

# Question Bank on **Indian Economy**

For UPSC and State Civil Services Examinations

*Edited by*

**Vinay G.B.**

*Director, Insights IAS, Bengaluru*

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# Preface

The UPSC exam is one of the toughest exams in the world. More than 6 lakh students from different streams converge and attempt to achieve their dream of attaining the coveted posts of IAS/IPS/IFS/IRS. An aspirant is expected to be a jack of all trades and have the know-how of almost anything under the sun. This book—*Question Bank on Indian Economy*—covers each and every aspect of the past and current economic scenario, providing the aspirants with a wide variety of questions having varied difficulty levels.

The aim of this book is to provide the civil services aspirants—especially those who are aiming to get into sought-after posts such as IAS/IPS/IFS/IRS—a single source of reference and practice questions, which will not only test their grasp of the subject but will also give them adequate practice to improve the skills necessary to solve tricky MCQs in the real exam. The latest trend that we have observed in recently concluded UPSC civil services preliminary examination (2019) is that the questions are no more factual. The questions in the exam now demand an in-depth understanding of an issue and test both knowledge and aptitude of a candidate. The nature of questions is such that they make an aspirant think hard to find the most appropriate answer.

## About the Book

In this context, the book comprises thousands of high quality questions framed on various aspects of the Indian economy, which will help an aspirant get a competitive advantage if he/she makes use of the book early on and effectively. The questions in the book have been designed to test conceptual clarity and have taken into account the latest trends observed in the UPSC civil services preliminary examination. The sources that are referred to frame these questions range from Economic Survey to NITI Aayog documents to RBI reports. This means that only authentic sources have been used to avoid any factual or data inaccuracy.

The book covers around 18 main topics such as economics as a discipline, growth, development, and happiness, evolution of the Indian economy,

economic planning, planning in India, and economic reforms. These main topics have been divided into 18 chapters with each chapter containing several sub-topics related to the main topic.

## Key Features

- Contains detailed solutions at the end of each chapter to provide students with not only an in-depth answer to the respective question, but also the additional information necessary to write better answers in the UPSC Mains General Studies Paper - 3
- Provides a separate answer key at the end of each chapter for better practice
- Provides a solved question paper
- Provides previous years' questions from 1979 to 2018 with answer key
- Includes online mock tests for practice

## Acknowledgement

This book is the product of the hard work of my team, especially Aditya Jha, Shruthi Gayakwad, and Kailash. They along with others have curated and helped me edit the content to make the book useful for civil services exam aspirants. We thank Oxford University Press, India sincerely for giving us an opportunity to partner with them and provide quality content to students preparing for various competitive examinations across India. We would also like to thank Dr Sunayana Assistant Professor, Lovely Professional University, Jalandhar and Harpreet Kaur, Guest Faculty, Guru Nanak Dev University, Amritsar for their valuable feedback and suggestions.

Today, InsightsIAS ([www.insightsonindia.com](http://www.insightsonindia.com)) is synonymous with UPSC civil services exam preparation. The quality guidance and content given to IAS aspirants has resulted in exceptional results over the years. With books like this, more number of aspirants will be benefited and their preparation will be simplified. As this book is purely driven to give competitive edge to its readers, their chances of clearing the prelims exam will be very high.

**Vinay G.B.**

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# Economics: The Discipline

## MULTIPLE CHOICE QUESTIONS

### Basic Concepts and Terminologies in Economy

- Fisher effect shows the relationship between:  
1. Inflation      2. Unemployment  
3. Interest rate      4. Economic growth  
Select the correct answer using the codes below.  
(a) 1 and 3 only      (b) 2 and 3 only  
(c) 1 and 4 only      (d) 1, 2, 3, and 4
- The Pareto principle is sometimes used to judge:  
1. Effectiveness of welfare programmes  
2. Efficient allocation of public finances  
Which of the above is/are correct?  
(a) 1 only      (b) 2 only  
(c) Both 1 and 2      (d) Neither 1 nor 2
- In the Phillips curve, what is the relationship between the rate of unemployment and inflation in the short-run?  
(a) Unemployment and inflation are not related to each other.  
(b) Decreasing unemployment rate leads to lower inflation in the economy.  
(c) Decreasing unemployment rate requires higher inflation in the economy.  
(d) Inflation can grow even at constant levels of unemployment in the economy.
- Okun's law is the relationship between:  
(a) Inflation and GDP growth rate  
(b) Unemployment rate and gross national product (GNP)  
(c) Supply and demand of currency in an economy  
(d) Population and economic growth rate
- Ricardian equivalence is a proposition that argues that consumers are forward looking. It argues that:  
(a) Taxation and borrowing are equivalent means of financing expenditure  
(b) Borrowing abroad and borrowing domestically are equivalent means of financing expenditure  
(c) Saving or investment are equivalent  
(d) None of the above
- Which of the following is NOT one of the components of Mundell's *impossible trinity*?  
(a) Free capital flows  
(b) Fixed exchange rate  
(c) Balanced budget  
(d) Independent monetary policy
- Laffer curve shows the relationship between:  
(a) Tax rate and tax revenue  
(b) Inflation and unemployment  
(c) GDP growth and endogenous technology  
(d) Environmental degradation and economic inequality
- Expectations augmented Phillips curve* is often used to predict the short-term and long-term impact of macroeconomic management policies in an economy. The term *expectations* denotes expectations about:  
(a) GDP growth rate  
(b) Inflation  
(c) External balance  
(d) Environmental degradation
- The famous Kuznets inverted-U curve is often used by policymakers to study the:  
(a) Rise and fall in inequality with economic growth  
(b) Trade-off between inflation and unemployment  
(c) Change in energy elasticity with growth  
(d) Effects of tax policy on redistribution of income in a society
- Lorenz curve is associated with the determination of:

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- (a) Economic inequality  
(b) Tax revenue for different tax bases  
(c) Unemployment as against rates of inflation  
(d) Market prices in situations of boom and recession
11. Which of these is/are examples of fixed capital formation?  
1. Accumulation of foreign exchange reserve  
2. Road and bridge construction  
3. Energy infrastructure  
4. Office equipment such as computers  
Select the correct answer using the codes below.  
(a) 2, 3, and 4 only (b) 1, 2, and 4 only  
(c) 1, 3, and 4 only (d) 2 and 3 only
12. A high savings rate in the economy can lead to:  
1. Lower interest rate for investments  
2. Lower consumption demand leading to moderation of inflation  
3. Reduced revenue deficit in the public budget  
Select the correct answer using the codes below.  
(a) 1 and 2 only (b) 2 and 3 only  
(c) 3 only (d) 1, 2, and 3
13. Aggregate demand in an economy usually increases with an increase in:  
1. National income  
2. Investment  
3. Government spending  
Select the correct answer using the codes below.  
(a) 1 and 2 only (b) 2 and 3 only  
(c) 1 and 3 only (d) 1, 2, and 3
14. With reference to the term *consumer surplus*, consider the following statements.  
1. Consumer surplus explains the situation of a buyer's market where supply exceeds the demand.  
2. Economies with a consumer surplus are developed economies.  
Which of the above is/are correct?  
(a) 1 only (b) 2 only  
(c) Both 1 and 2 (d) Neither 1 nor 2
15. For his contributions in the field of behavioural economics, US economist Richard Thaler won the 2017 Nobel Economics Prize. The study of behavioural economics includes how market decisions are made and the mechanisms that drive public choice. In this context, consider the following.  
1. As per Heuristics, most decisions made by humans are done using rules of thumb.  
2. Mis-pricings and non-rational decisions are part of market behaviour and are considered as market inefficiencies.  
Which of the above is/are correct?  
(a) 1 only (b) 2 only  
(c) Both 1 and 2 (d) Neither 1 nor 2
16. If an economy predominantly keeps producing consumption goods at the expense of capital goods it will lead to:  
1. Short-term as well as long-term inflation  
2. A roadblock in the long-term growth  
Which of the above is/are correct?  
(a) 1 only (b) 2 only  
(c) Both 1 and 2 (d) Neither 1 nor 2
17. The Phillips curve suggests that:  
1. Lower the inflation, lower is the unemployment  
2. Higher the environmental degradation, higher is the economic inequality  
Which of the above is/are correct?  
(a) 1 only (b) 2 only  
(c) Both 1 and 2 (d) Neither 1 nor 2
18. A shortage of investible capital in an economy can result from:  
1. Very high and erratic inflation  
2. Low savings  
3. High borrowing costs  
Select the correct answer using the codes below.  
(a) 1 and 2 only (b) 2 and 3 only  
(c) 3 only (d) 1, 2, and 3
19. The main difference between secondary activities and tertiary activities is that:  
1. The expertise provided by tertiary services relies more on the specialized skills and knowledge of the workers than on



the production techniques or the machinery as in secondary sector.

2. Tertiary activities involve the commercial output of services rather than the production of tangible goods as in the secondary sector.

Which of the above is/are correct?

- (a) 1 only                      (b) 2 only  
(c) Both 1 and 2              (d) Neither 1 nor 2

20. A seller's market is an economic situation in which:
- (a) Goods are scarce and sellers can keep prices high  
(b) There is only one buyer and a large number of sellers leading to monopsony  
(c) Goods are plenty and sellers are forced to keep prices low  
(d) There is only one seller and a large number of buyers leading to monopoly
21. Pareto optimality is a situation where:
- (a) Resources are allocated in a way in which it is impossible to make any one individual better off without making at least one individual worse off  
(b) Resources are allocated in the most socially desirable way  
(c) Resources are allocated as per democratic means based on the principles of equity and fairness  
(d) All of the above apply
22. What are *wage goods*?
- (a) Goods consumed by the salaried class  
(b) Heavy capital goods used for income generation in a nation  
(c) Goods produced by the organized sector  
(d) Export based goods
23. The concept of Engel's elasticity, in economics is used to analyse:
- (a) Inward foreign remittances  
(b) Consumer behaviour  
(c) Impact of monetary policy  
(d) Government budgeting
24. According to Ricardian ideas, a landowner should have a claim only to:
- (a) Half of the produce of an agricultural land  
(b) Average rent that prevailed at a given time

- (c) Taxable part of the produce  
(d) The produce voluntarily given by the cultivators

