company's operations. It is different from the gross income, which only deducts the cost of goods sold.

For households and individuals, net income refers to the (gross) income minus taxes and other deductions (e.g., mandatory pension contributions). It is usually the basis to calculate how much income tax is owed.

Q89] Ans: c

An open economy is a type of economy where the domestic community and out have trade in products (goods and services). Trade can take the form of managerial exchange, technology transfers, and all kinds of goods and services. Total foreign trade as a proportion of GDP is measure of degree of openness. Hence statements 1& 2 are correct.

Q90] Ans: b

Methods are usually used by government for deficit reduction:

1. Disinvestment increases disposable income of government.
2. Rationalization of subsidies helps in reduction of revenue deficit.
3. Improving administration increases ease of doing business which promotes economic growth of the country.
4. Devaluation of currency increases current account deficit which may worsen twin deficits. Hence statement 4 is incorrect.

Q91] Ans: d

The objective of fiscal policy is to maintain the condition of full employment, economic stability, equity in economy and to stabilize the rate of growth. For an under-developed economy, the main purpose of fiscal policy is to accelerate the rate of capital formation and investment.

Q92] Ans: c

Opportunity costs represent the benefits an individual, investor or business misses out on when choosing one alternative over another.

Synergy Study point

Q93] Ans: a

The Phillips curve relates the rate of inflation with the rate of unemployment. The Phillips curve argues that unemployment and inflation are inversely related: as levels of unemployment decrease, inflation increases. The relationship, however, is not linear. There is a short-run but not a long-run trade-off between inflation and unemployment

Q94] Ans: d

An externality is an economic term referring to a cost or benefit incurred or received by a third party. However, the third party has no control over the creation of that cost or benefit.

An externality can be both positive or negative and can stem from either the production or consumption of a good or service. The costs and benefits can be both private—to an individual or an organization—or social, meaning it can affect society as a whole.

Pollution emitted by a factory that muddies the surrounding environment and affects the health of nearby residents is a negative externality. The effect of a well-educated labor force on the productivity of a company is an example of a positive externality. Hence all statements are correct.

Q95] Ans: d

Self-explanatory

Sterilization is a form of monetary action in which a central bank seeks to limit the effect of inflows and outflows of capital on the money supply. Sterilization most frequently involves the purchase or sale of financial assets by a central bank, and is designed to offset the effect of foreign exchange intervention.

Q96] Ans: d

The free rider problem is an issue in economics. It is considered an example of a market failure. That is, it is an inefficient distribution of goods or services that occurs when some individuals are allowed to consume more than their fair share of the shared resource or pay less than their fair share of the costs.

Examples:

1. LPG subsidy for everyone
2. Free education for everyone
3. Universal Basic Income

Q97] Ans: d

Informal Sector which encompasses all jobs which are not recognized as normal income sources, and on which taxes are not paid. The term is sometimes used to refer to only illegal activity, such as an

Synergy Study point

individual who earns wages but does not claim them on his or her income taxes, or a cruel situation where people are forced to work without pay. However, the informal sector could also be interpreted to include legal activities, such as jobs that are performed in exchange for something other than money.

It is opposite of formal sector.

Informal sector does not have: Social security, Job security, Labour laws security & Income security. Hence all statements are correct.

Q98] Ans: a

The Suresh Tendulkar Committee set up to look into the people living under the poverty line in India submitted its report in November 2009. It provided a new method of calculating the poverty line based on per capita consumption expenditure per month or day. For rural areas, it was Rs 816 per month or Rs 27 per day.

The S.R. Hashim Committee report on urban poor. The report, submitted in December 2012 set out the criteria by which the poor living in urban areas were to be identified for various government schemes, especially the National Food Security Act (NFSA), 2013.

The Rangarajan committee raised the daily per capita expenditure to Rs 32 from Rs 27 for the rural poor and to Rs 47 from Rs 33 for the urban poor, thus raising the poverty line based on the average monthly per capita expenditure to Rs 972 in rural India and Rs 1,407 in urban India.

Q99] Ans: b

Nominal Effective Exchange Rate is the weighted average of bilateral nominal exchange rates of the home currency in terms of foreign currencies. It is the exchange rate of one currency against a basket of currencies, weighted according to trade with each country (not adjusted for inflation).

Real Effective Exchange Rate (REER) is the weighted average of nominal exchange rates, adjusted for inflation. REER is calculated on the basis of NEER. REER captures inflation differentials between India and its major trading partners and reflects the degree of external competitiveness of Indian products. It captures movements in cross-currency exchange rates.

Q100] Ans: c

1. **Insolvency** is the state of being unable to pay the money owed, by a person or company, on time; those in a state of insolvency are said to be insolvent. There are two forms: cash-flow insolvency and balance-sheet insolvency.

Cash-flow insolvency is when a person or company has enough assets to pay what is owed, but does not have the appropriate form of payment. For example, a person may own a large house and a valuable car, but not have enough liquid assets to pay a debt when it falls due. Cash-flow insolvency can usually

Synergy Study point

be resolved by negotiation. For example, the bill collector may wait until the car is sold and the debtor agrees to pay a penalty.

Balance-sheet insolvency is when a person or company does not have enough assets to pay all of their debts. The person or company might enter bankruptcy, but not necessarily. Once a loss is accepted by all parties, negotiation is often able to resolve the situation without bankruptcy.

2. **Bankruptcy** is a legal process through which people or other entities who cannot repay debts to creditors may seek relief from some or all of their debts. In most jurisdictions, bankruptcy is imposed by a court order, often initiated by the debtor. Bankruptcy is not the only legal status that an insolvent person may have, and the term bankruptcy is therefore not a synonym for insolvency.