25. What is paradox of thrift?
- (a) When people try to save more, they actually end up saving less  
(b) When a nation tries to produce more, it ends up producing less  
(c) When a bank lends, the borrowers do not receive an amount less than that was lent to them  
(d) When a nation exports more, its total savings decline
26. The term *blue economy* in India's MOUs with other countries refers to:
- (a) Electronics based economy  
(b) Ocean based economy  
(c) An economy that gives greater priority to bluechip companies  
(d) Fisheries based economy
27. Aggregate demand is an important economic indicator. It can be increased by:
1. More investments
  2. Increasing bank rate by RBI
  3. Lower taxation
- Select the correct answer using the codes below.
- (a) 1 and 2 only              (b) 2 and 3 only  
(c) 1 and 3 only              (d) 1, 2, and 3
28. *Forced savings*, a term often used by policy-makers, refers to:
- (a) A non-desirable tax imposed on taxpayers  
(b) Excessive provident fund contribution by private sector employees  
(c) Reduction of consumption consequent to a steep rise in prices  
(d) Savings generated by large capital goods investments
29. The term *allocative efficiency* is often used in economics to connote a state of:
- (a) Highest production quantum  
(b) Highest economic welfare of agents involved  
(c) Production level relating to highest employment of labour  
(d) Highest consumption quantum

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30. *Economic efficiency* as used by economists and policymakers is related to which of the following?
1. Optimal allocation of goods and services
  2. Resource efficient production
  3. Reaching equal income levels for all economic agents
- Select the correct answer using the codes below.
- (a) 1 and 2 only      (b) 2 and 3 only  
(c) 1 and 3 only      (d) 1, 2, and 3
31. An economy is said to have reached its highest possible efficiency when:
- (a) Factors of production are allocated optimally in the production of goods and services
  - (b) Equal income level has been reached for all economic agents
  - (c) Economy is utilizing all its natural resources in production
  - (d) Unemployment level has been consistently maintained at zero
32. *Total factor productivity* (TFP) of an economy can improve in which of these ways?
1. Increasing taxation on the private sector
  2. Investing in research and development (R&D)
  3. Creating infrastructure
- Select the correct answer using the codes below.
- (a) 1 and 2 only      (b) 2 and 3 only  
(c) 3 only              (d) 1, 2, and 3
33. In economics, the term *social marginal cost* (SMC) stands for:
- (a) Cost incurred in use of an additional unit of physical capital
  - (b) Total social productivity of skilled labour
  - (c) Costs that occur to the society in addition to the producer
  - (d) All of the above
34. Despite a reduction in fixed capital (FC) formation in the Indian economy, why a higher growth can be reaped?
- (a) FC is not directly correlated with economic growth rate
- (b) FC includes construction of dwellings as a sub-component which may not add to the productive capacity of the economy
- (c) Long-term growth can still be achieved if resources from FC are diverted towards consumption
- (d) All of the above
35. The term *dual-gap analysis* is often used by policymakers to point out:
- (a) Demand for investment and availability of domestic and foreign capital to finance the same
  - (b) Shortage of skilled labour in an emerging market economy
  - (c) Persistence of inflation despite corrective policy measures
  - (d) Failure of market despite pro-active state intervention in both goods and capital markets
36. Which of the following reduce accumulation of capital stock in the economy?
1. Depreciation of assets
  2. Spending on infrastructure rather than capacity building of financial institutions
- Which of the above is/are correct?
- (a) 1 only              (b) 2 only  
(c) Both 1 and 2      (d) Neither 1 nor 2
37. The free rider problem is most observable with public goods because:
1. Marginal cost of their consumption by an extra user is zero.
  2. Marginal utility derived from their consumption by an additional user is zero.
- Which of the above is/are correct?
- (a) 1 only              (b) 2 only  
(c) Both 1 and 2      (d) Neither 1 nor 2
38. Which of these types of goods best qualifies as a public good?
- (a) Rival and exclusive goods
  - (b) Non-rival and exclusive goods
  - (c) Rival and non-exclusive goods
  - (d) Non-rival and non-exclusive goods
39. Capital goods are those goods that are:
1. Used for the production of intermediate goods
  2. Used for the production of consumer goods

3. Used for generation of capital
4. A part of the nation's fixed capital formation

Choose the correct answer using the codes below.

- (a) 1, 2, and 4 only (b) 3 and 4 only  
(c) 2 and 4 only (d) 1 only

40. Which of these can be categorized as *capital goods industry*?

1. Engineering goods
2. Textiles
3. Financial services industry
4. Construction and mining equipment industry

Select the correct answer using the codes below.

- (a) 1 and 4 only (b) 2 and 3 only  
(c) 1, 2, and 3 only (d) 2 and 4 only

41. An economy generally sacrifices consumption goods in order to produce more capital goods. Why is it done?

1. To generate long-term growth
2. To avoid inflationary situations

Which of the above is/are correct?

- (a) 1 only (b) 2 only  
(c) Both 1 and 2 (d) Neither 1 nor 2

42. Assume that in an economy all production is undertaken by firms. In a particular year, the recorded sales of all the firms are less than their respective recorded costs. In such a case, which of the following statements is necessarily true?

- (a) The economy has been facing negative growth for many years consecutively.
- (b) The firms must have made fundamental accounting errors.
- (c) The firms bought more intermediate goods than their total sales of final products.
- (d) The economy has been experiencing lagged effect of infrastructure investments.

43. Inventories are likely to be accumulated in the economy due to:

- (a) Excess consumption by the consumers
- (b) Firms overproducing in anticipation of higher prices in the future
- (c) High depreciation of capital goods

- (d) Degradation of physical infrastructure in the economy

44. Gross investment in an economy essentially means:

- (a) Measure of final output comprising capital goods
- (b) Total infrastructure buildup in the economy
- (c) Aggregate monetary resources available with all the banks in the nation
- (d) Sum total value of the consumer and capital goods in the economy

45. Celebrity endorsement for a product can increase its sales given that:

- (a) The product is homogenous, meaning that its units are analogous to each other
- (b) The demand for the product is inelastic
- (c) The product can be differentiated into multiple categories
- (d) The demand for the product is elastic

46. A seller's market is an economic situation where:

1. Prices of goods always remain depressed
2. There are many sellers and few buyers

Which of the above is/are correct?

- (a) 1 only (b) 2 only  
(c) Both 1 and 2 (d) Neither 1 nor 2

47. What is often referred to as *market failures* by economists is actually:

- (a) A situation where supply and demand forces in the market are not in equilibrium
- (b) Failure of markets to allocate resources efficiently
- (c) Unequal distribution of resource use between private and social goods
- (d) Too much competition at the market place leading to failure of individual firms

48. In a *paradox of thrift* situation:

1. Individuals end up saving less in a bid to save more
2. Governments default on debt in the long-run despite considerable investment in human and physical capital
3. Investment does not pick up despite lower interest rates and available opportunities

Select the correct answer using the codes below.

- (a) 1 only                      (b) 1 and 2 only  
(c) 2 and 3 only                (d) 1 and 3 only

49. The term *moral hazard* is often used by policymakers to point out to a situation where:

1. A person takes more risks because someone else bears the cost of those risks
2. A government servant abuses his authority and financial powers to the detriment of public interest

Which of the above is/are correct?

- (a) 1 only                      (b) 2 only  
(c) Both 1 and 2                (d) Neither 1 nor 2

50. Calculation of consumer surplus is a crucial element of welfare economics. However, the validity of consumer surplus would lose ground if the following law was to be invalidated:

- (a) Law of diminishing marginal utility
- (b) Law of equi-marginal utility
- (c) Law of variable proportions
- (d) Law of divided fractions

51. In economic theory and policy making, consumer welfare is deemed to be maximized when:

- (a) Every individual is able to purchase goods at the exact market price they were willing to pay
- (b) A large number of individuals are able to purchase goods at a much lower market price than what they were willing to pay
- (c) All individuals attain an ideal state of having no demand for any more goods and services
- (d) They are able to purchase goods beyond their means of earning

52. What is the economic logic of pricing decorative mineral stones higher than water?

1. In ordinary situations, their marginal utility to buyers is higher than that of water.
2. Market for mineral stones is heavily monopolized, unlike water, which increases their price compared to water.

Which of the above is/are correct?

- (a) 1 only                      (b) 2 only  
(c) Both 1 and 2                (d) Neither 1 nor 2

53. Law of variable proportions is related to:

- (a) Production in an industry in the short-run
- (b) Calculation of total natural resources in an economy
- (c) Poverty amidst cultural diversity
- (d) Reducing psychological satisfaction with a gain in income

54. The real balance of Pigou effect of a fall in prices works through which of these routes?

- (a) Consumption expenditure
- (b) Investment expenditure
- (c) Government expenditure
- (d) Foreign direct investment

55. Which of the following always remains constant during the short-term production process of a firm?

- (a) Marginal cost
- (b) Average fixed cost
- (c) Marginal revenue productivity of capital
- (d) None of the above

56. When we refer to the stabilizing market forces we generally refer to:

- (a) Forces of supply and demand
- (b) Perfect competition in the market
- (c) Optimizing behaviour of individuals
- (d) All of the above

57. A firm in the economy faces diminishing marginal product of labour as it tries to increase output in the short-run. What does it mean?

- (a) With fixed set of machines, employing any additional labour in the firm is unproductive
- (b) The productivity of labour decreases due to additional workload
- (c) The output produced by each additional worker reduces as the output is expanded with fixed set of factors of production
- (d) None of the above

58. Giffen goods are those goods that:

- (a) May show a positive relationship of quantity consumed with rising consumer income
- (b) May show an unclear relationship of quantity consumed with rising consumer income

- (c) Are consumed in more quantity because they are in greater demand in public  
 (d) Are in greater demand because they are in scarcity
59. Veblen goods in economic terms are those goods whose:  
 (a) Price is directly proportional to their supply in the market  
 (b) Price is directly proportional to their demand in the market  
 (c) Price does not relate to their demand in the market  
 (d) Price and demand are inversely related
60. Marginal efficiency of capital means:  
 1. Expected rate of return from additional investment  
 2. Efficiency of production process as each factor is increased  
 Which of the above is/are true?  
 (a) 1 only (b) 2 only  
 (c) Both 1 and 2 (d) Neither 1 nor 2
61. In a perfectly competitive market, the equilibrium market price of goods is determined by:  
 (a) The government  
 (b) Considerations of marginal cost and revenue  
 (c) The buyers  
 (d) Total capital output
62. Consider the following examples related to the *opportunity costs* between two options in each of the statements below.  
 1. An entrepreneur is making zero profits on both production and non-production of goods.  
 2. A labourer earns as much money in a given time as much he values leisure.  
 In which of the above case(s) is the opportunity cost between the two options non-zero?  
 (a) 1 only (b) 2 only  
 (c) Both 1 and 2 (d) Neither 1 nor 2

## Role of the State in an Economy

63. The *free-rider* problem in economics is usually associated with:  
 1. Public goods  
 2. All private goods  
 3. Foreign investment  
 Select the correct answer using the codes below.  
 (a) 1 and 2 only (b) 3 only  
 (c) 2 and 3 only (d) 1 only
64. Public goods provide which of the following advantages to the general population?  
 1. A number of public goods are affordable which when privately provided are expensive.  
 2. Public goods create a social security net for the downtrodden and poor, especially in times of economic recession.  
 Which of the above is/are correct?  
 (a) 1 only (b) 2 only  
 (c) Both 1 and 2 (d) Neither 1 nor 2
65. Often public goods cannot be provided through market mechanism. This is because:  
 1. It is difficult to separate individual users of the service.  
 2. The good does not decrease in value even after being consumed by additional users.  
 Which of the above is/are correct?  
 (a) 1 only (b) 2 only  
 (c) Both 1 and 2 (d) Neither 1 nor 2
66. Consider the following statements about the role of the state in an economy.  
 1. The state cannot earn profits like a private enterprise.  
 2. The state regulates competitive practices in the economy.  
 3. The state has the responsibility to redistribute economic resources in the economy.  
 Choose the correct answer using the codes below.  
 (a) 1 and 2 (b) 2 and 3  
 (c) 1 and 3 (d) All of the above

67. Public goods are those goods that are
- (a) Subsidized by the government to reduce the cost to the consumer
  - (b) To be ideally provided by the government since private enterprises may not find it economically viable
  - (c) Produced by the state owned enterprises in strategic interest
  - (d) Consumed by more than one individual

## Washington Consensus

68. As per Washington Consensus:
1. There should be a greater role of state vis-à-vis the private sector in a growing economy.
  2. Developed countries should stop deregulation measures which, in the past, have led to increased economic inequality.
- Which of the above is/are correct?
- (a) 1 only
  - (b) 2 only
  - (c) Both 1 and 2
  - (d) Neither 1 nor 2

## Types of Economies

69. *Class conflict* is central to which of the following ideologies?
- (a) Socialism
  - (b) Marxism
  - (c) Capitalism
  - (d) Fascism
70. Economically optimal or efficient allocation of goods and services is always reached in an economy when:
1. Every resource in the economy is employed
  2. Resources go to those who need them the most
- Which of the above is/are correct?
- (a) 1 only
  - (b) 2 only
  - (c) Both 1 and 2
  - (d) Neither 1 nor 2
71. A communist economy advocates:
1. State ownership of all properties including labour in the economy
  2. Absolute power to the state in running and managing the economy
- Which of the above is/are correct?
- (a) 1 only
  - (b) 2 only
  - (c) Both 1 and 2
  - (d) Neither 1 nor 2
72. The term *state-market mix* can be applied to which of the following hypothetical economic situations?
1. The government sub-contracting the construction of a national highway to a private developer.
  2. An economy where all goods and services are produced by state-owned firms but bought by private parties.
  3. Opening bids for the management of a state-owned railway station to private companies.
- Select the correct answer using the codes below.
- (a) 1 only
  - (b) 1 and 3 only
  - (c) 2 and 3 only
  - (d) 1 and 2 only
73. Consider the following about imperative planning.
1. This planning process is followed by socialist economies.
  2. Economic planning decisions are made through a central planning authority instead of a market system.
  3. This process assumes that state and non-state actors have equitable control over economic resources.
- Select the correct answer using the codes below.
- (a) 1 and 2 only
  - (b) 3 only
  - (c) 2 and 3 only
  - (d) 1, 2, and 3
74. The idea of *non-interference* as proposed by Adam Smith is essentially the philosophy of:
- (a) Political liberalism
  - (b) Capitalism

- (c) Social Marxism  
(d) Leninism
75. Which of the following are the major economic challenges for a state economy?
1. Deciding what goods to produce
  2. Allocating supply chain networks to private sector
  3. Ensuring a balance between supply and demand of goods
  4. Ascertaining the level of investment required for an optimal productive capacity in the economy
- Select the correct answer using the codes below.
- (a) 1, 2, and 3 only (b) 3 and 4 only  
(c) 1, 3, and 4 only (d) 2 and 4 only
76. In market socialism:
- (a) Shift to imperative planning occurs in a capitalistic economy
  - (b) Complete control of market resources by the state is a norm
  - (c) Production is not centrally planned but mediated through the market
  - (d) Factors of production are owned entirely by workers in each company
77. The main concern(s) of socialism is/are:
1. Minimize existing inequality and distribute resources justly
  2. Prevent market based distribution of goods and services
  3. Cut down government regulation and planning to the least
- Select the correct answer using the codes below.
- (a) 1 only (b) 1 and 2 only  
(c) 1 and 3 only (d) 2 and 3 only
78. *Rolling back of the state* is a popular catchphrase in economics. It is least likely to be used in the context of a:
- (a) Communist economy
  - (b) Socialist economy
  - (c) Economy following indicative planning
  - (d) Capitalist economy
79. In a perfectly competitive market, the equilibrium market price of goods is determined by:
- (a) Total capital stock of the economy
  - (b) Marginal cost and marginal revenue
  - (c) Average cost of production
  - (d) Employment-output ratio
80. As per Classical Economic thought:
- Assertion (A):** Markets, even if left free, always require government intervention.
- Reason (R):** Buyers and sellers acting in their self-interest fail to coordinate with each other.
- In the context of the above, which of these is correct?
- (a) A is correct, and R is an appropriate explanation of A.
  - (b) A is correct, but R is not an appropriate explanation of A.
  - (c) A is correct, but R is incorrect.
  - (d) Both A and R are incorrect.
81. Characteristics that are central to capitalism include:
1. A market determined price system
  2. Competitive markets
  3. Ownership of factors of production by the state
- Select the correct answer using the codes below.
- (a) 1 only (b) 1 and 2 only  
(c) 2 and 3 only (d) 1, 2, and 3
82. Which of the following shows that India is a mixed economy?
- (a) The state regulates private economic activities
  - (b) State owned enterprises exist alongside private enterprises
  - (c) The government infuses fiscal stimulus occasionally to boost economic activity
  - (d) All of the above
83. In the Keynesian system, speculative demand for money is caused due to:
- (a) Expenditure towards luxury goods
  - (b) High taxation by the government
  - (c) Uncertainty of future interest rates
  - (d) Excess spending by households during boom periods
84. The term *crony capitalism*, often seen in news, refers to:

- (a) Displacement of socialism with the model of capitalism  
 (b) Adverse effects of capitalism on sustainability of growth process  
 (c) Mutually advantageous relationships between business leaders and government officials  
 (d) Greater importance of the money sector vis-à-vis the real sector
85. The great debate between the Keynesians and Classical economists concerns with:  
 (a) Role of government in managing economic shocks  
 (b) Existence of private capital  
 (c) Role of tariff versus non-tariff barriers in trade  
 (d) Conflict between indigenous and foreign capital
86. The *Keynesian revolution* is against:  
 (a) A mixed economic system  
 (b) Blind capitalism  
 (c) Existence of public sector in the economy  
 (d) Economic planning
87. In a mixed economic system:  
 (a) Only consumer goods are produced for sale in a general market  
 (b) Profits are shared between government and capitalists  
 (c) State-run enterprises are disinvested once they start making profits  
 (d) Both the government and the market together decide the economic production and distribution
88. In a socialist economic system:  
 1. Market forces of supply and demand do not exist  
 2. Only those goods are produced which yield sustained profits  
 3. The government guides the overall economic activity in the economy  
 Select the correct answer using the codes below.  
 (a) 1 only (b) 1 and 2 only  
 (c) 3 only (d) 1, 2, and 3
89. Consider the following statements about a state-led distribution network in an economy.
1. The government takes the sole responsibility of providing goods and services to the population.  
 2. No direct payments are made by the consumer.  
 3. Prices of the goods and services are determined in the open market.  
 Choose the correct answer using the codes below.  
 (a) 1 and 2 (b) 2 and 3  
 (c) 1 and 3 (d) All of the above
90. A capitalist economy features:  
 (a) Nationalization of all property  
 (b) Non-existence of competitive markets  
 (c) Market based pricing of products  
 (d) Public provision of all goods and services
91. Regional disparities tend to increase over time in a competitive free market economy due to:  
 (a) Absence of economies of scale and scope in the free market economy  
 (b) Lack of entry and exit of firms from the economy  
 (c) A very small number of firms competing in the market  
 (d) Movement of factors of production in search of better returns
92. The metaphorical *invisible hand* in economics is used to refer to:  
 1. Forces of free market  
 2. Socialist orientation of state  
 3. Public private partnership  
 Select the correct answer using the codes below.  
 (a) 1 only (b) 2 and 3 only  
 (c) 1 and 3 only (d) 2 only
93. Which of the following arguments support a market led economy?  
 1. Dynamic operation of market forces brings a state of equilibrium to the economy.  
 2. It values continuous improvement in provision of goods and services as it is based on competition.  
 3. Markets can fulfil all the needs of an economy.



Choose the correct answer using the codes below.

- (a) 1 and 2                      (b) 2 and 3  
(c) 1 and 3                      (d) All of the above

94. A person with zero income may not be able to avail drinking water in a society based on which of these economic systems?

- (a) Socialistic model  
(b) Capitalistic model  
(c) Mixed economic model  
(d) Communist model

95. In a perfectly competitive market model, in the long-run:

- (a) All firms make super-normal profits  
(b) No firms exist due to the collapse of the industry  
(c) All firms make zero economic profits  
(d) Some firms make huge profits, and some make small losses, but all firms stay in business

96. Consider the following statements.

**Assertion (A):** Keynesians reject the effectiveness of a fiscal stimulus in reviving the market.

**Reason (R):** Keynesians believe that investment depends solely on the rate of interest.

In the context of the above, which of these is correct?

- (a) A is correct, and R is an appropriate explanation of A.

(b) A is correct, but R is not an appropriate explanation of A.

(c) A is correct, but R is incorrect.

(d) Both A and R are incorrect.

97. Which of the following statements is/are true?

- China was the first nation to experiment with market socialism.
- Market socialism is the shift to state controlled mechanisms in capitalistic economies.

Choose the correct answer using the codes below.

- (a) Only 1                      (b) Only 2  
(c) Both 1 and 2              (d) Neither 1 nor 2

98. Resources in an economy are distributed based on the economic theory the nation is following. In capitalistic theory, which of the following can be seen?

- Resources are distributed solely on the basis of market mechanism.
- State intervention in the economy is kept to the least.
- The amount of goods to be produced is dictated broadly by the state, and the rest by the capitalists.

Choose the correct answer using the codes below.

- (a) 1 and 2                      (b) 2 and 3  
(c) 1 and 3                      (d) All of the above

## The Idea of National Income

99. It is said that net domestic product (NDP) is a more realistic assessment of an economy's resources than gross domestic product (GDP). This is because:

- NDP takes into account taxes and subsidies paid which GDP does not.
- NDP accounts for economic depreciation which GDP does not.

Which of the above is/are correct?

- (a) 1 only                      (b) 2 only  
(c) Both 1 and 2              (d) Neither 1 nor 2

100. Annual economic growth can be most realistically determined by comparing which

of these figures relating to two successive years?

- (a) GDP at market cost  
(b) GNP at factor cost  
(c) Net national product (NNP) at market cost  
(d) NNP at factor cost

101. The national income estimates of GDP are released quarterly by the:

- (a) Chief Economic Advisor, Ministry of Finance  
(b) Reserve Bank of India (RBI)

- (c) Central Statistics Office (CSO)
- (d) Department of Commerce and Industry

102. Why is GNP a better measure of national income than GDP?

1. GNP reflects an economy's interconnection and interdependence on world economy, which is not captured by GDP.
2. GNP includes the idea of depreciation of national capital, which is not accounted by GDP.
3. GNP accounts for the population headcount in the nation, which GDP does not include.

Select the correct answer using the codes below.

- (a) 1 and 3 only      (b) 1 only
- (c) 1 and 2 only      (d) 2 and 3 only

103. If the GDP of a country is growing, it implies that:

1. The nation must be experiencing an expansion of the share of manufacturing vis-à-vis other sectors in the GDP.
2. The nation must be experiencing a general rise in the prices of goods and services on an annual basis.

Which of the above is/are correct?

- (a) 1 only      (b) 2 only
- (c) Both 1 and 2      (d) Neither 1 nor 2

104. Consider the following statements. If we take into account the economic growth data of last few years:

1. India has consistently grown faster than US and all the other OECD developed economies in Europe.
2. India's average growth rate has been higher than that of China

Which of the above is/are correct?

- (a) 1 only      (b) 2 only
- (c) Both 1 and 2      (d) Neither 1 nor 2

105. As per the presently followed system, gross national income (GNI) at constant and current prices in India will be equal in which of the following financial years?

- (a) 1951–52      (b) 1991–92
- (c) 2004–05      (d) 2011–12

106. Largest share in gross world product (GWP) is constituted by:

- (a) Agriculture sector
- (b) Services sector
- (c) Industrial sector
- (d) Tourism sector

107. GDP per capita of a country will necessarily increase if:

1. Gross capital formation has increased
2. Export goods have increased
3. Index of industrial production has increased
4. Higher remittances have been received in the previous year

Select the correct answer using the codes below.

- (a) 1 and 2 only      (b) 1, 2, and 3 only
- (c) 2, 3, and 4 only      (d) None of the above

108. What is/are the major criticisms of the GNP metric used to measure the status of an economy?

1. It cannot be used to measure consumer welfare.
2. It suffers with the problem of double counting environmental degradation and then environmental restoration.
3. It includes the value of natural resources of the economy in the estimation.

Select the correct answer using the codes below.

- (a) 1 and 2 only      (b) 2 only
- (c) 3 only      (d) 1, 2, and 3

109. During the last three financial years, growth rate of gross value addition (GVA) at basic price and at constant (2011-12) prices has been highest on an average for which of the following sectors?

- (a) Agriculture
- (b) Services
- (c) Mining and quarrying
- (d) Manufacturing

110. Consider the following uses of the concept of GDP.

1. It does not say anything about the *qualitative* aspects of the produced goods and services by the economy.
2. It is used by the IMF/WB in the comparative analyses of its member nations.

3. If the GDP is growing at the same rate every successive year, it will add the same income to the income of the economy in all these years.

Choose the correct answer using the codes below.

- (a) 1 and 2                      (b) 2 and 3  
(c) 1 and 3                      (d) All of the above

111. Which of the following can be termed as the limitation(s) of GDP as an index of welfare of a country?

1. It does not account for economic inequalities.
2. Several non-monetary exchanges are not accounted for.
3. Environmental costs are neglected.

Choose the correct answer using the codes below.

- (a) 1 and 2 only                (b) 2 and 3 only  
(c) 1 and 3 only                (d) All of the above

112. Why higher GDP does not necessarily imply higher welfare for a nation?

1. It may not be uniformly distributed.
2. It does not include the spending by the unorganized sector.
3. It does not capture the extent of environmental degradation.

Select the correct answer using the codes below.

- (a) 1 and 2 only                (b) 2 only  
(c) 1 and 3 only                (d) 1, 2, and 3

113. It is argued that GDP does not cover up externalities in production of goods and services. If there are positive externalities then:

- (a) The socially desirable GDP will be lower than the commercially desirable GDP
- (b) The socially desirable GDP will be higher than the commercially desirable GDP
- (c) The socially desirable GDP cannot be produced with the intervention of the state
- (d) The commercially desirable GDP will not be able to utilize all economic resources efficiently

114. A reduction in per capita income of India can happen due to:

1. High rates of depreciation in the economy
2. Negative net income from abroad
3. Lowering of India's GDP

Choose the correct answer using the codes below.

- (a) 1 and 2 only                (b) 2 and 3 only  
(c) 1 and 3 only                (d) All of the above

115. How can two nations with the same money supply have different GDPs?

1. Circulation of the same money supply happens differently in both the economies.
2. Labour productivity can be different in the two economies.

Which of the above is/are correct?

- (a) 1 only                        (b) 2 only  
(c) Both 1 and 2                (d) Neither 1 nor 2

116. To compare GDP across nations, real GDP is used because it:

- (a) Calculates GDP at constant prices
- (b) Takes inflation into account
- (c) Excludes the subsidies given by a particular country
- (d) Has been prescribed by IMF

117. Consider the following.

1. Real GDP has increased year after year.
2. Government is continuously running a budget surplus.

The above statements necessarily imply that:

- (a) The government is not spending on infrastructure creation
- (b) The economy is suffering with very high inflation
- (c) Tax yields are very low in the economy
- (d) None of the above can be a correct assessment

118. Which of the following changes have been made in the calculation of headline growth in India?

1. Headline growth rate will now be measured by GDP at constant market prices instead of GDP at factor cost at constant prices.
2. Sector-wise estimates of gross value added (GVA) will now be given at basic prices instead of factor at cost.

3. GDP growth data will be released on a monthly basis for the information of investors.

Choose the correct answer from the codes below.

- (a) 1 and 2 only      (b) 2 and 3 only  
(c) 1 and 3 only      (d) All of the above

119. GDP of India will NOT increase in the short-run if:

1. The government continues to have a high fiscal deficit
2. There is inflation in the economy
3. The monetary policy is loose
4. The government liberalizes the external sector

Choose the correct answer using the codes below.

- (a) 1 and 2 only  
(b) 2 and 4 only  
(c) All of the above  
(d) None of the above

120. GNP of a nation is NOT affected in the short-run by:

1. Growing trade deficit
2. Growing flow of remittances
3. Cutting down on interest rates in the economy

Choose the correct answer using the codes below.

- (a) 1 and 3 only  
(b) 2 and 3 only  
(c) 1 and 2 only  
(d) All of the above

121. If the total size of the economy is growing year after year, it implies that:

1. Growth rate of the economy must be increasing year on year
2. Total investments must be increasing year on year

Which of the above is/are correct?

- (a) 1 only      (b) 2 only  
(c) Both 1 and 2      (d) Neither 1 nor 2

122. If the difference between the GDP and NDP of an economy is becoming less year over year, it may imply that:

1. Research and development in the economy is cutting down the levels of depreciation in the economy
2. The GDP growth rate has reduced over the years
3. The government has reduced subsidies and indirect taxes over the years

Choose the correct answer using the codes below.

- (a) 1 and 2      (b) 2 and 3  
(c) 1 only      (d) All of the above

123. The market value of intermediary goods is deducted from the calculation of GDP to:

1. Avoid double counting of goods
2. Include the value of depreciation in the capital stock

Which of the above is/are correct?

- (a) 1 only      (b) 2 only  
(c) Both 1 and 2      (d) Neither 1 nor 2

124. NDP is not used to compare the economies of the world. This is because:

- (a) The depreciation levels set by different economies for goods are different
- (b) NDP is also affected by the levels of indirect taxes and subsidies offered by an economy which can be different for different economies
- (c) IMF and World Bank do not use NDP for comparing economies
- (d) None of the above

125. In which of the following cases, the GNP of India would increase?

1. More remittances are being sent by Indians residing in Gulf countries.
2. India borrows less and lends more to other world economies.
3. Software exports from India increase.

Choose the correct answer using the codes below.

- (a) 1 and 2      (a) 2 and 3  
(a) 1 only      (a) All of the above

126. In which of the following ways is the concept of GNP used across the world?

1. IMF ranks nations as per their GNP in terms of purchasing power parity (PPP).
2. GNP also shows the external strength of the economy.

3. It shows the financial dependence of one economy over the other.

Choose the correct answer using the codes below.

- (a) 1 and 2                      (b) 2 and 3  
(c) 1 and 3                      (d) All of the above

127. Consider the following statements about NNP.

1. National income of an economy is counted in terms of NNP.
2. Per capita income of a nation is obtained from NNP by dividing it with the working population of the country.
3. It is not influenced by factors external to the economy.

Choose the correct answer using the codes below.

- (a) 1 and 2                      (b) 1 only  
(c) 1 and 3                      (d) 2 and 3

128. Choose the correct equation of national income from the following.

- (a) National income at factor cost = NNP at market cost – Indirect taxes + Subsidies
- (b) National income at factor cost = GNP at market cost – Indirect taxes + Subsidies
- (c) National income at market cost = NNP at factor cost – Indirect taxes + Subsidies
- (d) National income at market cost = GNP at factor cost – Indirect taxes + Subsidies

129. NNP is obtained after:

- (a) Adding net factor income from abroad to the NDP
- (b) Discounting depreciation from GDP
- (c) Adding net capital formation to GDP
- (d) Summing the consumption expenditures of all individuals residing within the economy

130. NNP excludes:

1. Subsidies
2. Indirect taxes
3. Depreciation

Choose the correct answer using the codes below.

- (a) 1 and 2 only                (b) 2 and 3 only  
(c) 1 and 3 only                (d) 3 only

131. Net foreign factor income (NFIA) of India will change if:

1. More remittances are received from Indian workers in Gulf countries
2. The returns of foreign investors on investment in India start rising

Which of the above is/are correct?

- (a) 1 only                      (b) 2 only  
(c) Both 1 and 2                (d) Neither 1 nor 2

132. The term *factor cost* is often used in the estimation of national income. It is:

- (a) Final market price of goods and services
- (b) Total subsidies and taxes levied on factors
- (c) Total concessions given to units of production
- (d) None of the above

133. The national income of a nation is best defined as the:

- (a) Annual revenue of the government
- (b) Total earnings from abroad including exports
- (c) Surplus generated by public sector enterprises
- (d) Sum total of factor incomes

134. The Economic Survey notes that the nominal GDP growth is generally not of particular interest to policymakers. This is because:

1. Inflation erodes the real value of nominal GDP growth
2. Nominal GDP numbers do not capture services sector's contribution

Which of the above is/are correct?

- (a) 1 only                      (b) 2 only  
(c) Both 1 and 2                (d) Neither 1 nor 2

135. Real GDP of a country will rise if:

1. There is high inflation in the economy but no growth in production
2. There is high growth in production but no inflation in the economy
3. There is very little growth in production but heavy deflation in the economy
4. There is very little deflation in the economy but no growth in production

Choose the correct answer using the codes below.

- (a) 1 and 4 only      (b) 2 and 3 only  
(c) 1 and 3 only      (d) 2 and 4 only

136. National disposable income includes which of the following?

1. NNP at market prices
2. Current transfers from the rest of the world
3. Current transfers from the government

Choose the correct answer using the codes below.

- (a) 1 and 2 only      (b) 2 and 3 only  
(c) 1 and 3 only      (d) All of the above

137. The total market value of all final goods and services produced by the citizens of a country and their property, whether operating within the domestic territory of the country or outside in a year is termed as:

- (a) Gross national income
- (b) Gross disposable income at factor cost
- (c) Gross domestic product
- (d) Net domestic product

138. Consider the following statements about depreciation in an economy.

1. More depreciation will reduce the net investment in the economy.
2. Depreciation takes natural calamities and sudden destruction of property into account.

Which of these is/are true?

- (a) 1 only              (b) 2 only  
(c) Both 1 and 2      (d) Neither 1 nor 2

139. If the difference between the GDP and NDP is very less for an economy, what can it imply?

- (a) The economy is growing at a very slow rate.
- (b) The economy can be technologically advanced.
- (c) The economy has low natural resource base.
- (d) Foreign investments form a major chunk of investments in the economy.

140. The calculation of national income covers which of the following?

1. Government consumption expenditure
2. Net exports
3. Gross capital formation

Choose the correct answer using the codes below.

- (a) 1 and 2 only      (b) 2 and 3 only  
(c) 1 and 3 only      (d) All of the above

141. Which of these authorities is responsible for GDP data calculation and which authority is responsible for revising GDP calculation methodology?

1. Central Government
2. Economic Adviser to Finance Ministry
3. RBI
4. CSO

Choose the correct answer using the codes below.

- (a) 3 and 1              (b) 3 and 2  
(c) 4 and 1              (d) 4 only

142. GDP is the value of all the final goods and services produced within the boundary of a nation during one year. For India, this calendar year period is from:

- (a) 1st April to 31st March
- (b) 1st January to 31st December
- (c) 1st March to 28th February
- (d) There is no standard calendar year period. GDP is calculated for different annual periods

143. Consider the following statements.

1. Intermediary goods are not counted in the calculation of GDP.
2. Only those goods that are produced within the territory of India are included in the GDP.

Which of these is/are true?

- (a) 1 only              (b) 2 only  
(c) Both 1 and 2      (d) Neither 1 nor 2

144. GDP is often calculated based on the *value added method*. What do you understand by the term *value added*?

- (a) Difference in the costs of input and output
- (b) Difference in market price and subsidized price
- (c) Difference in export price and import parity price
- (d) Difference between earnings and taxes on the product

145. GDP of India is:  
 (a) Total capital investment made in the country within an year  
 (b) Total value of goods and services produced by its nationals  
 (c) Total consumption expenditure of all residents of India  
 (d) None of the above
146. Presently India is a *lower middle income* category country as per the World Bank. The World Bank defines such economic categories based on:  
 (a) Gross national income in US dollars  
 (b) Per capita gross national income in US dollars  
 (c) Poverty rate, index of inequality, and overall national income  
 (d) Economic size, economic potential, and population of a country

### Answers

1. (a)	2. (c)	3. (c)	4. (b)	5. (a)	6. (c)	7. (a)	8. (b)	9. (a)
10. (a)	11. (a)	12. (a)	13. (d)	14. (d)	15. (c)	16. (c)	17. (d)	18. (d)
19. (c)	20. (a)	21. (a)	22. (a)	23. (b)	24. (b)	25. (a)	26. (a)	27. (c)
28. (c)	29. (a)	30. (a)	31. (a)	32. (b)	33. (c)	34. (b)	35. (a)	36. (a)
37. (a)	38. (d)	39. (a)	40. (a)	41. (c)	42. (c)	43. (b)	44. (a)	45. (d)
46. (d)	47. (b)	48. (a)	49. (a)	50. (a)	51. (b)	52. (a)	53. (a)	54. (a)
55. (d)	56. (d)	57. (c)	58. (a)	59. (b)	60. (a)	61. (b)	62. (d)	63. (d)
64. (c)	65. (c)	66. (b)	67. (b)	68. (d)	69. (b)	70. (d)	71. (c)	72. (b)
73. (a)	74. (b)	75. (c)	76. (c)	77. (a)	78. (a)	79. (b)	80. (d)	81. (b)
82. (d)	83. (c)	84. (c)	85. (a)	86. (b)	87. (d)	88. (c)	89. (a)	90. (c)
91. (d)	92. (a)	93. (a)	94. (b)	95. (c)	96. (d)	97. (a)	98. (a)	99. (b)
100. (d)	101. (c)	102. (b)	103. (d)	104. (c)	105. (d)	106. (b)	107. (d)	108. (b)
109. (b)	110. (a)	111. (d)	112. (c)	113. (b)	114. (d)	115. (c)	116. (b)	117. (d)
118. (a)	119. (d)	120. (d)	121. (d)	122. (c)	123. (a)	124. (a)	125. (d)	126. (d)
127. (b)	128. (a)	129. (a)	130. (d)	131. (c)	132. (d)	133. (d)	134. (a)	135. (b)
136. (a)	137. (a)	138. (a)	139. (b)	140. (d)	141. (d)	142. (a)	143. (c)	144. (a)
145. (d)	146. (b)							

### Explanation

1. The answer is (a).  
**Justification:** Fisher effect is an economic concept which describes the relationship between inflation and interest rate. The equation is  $R = r + F$ , where  $R$  and  $r$  are nominal and real interest rates respectively, and  $F$  = rate of annual inflation.  
 The equation suggests direct relationship between nominal interest rate and inflation.
2. The answer is (c).  
**Justification:** The principle shows ways for maximization of the economic welfare of the community.
- It points to a situation where nobody can be made better off without making someone else worse off.
  - By an efficient use of resources an economy is able to do so, i.e., without making somebody else worse off, somebody might be made better off.
  - In reality, change often produces losers as well as winners.
- Statement 2:** For example, if the government increases spending on all the sections of the society, other than the rich, everyone except the rich are made better off (without making the rich worse

off). This represents a Pareto optimal solution. So, 2 is correct.

**Statement 1:** Extending the similar logic, if a welfare programme benefits some sections of the society without causing any additional burden to others, it is Pareto efficient. So, 1 is correct as well.

3. The answer is (c).

**Justification:** In economics, the Phillips curve is a concept which describes that rates of unemployment and rates of inflation in an economy are inversely related. Higher the rate of inflation, lower is the rate of unemployment.

4. The answer is (b).

**Justification:** Okun's law states that (for US economy) if the unemployment rate increases by one percentage point, it is associated with three percentage points of rise of GNP.

The relationship varies depending on the country and time period under consideration. However, it is more of a *rule of thumb* than a law.

5. The answer is (a).

**Justification:** *Ricardian equivalence* is called *equivalence* because it argues that borrowing and taxation are equivalent means of financing expenditure. When the government increases spending by borrowing today, which will be repaid by taxes in the future, it will have the same impact on the economy as an increase in government expenditure that is financed by a tax increase today.

*Ricardian equivalence* also views that the public saves its excess money to pay for expected future tax increases that will be used to pay off the government debt.

It has often been argued that *debt does not matter because we owe it to ourselves*. This is because although there is a transfer of resources between generations, purchasing power remains within the nation. However, any debt that is owed to foreigners involves a burden since we have to send goods abroad corresponding to the interest payments.

6. The answer is (c).

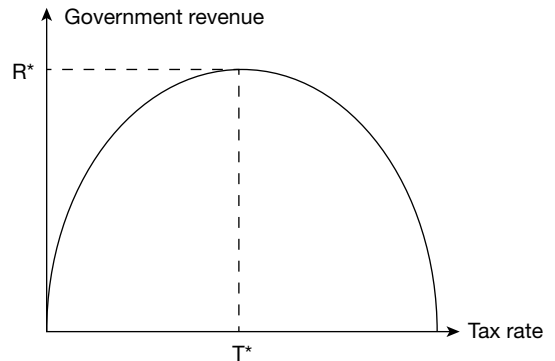
**Justification:** The components of Mundell's impossible trilemma are based on three policy goals, which are:

- i. an independent monetary policy
- ii. free capital flows
- iii. fixed exchange rates
- If we maintain free capital flows and a fixed exchange rate, the money supply in the economy will increase/decrease with an increase/decrease in capital flows. There is no way we can manage inflation in the economy (due to external influences) as the option of sterilization and exchange rate management is not available.
- If we maintain free capital flows and have an independent monetary policy, then exchange rate will change. It cannot be stable.
- The same applies for the other option, we cannot have free capital flows, if exchange rate is fixed and monetary policy acts independently. It will block free flow of capital.

7. The answer is (a).

**Justification:** It shows the relationship between tax rates and the amount of tax revenue collected by governments.

The Laffer curve suggests that, as taxes increase from low levels, tax revenue collected by the government also increases.



Laffer curve

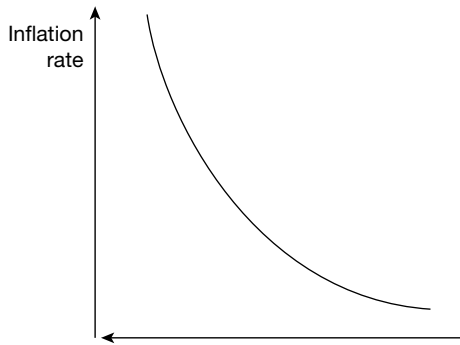
But after a certain percentage points of increase of tax ( $T^*$ ), people will not work as hard or will not work at all, thereby reducing tax revenue.

8. The answer is (b).

**Justification:** In economics, the Phillips curve is a concept which describes that rates of unemployment and rates of inflation in an economy are inversely related. Higher the rate of inflation, lower is the rate of unemployment.

As per the Phillips curve there is a *trade off* between inflation and unemployment, i.e., an inverse relationship between them.





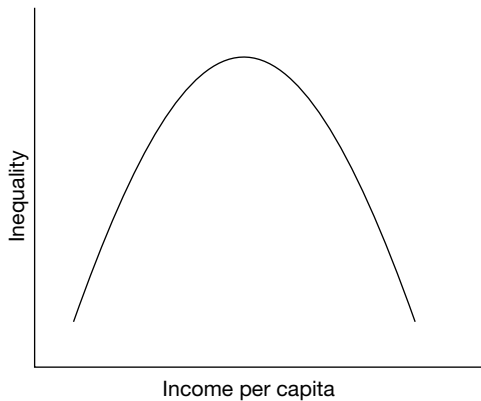
Phillips curve

The expectations-augmented Phillips curve thus introduces adaptive expectations into the Phillips curve and makes it dynamic. Inflation is the expectations, based on this macroeconomic policy is predicted.

9. The answer is (a).

**Justification:** The hypothesis says that income inequality rises in the initial stages of development, stabilizes for a time and then declines later.

This is because in the initial stages of development, all the benefits from growth (urbanization, industrialization) are appropriated by the highly skilled and educated workers only. The rural, unskilled, and farm workers lag behind because they cannot get employment which would have raised their income.

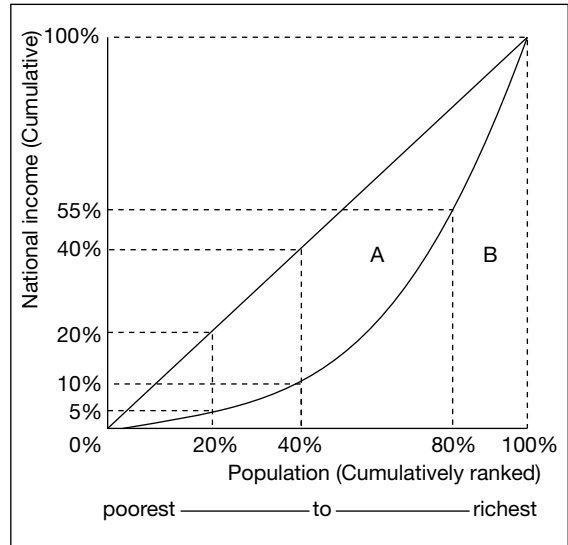


Kuznets inverted-U curve

But in later stage, government redistributes income that is collected from the increased tax revenues from growth. The tax revenue is used to provide education, health services, and skilled labour and push for inclusive growth and development. With inclusive growth, employment increases and everyone benefits from the growth. This will lead to decline in inequality.

10. The answer is (a).

**Justification:** The Lorenz curve is the graphical representation of wealth distribution.



Lorenz curve

The Lorenz curve can be used to show what percentage of a nation's population possesses what percentage of that nation's income. For example, as shown in the graph the country's poorest 20% hold 5% of country's wealth whereas the richest 20% hold 45% of wealth, clearly bringing out the persistent inequality.

The diagonal line in the graph reflects perfect equality, whereas the Lorenz curve lies below it, which is the real situation.

11. The answer is (a).

**Justification: Statement 1:** Currency is not considered as fixed capital, it is liquid capital. Fixed capital are the assets used in the productive process.

Other examples include building or expanding existing factory, purchase of transport equipment and all other machineries used in the productive process.

With an increase in fixed capital, the economy's productivity also increases. With increase in productivity, the income of an economy will also increase.

12. The answer is (a).

**Justification: Statement 1:** Investments in the economy are financed either through private sav-

ings, public savings or government investments, all of which require savings by some economic agent. More the saving, more are the funds in the market, and thus based on the supply-demand principle, lower will be the interest rate.

**Statement 2:** Higher savings mean lower consumption and thus lower inflation.

**Statement 3:** This has nothing to do with the revenue deficit. However, this might have a relation with the capital side of the budget where government borrowing cost might be reduced due to higher savings.

13. The answer is (d).

**Justification:** According to effective demand principle, the equilibrium output of the final goods and services in an economy is equal to ex-ante aggregate demand.

The basic equation used to determine aggregate demand is:

Aggregate demand = National income + Investments + Government spending

Increase in any one component will increase the aggregate demand of the economy.

14. The answer is (d).

**Justification:** Both statements are wrong.

The benefits enjoyed by consumers as a result of being able to purchase a product for a price that is less than the most that they would be willing to pay is what is termed as consumer surplus. It is one of the basic concepts to measure consumer wellness or welfare in economics.

Both consumer surplus and producer surplus together form total social surplus and it is a measure of consumer satisfaction.

15. The answer is (c).

**Justification: Statement 1:** Research says that humans make nearly 95% of their decisions using mental shortcuts or rules of thumb. This means that decisions do not involve elaborate reasoning and are often based on simplistic rules that are applied to a wide range of choices, even if those rules do not really fit there.

**Statement 2:** Such mis-pricing can be due to lack of competition in the market, for example, monopoly or due to irrational decision-making such as selling stocks in hoards in the event of a rumor.

These cause market turbulence and inefficiencies.

**Learning:** By exploring the consequences of limited rationality, social preferences, and lack of self-control, the Nobel laureate has shown how these human traits systematically affect individual decisions as well as market outcomes.

In total, Richard Thaler's contributions have built a bridge between the economic and psychological analyses of individual decision-making.

16. The answer is (c).

**Justification:** Capital goods are tools, implements or machines that make production of consumption goods such as furniture possible.

Since resources are limited in an economy, they can either be channelized for immediate consumption or immediate investment to feed long-term consumption.

If they are channelized for immediate consumption (i.e., say we are producing more tools but not tool making machines), a time would come when demand would overshoot supply and economic stagnation would follow.

If, however, a balance is maintained by sacrificing some consumption goods to produce more capital goods, we can have more aerated drinks in the future as there will be more machines to fulfil the demand.

**Statement 1:** As production expands it leads to an increase in the income of the workers and thus more demand for goods and services. But this increased demand can be fulfilled only when there are capital goods to produce the additionally required consumption goods. Otherwise this leads to inflation.

**Statement 2:** If this trend keeps going there will be very few capital goods left in the economy as the leftovers will start depreciating. It will become increasingly difficult to produce consumption goods leading to a halt in economic growth.

This is why the RBI Governor has prescribed moving from consumption spending to investment spending for the Indian economy.

17. The answer is (d).

**Justification: Statement 2:** It does not discuss about inequality or environmental degradation.

**Statement 1:** As per the curve, there is a *trade off* between inflation and unemployment, i.e., an inverse relationship exists between them.

The curve suggests that lower the inflation, higher the unemployment, and higher the inflation, lower the unemployment.

During 1960s, this idea was among the most important theories of the modern economists. However, economists later contested this curve and suggested some modifications to it.

18. The answer is (d).

**Justification: Statement 1:** High and erratic inflation deters investors from making investment decisions because real returns on investments are uncertain.

**Statements 2 and 3:** Savings forms the base of the money that is borrowed for infrastructure building in the economy. Low savings and high demand of capital lead to high borrowing costs and deter investors.

19. The answer is (c).

**Justification:** Tertiary activities are part of service sector and are different from the secondary activities, which are part of the industrial and manufacturing sector.

Tertiary activities include production (provision of services that are *consumed*) and exchange. The output is measured indirectly in terms of salaries and wages. Example, doctor, plumber.

The processing of physical raw materials is done under secondary sector.

20. The answer is (a).

**Learning:** This is a market situation wherein sellers are outnumbered by buyers by a big margin and the quantity of goods available for sale becomes far less than the quantity demanded.

During boom as demand outstrips supply, the situation can often be seen across.

For example, in summer, there is a huge demand for mangoes. In a certain location where there are just two mango sellers and the demand is extremely high for the same, then that would be a seller's market.

Since the demand is high, the sellers will be able to charge a high price for mangoes and get better sale conditions.

21. The answer is (a).

**Justification and Learning:** The situation in option (a) may not be socially desirable.

For example, we may take away ₹10,000 from a billionaire and give it to a BPL family; it would hardly make a difference to the welfare of the rich but would matter a lot for the BPL family.

So, while this transfer of ₹10,000 is socially desirable, it would not be considered pareto optimum, nor is it done based on democratic means.

The concept is purely based on the idea that greater economic efficiency leads to more economic welfare, which as we just verified, may not be correct.

22. The answer is (a).

**Learning:** Wage goods, in contrast to capital goods, are consumed by the workers of the country.

In the initial phase of Indian economic development, it was alleged that wage goods were given lesser priority as compared to the capital goods that require a specialized workforce and heavy investment to pick up.

This industrialization-led strategy of development neglected the constraint of wage goods availability on two things:

- Employment generation as demand for workers and thus wage goods increases post-economic growth.
- Its potential influence on inflation that is caused by the shortage of wage goods as a nation's GDP starts growing.

However, with the renewed focus on catching up with the national GDP, wage goods are no longer neglected.

23. The answer is (b).

**Learning:** The Economic Survey 2017-18 mentions this concept, which is one of the most basic concepts of microeconomics.

One of the ways to analyse the consumer's behaviour is through Engel's elasticity.

The following table gives the Engel's elasticity for some selected group of commodities. It may be mentioned that Engel's elasticities calculated here refer to the responsiveness of Private Final Consumption Expenditure (PFCE) of a particular commodity group to the aggregate PFCE at constant 2011–12 prices.

CAGR of PFCE in Domestic Market and Engel's Elasticity

Item Description	CAGR (per cent) 2011–12 to 2015–16	Elasticity with Respect to PFCE
Food and non-alcoholic beverages	4.1	0.61
Clothing and footwear	9.6	1.44
Housing, water, electricity, gas and other fuels	5.2	0.78
Furnishing, household equipment and routine household maintenance	9.3	1.39
Health	13.1	1.95
Transport	6.5	0.98
Communication	7.3	1.09
Education	6.3	0.93

Source: Based on the data from National Accounts Statistics (NAS), CSO

As expected, the Engel elasticity of food items is significantly less than one, confirming the hypothesis that as the income levels rise, the expenditure on food increases less than proportionately.

Within food, the elasticity of products such as eggs, meat, fish, and vegetables is higher than that on items such as bread, cereals, and pulses. While the elasticity of expenditure on health is significantly higher than unity, surprisingly that of education is a little less than unity.

24. The answer is (b).

**Learning:** As per David Ricardo, an economist of the classical period, when the land yielded more than its *average rent*, the landowner had a surplus that the state needed to tax.

If tax was not levied, cultivators were likely to turn into rentiers, and their surplus income was unlikely to be productively invested in the improvement of the land.

Many British officials in India thought that the history of Bengal confirmed Ricardo's theory. There the zamindars seemed to have turned into rentiers, leasing out land and living on the rental incomes.

It was therefore necessary, the British officials now felt, to have a different system, which led to devising of various land revenue arrangements by the British.

25. The answer is (a).

**Justification:** John Maynard Keynes, the famous economist, publicized the paradox of thrift theory.

As per the paradox of thrift, during economic recession, individuals try to save more, which leads to a fall in aggregate demand and econom-

ic growth. This is harmful as the investment has lower returns than normal.

Keynes further said that such a mass increase in savings eventually hurts the economy as a whole.

26. The answer is (a).

**Justification:** Mr Modi, the Indian prime minister, recently visited Seychelles. The visit was a part of a three-nation tour that aimed at strengthening strategic partnership with island courtiers of Seychelles, Maldives, and Sri Lanka. During the visit, both nations decided to establish a joint working group to promote ocean-based economy, that is, a blue economy. In this regard, India committed to provide all help to Seychelles.

27. The answer is (c).

**Justification:** Aggregate demand is the total demand for final goods and services in an economy at a given time.

**Statement 1:** Investment creates infrastructure, generates demand for raw material, labour, provides employment, and adds to the productive capacity of the economy. It is one of the most potent factors in increasing aggregate demand (AD).

**Statements 2 and 3:** The government has some ability to impact AD. It can give fiscal stimulus or increase taxes in order to influence how consumers spend or save. An expansionary fiscal policy (higher spending, lower taxes) causes AD to increase, while a contradictory monetary policy (example, high bank rates) causes AD to decrease.

28. The answer is (c).

**Learning:** When someone decides to put some of their income into a savings account or other form of investment, it is normal or voluntary savings.

But when people spend less (and save more) than they earn because there are not enough goods available to buy or because goods are too expensive, it is called as forced savings.

Such forced savings constitute an increase in the supply of loanable funds, and thereby push interest rates down, which increases investment in the economy.

Forced savings play an important role in explaining how expansionary monetary policy generates artificial booms.

29. The answer is (a).

**Justification:** Allocative efficiency is a state of the economy in which there is optimum distribution of goods and services and production represents consumer preferences; every good or service is produced up to the point where the last unit's marginal (additional) cost of producing is equal to marginal (additional) benefit to consumers.

At this point, consumers get what they want and producers sell what they wish to. So, both consumer and producer welfare are maximized. Therefore, option (a) is correct.

However, at the point where the welfare is maximized, employment or resource consumption or production need not be maximum. It is possible for example, for an economy to use only 30% of its total labour force to supply a socially optimum output.

30. The answer is (a).

**Justification: Statement 1:** It is when goods and services are distributed according to consumer preferences and needs of corporations.

**Statement 2:** It is when the maximum number of goods and services are produced with a given amount of inputs.

**Statement 3:** All agents may not have equal incomes, and yet the economic system can be most efficient. So, 3 is wrong.

31. The answer is (a).

**Concept:** Efficiency is concerned with the optimal production and distribution of the scarce resources.

There are mainly two different types of efficiency—production efficiency and allocative efficiency.

The efficiency when the maximum number of goods and services are produced with a given amount of inputs is said to be production efficiency.

The efficiency when goods and services are distributed according to consumer preferences is said to be allocative efficiency.

**Justification: Option (b):** It is not necessary that income levels will be equal when resources are efficiently allocated.

**Option (c):** It is possible that resources are most efficiently utilized when it is not utilizing all of its natural resource base, i.e., by using additional resources, efficiency may have come down.

**Option (d):** The same applies to human resources as well. So, (d) is also wrong.

32. The answer is (b).

**Justification:** If a nation has the same stock of land, labour and capital, and yet it achieves high rates of GDP growth consistently. If inputs are same, how does output increase over time?

Either the individual productivities of factors would have increased or the total combined productivity of the economy has increased.

This can happen either by better technology or better infrastructure, which improves the total factor productivity of the economy. Suppose, currently a factory requires 10 hours to produce a good. With better techniques of production, the same can be achieved in 2 hours and the company can produce more than ever before.

This TFP is called as the part of the output not explained by the change in inputs.

33. The answer is (c).

**Learning:** Externalities refer to the benefits (or harms) a firm or an individual causes to another for which they are not paid (or penalised).

Firms have a private marginal cost and a social marginal cost. The total cost to society as a whole for producing one further unit or taking one further action, in an economy is called as social cost.

This total cost of producing one extra unit of something is not simply the direct cost borne by the producer, but also must include the costs to the external environment and other stakeholders.

The idea of SMC is taken into account in evaluating investment projects.

34. The answer is (b).

**Justification:** Fixed capital formation (growth of productive infrastructure, etc.) is directly related with economic growth rate. So, option (a) is incorrect.

Option (c) is incorrect, as only short-term growth may be achieved if such diversion occurs. In the long-term, quality and quantity of infrastructure is a major determinant of economic growth.

Dwellings form more than 50% of the fixed capital formation in India as shown in the following table.

Assets-wise Fixed Investment by Institutional Sector as a Share of Total Fixed Investment (per cent)

	2011–12	2012–13	2013–14	2014–15	2015–16
Dwellings	57.5	56.6	57.7	58.6	57.1
Machinery & Equipment	35.0	34.5	31.9	31.6	32.5
Others	7.6	9.0	10.5	9.9	10.5

Source: Based on the data from NAS, CSO

Since dwellings do not add to the productive capacity of the economy, even if its growth rate reduces, the economy can still grow. So, option (b) is correct.

**Learning:** Fixed capital is assets used in the productive process. Examples of fixed capital formation include building or expanding existing factory, road and bridge construction, purchase of transport equipment and office equipment such as computers, printers, machinery used in the productive process, and energy infrastructure.

Generally, high capital formation leads to increase in capacity of production of an economy.

35. The answer is (a).

**Learning:** In an economy (without government interference), the following identity holds true:  $Y = C + I + (X - M)$

This can be alternatively expressed as:  $Y - C - I = X - M$ .

$Y - C$  is nothing but savings. So,  $S - I = X - M$ .

This means that an excess of investment over savings ( $I > S$ ) must be financed by an excess of exports over imports, i.e., the inflow of foreign exchange.

The dual gap consists of two gaps: (i) the savings gap = Investment – Savings (i.e.  $I - S$ ); and (ii) the trade gap or the difference between imports ( $M$ ) and exports ( $X$ ) (i.e.  $M - X$ ). In national income accounting, the two gaps must be identical.

If investment can be financed by domestic savings, no savings gap arises. But, if savings gap arises, there is a problem as the country must get foreign exchange to finance.

This is significant for developing economies, as it shows the limitations of domestic capital in a nation's development. They must recognize the importance of foreign exchange in their growth and development.

36. The answer is (a).

**Justification: Statement 1:** Depreciation in an economy means wear and tear of goods in an economy and it decreases the economic value of the capital stock of a firm, nation or other entity.

**Statement 2:** Capital stock is one which increases the production capacity of the economy. Spending on infrastructure increases (rather than decreasing as in statement 2) the capital stock of the nation.

37. The answer is (a).

**Justification:** This occurs when people can enjoy a good service without paying any money or making a small contribution less than their benefit.

- If enough people can enjoy a good without paying for the cost, then there is a danger that in a free market, the good will be under-provided or not provided at all.

A public good has a classic free rider problem because public goods have two characteristics:

- Non-excludability– Cannot stop anyone from consuming the good
- Non-rivalry– Benefiting from good or service does not reduce the amount available to others (marginal cost of admitting an extra user is zero).

Therefore, public goods such as national defence, street lighting, and beautiful gardens may not be provided in a free market.

A free rider problem is also said to occur when there is overconsumption of shared resources.

38. The answer is (d).

**Justification:** A rival good is a good whose consumption by one consumer prevents simultaneous consumption by other consumers, for example, a berth on train. But not all public goods are rival, for example, defence, police security, public parks, etc.

Excludable goods are those for which one can at low cost prevent those who have not paid for the good from consuming it. You can require people to pay for a stamp before you deliver mail or pay for a ticket before they board a train; you cannot cheaply or easily prevent people from entering a park or from listening to a radio station.

So, any good that has both characteristics (non-rival and non-exclusive) can be only provided by the government. It will be economically unviable for the private sector to provide such goods.

39. The answer is (a).

**Justification:** Of the final goods, we can distinguish between consumption goods and capital goods.

Capital goods are goods that are used in the production of consumer or intermediate goods. For example, tools, machines. In the process of production of consumer or intermediate goods, they do not get transformed into other goods. Capital goods form a part of fixed capital, and these goods continue to enable the production process to go on for continuous cycles of production.

40. The answer is (a).

**Justification: Statements 1 and 4:** *Capital goods* include engineering goods, mining equipment, and construction equipment.

**Statements 2 and 3:** Textiles and financial service industry make consumer goods and services respectively and hence, statements 2 and 3 are wrong.

41. The answer is (c).

**Justification: Statements 1 and 2:** Since resources in an economy are limited they should be channelized towards investment to feed long-term consumption.

If they are channelized for immediate consumption (i.e., say we are producing more cell phones but not cell phone making machines), a time would come when demand would overshoot supply and economic stagnation would follow.

If, however, a balance is maintained by sacrificing some consumption goods to produce more capital goods, then we can have more cell phones in the future as there will be more machines to fulfil the demand.

Only this generates long-term growth. This is why the former RBI Governor—Mr G. Raghuram Rajan has prescribed moving from consumption spending to investment spending for the Indian economy.

42. The answer is (c).

**Justification:** Firms buy intermediates, add value to them and then sell them as the final product.

- If they have bought a lot of intermediate goods (in the hope of good demand for their final products), they would incur high costs.
- But if they are not able to sell all of it off, their investment would not show up in their profit books. So, recorded costs are more than recorded sales. Thus, the most appropriate option is (c).

**Option (d):** Even if the investment effect is lagged, it does not make difference at the level of the individual firm. In fact, the lagged effect will only increase demand and reduce costs thus increasing profits later.

43. The answer is (b).

**Justification:** Inventories are unsold stock. Firms will accumulate inventories when either present raw material prices are high or they anticipate high product prices or if they think raw material prices will sharply increase in the near future.

It can also be caused if consumers do not spend too much or consume less, and the present stock is left unsold. So, inventories accumulate due to both supply side and demand side reasons.

44. The answer is (a).

**Justification:** Gross investment is the investment made for both *new acquires* and *capital goods (capital consumption)*.

The investments can be:

- Infrastructure such as roads, airports or bridges
- Machines and tools and its implements
- Buildings, office spaces and warehouses or storehouses

45. The answer is (d).

**Justification:** If demand is elastic, it usually increases given a price cut or advertisement or an increase in income, for example, luxury goods. If it is inelastic, it does not respond to either of these variables, for example, salt.

So, option (d) is the correct answer. Options (c) and (a) are not required criteria, since demand elasticity will work irrespective of whether the product is homogenous or not.

46. The answer is (d).

**Justification:** This is a market situation wherein sellers are outnumbered by buyers by a big margin and the quantity of goods available for sale becomes far less than the quantity demanded.

Such a market condition leads to shortage in the quantity of goods/securities available for sale. As a result, sellers are able to increase the prices and obtain better sale conditions. Thus, the situation becomes favourable for sellers.

**Statement 1:** Since goods are in short supply, it leads to a spike in prices. Statement 1 is wrong.

**Statement 2:** This is opposite of the market situation. So, 2 is wrong.

47. The answer is (b).

**Justification:** Option (a) is incorrect because equilibrium is seldom reached in the markets, which are highly dynamic. So, a supply or demand shortage looms large most of the times in the market. The same forces push prices up or down and incentivize producers to sell more or do the reverse.

Option (c) is incorrect as it refers to the distributional aspect of public welfare rather than the working of the market as such.

Option (d) is economically incorrect. More competition in the market place will likely improve the functioning of the market and correct monopolistic biases. It leads towards perfect competition, where each firm is so small that it cannot affect the economy on a large scale.

The ideology of *Laissez fairez* is based on the invisible hand of free markets. Such markets which work on self-interest of individuals help in the efficient allocation of resources in perfectly competitive markets.

But such markets seldom exist due to:

- Monopolies and other institutional factors
- Instable private sector
- Economic shocks
- High poverty and lack of purchasing power

Markets fail to deliver optimum results in the above cases and the intervention of the state becomes a must in these cases, for example, delivering public health infrastructure in rural areas where people cannot afford expensive private care or where such care may not be available.

48. The answer is (a).

**Justification:** Paradox of thrift was popularized by the renowned economist John Maynard Keynes.

According to paradox of thrift, during economic recession, individuals try to save more, which leads to a fall in aggregate demand and economic growth. This is harmful as the investment has lower returns than normal.

Keynes further said that such a mass increase in savings eventually hurts the economy as a whole.

As growth is lowered, the income of the people reduces. Since our savings and consumption depend on our income, with lower incomes we end up saving less; hence, the paradox.

Such a situation is harmful for everybody as investments give lower returns than normal.

49. The answer is (a).

**Justification:** In economics, moral hazard occurs when one person takes more risks because someone else bears the cost of those risks.

- It is one among the two kinds of market failures associated with the insurance sector.
- It means that the people with insurance cover may take greater risks than the uncovered ones as they know they are protected so the insurer may get more claims than it bargained for.
- The other kind of market failure is the adverse selection also related to insurance business.
- Adverse selection occurs when there's a lack of symmetric information prior to a deal between a buyer and a seller.
- Here the insurer is confronted with the probability of loss due to risk not factored in at the time of sale.

50. The answer is (a).

**Justification:** The difference between the amount that consumers are willing and able to pay for a particular good or service and the amount that they actually end up paying or market price of the good or service is known as consumer surplus.

The more they are willing to pay and the less they end up paying, the higher is the consumer surplus. For example, if you value a toothbrush at ₹10 and you have to pay only ₹1 to avail the toothbrush, ₹9 is your consumer surplus.

How much you value a good depends on how much you have it. For example, if you have zero toothbrush, you would desperately need that first toothbrush and would tend to place a high value on it. But if you already have one toothbrush, your value for the second and then the third and then the fourth toothbrush would go on declining because you do not need them.

This is what we call as the law of diminishing marginal utility, without which the consumer surplus concept would become invalidated.



51. The answer is (b).

**Justification:** The individual benefits derived from the consumption of goods and services is known as consumer welfare. In theory, individual welfare is said to be an individual's own assessment of satisfaction based on prices and income. With the help of information on individual benefits, exact measurement of consumer welfare can be determined.

Increasing consumer surplus is the main idea of consumer welfare.

The benefits enjoyed by consumers as a result of being able to purchase a product for a price that is less than the most that they would be willing to pay is what is termed as consumer surplus. It is one of the basic concepts to measure consumer wellness or welfare in economics.

52. The answer is (a).

**Justification: Statement 1:** Since water is available in large quantities and consumed in large quantities, the marginal utility of one extra unit of water is much lesser as compared to mineral stones which are consumed in very limited quantities.

Given their limited availability, their price is higher than water.

**Statement 2:** Even if the market for water can be monopolized, still that would not raise the price of water since people would not pay high prices and force companies to reduce the price.

53. The answer is (a).

**Justification:** Option (d) is related to the law of diminishing marginal utility.

According to the law of variable proportions, in constant state of technology, when the units of variable factor of production are increased within the units of other fixed factors, the marginal productivity increases at increasing rate up to a point, after that point it decreases.

This statement means that, in an industry, up to a certain amount of variable factor, marginal product of the factor may increase and then it starts diminishing or can even become negative.

54. The answer is (a).

**Learning:** It believes that a large fall in prices would stimulate an economy and create the *wealth effect* that will generate full employment.

- This means, as prices fall, more money becomes available to consumers for spending whose purchases create demand for more production and hence more jobs.

- This mechanism, however, does not work out in practice. Because, if a fall in prices is steep enough, firms will incur huge losses and would not be able to pay their debts.
- If the fall is gradual, nobody would know where it will stop and both consumers and producers will hold on to their cash, thus creating a liquidity trap.

55. The answer is (d).

**Justification: Option (a):** Marginal cost is the cost of producing an extra unit. It does not remain constant. It may decrease if the returns to scale are increasing; may increase if returns to scale decrease; or remain constant if constant returns to scale prevail. So, (a) is incorrect.

**Option (b):** The cost of establishing plant and machinery is known as fixed cost. Average fixed cost of a firm is equal to total fixed cost of the firm divided by total output of that firm. As output increases, average fixed cost of the firm decreases. So, (b) is incorrect.

**Option (c):** As firms produce, the productivity of capital goods (machinery) keeps declining as more and more workers are added to the same fixed set of machineries. Since machineries cannot be added overnight, the productivity of capital falls with increasing production, unless new machinery is installed in the long-run.

56. The answer is (d).

**Justification:** The stabilizing tendency of the market is often known as the *invisible hand*. When there is excess supply or lower demand for a commodity, the price of a commodity lowers. This in turn revives the demand in the market and increases production of the commodity. The reverse is also true. Optimizing behaviour of the individuals means that every individual acts rationally in his maximum self-interest. This is at the core of the principle of market forces. Perfect competition ensures that all such transactions take place in an unrestricted and non-monopoly market.

57. The answer is (c).

**Justification:** The law of diminishing marginal returns also known as the law of diminishing returns, states that during a production process, as one input variable is increased, there will be a point, i.e., after optimal level, at which the marginal per unit output will start to decrease, if other factors are kept constant.

If other production factors are kept constant, adding more workers beyond the optimal lev-

el will result in decreasing productivity as extra workers will lead to less efficient operations.

58. The answer is (a).

**Justification:** An increase in the purchasing power of a consumer can induce the consumer to reduce the consumption of a good. The demand for such goods can be positively or inversely related to its price depending on the relative strengths of these two opposing effects.

If the substitution effect is stronger than the income effect, the demand for the good and the price of the good would still be inversely related. However, if the income effect is stronger than the substitution effect, the demand for the good would be positively related to its price. Such a good is called giffen good.

59. The answer is (b).

**Justification:** In economics, Veblen goods are types of material commodities for which the demand is proportional to its high price, which is an apparent contradiction of the law of demand.

Veblen goods also are commodities that function as positional goods. Veblen goods are types of luxury goods, such as expensive wines, jewellery, designer handbags, and luxury cars, which are in demand because of the high prices asked for them.

The high price makes the goods desirable as symbols of the buyer's high social-status, by way of conspicuous consumption and conspicuous leisure; conversely, a decrease in the prices of Veblen goods would decrease demand for such products.

60. The answer is (a).

**Justification:** Marginal efficiency of capital (MEC) is calculated as the profit that a firm is expected to earn considering the cost of inputs and the depreciation of capital. It is influenced by expectations about future input costs and demand. The MEC and capital outlays are the elements that a firm takes into account when deciding about an investment project. The MEC needs to be higher than the rate of interest, for the investment to take place.

61. The answer is (b).

**Justification:** There are a very large number of buyers and sellers in a perfectly competitive market.

Marginal cost means the cost of producing one additional unit of a product. Marginal revenue is the price that every additional unit will fetch in the market. This is based on the demand of the buyers.

The equilibrium market price of goods is a point where marginal cost becomes equal to the marginal revenue.

This is one of the most fundamental concepts of economic theory and is used by many industrial firms in deciding the amount of output and prices. UPSC has asked questions on the *marginal concept*, hence the question.

62. The answer is (d).

**Justification:** Opportunity cost is the cost that you pay for the loss of other alternatives when one alternative is chosen. In statement 1, no matter what the entrepreneur chooses, he has to suffer the same loss or profit. In other words, both the options are same. In statement 2, no matter what the labourer chooses, his benefit from both the activities is the same.

63. The answer is (d).

**Justification:** The *free-rider* problem means the consumers will not voluntarily pay for what they can get for free and for which there is no exclusive title to the property being enjoyed.

For example, if we consider a public park or measures to reduce air pollution, the benefits will be available to all irrespective of them paying for it or not.

The consumption of such products by several individuals is not *rivalrous* in the sense that a person can enjoy the benefits without reducing their availability to others, which results in this free-rider problem.

In case of private goods, anyone who does not pay for the good can be excluded from enjoying its benefits.

However, in case of public goods, which are non-excludable, all can enjoy the benefits of the good, whether or not they pay the fee/cost for that good.

So, clearly statement 1 is correct and statement 2 is incorrect. Statement 3 is irrelevant in this context.

64. The answer is (c).

**Justification: Statement 1:** Sanitation, education, drinking water, healthcare, etc., come under the category of public goods and services. When provided privately, they often become unaffordable for the poor masses. When they are provided at a lower price, people can afford them and the money that is spare can be spent in the market.

**Statement 2:** During recession, often the demand for labour goes down and the first ones to be laid

off from the job are the contract workers who are usually at the lower rung of the society.

If public goods such as healthcare education, and drinking water are provided at low cost or free of cost, it gives such people a safety net even if they are unemployed. The money saved from spending on these public goods can be used for private consumption

65. The answer is (c).

**Justification: Statement 1:** A good can be priced only when you know who is using it and how much is being used, for example, a soap is used by one person and it is quite easy to make that person pay for it.

But in case of some goods doing this is not possible. For example, if providing clean air is a public good, then it is not possible to separate users who consume a fixed quantity of clean air, and it is also not possible to exclude someone from using it.

In such a case, a central authority or body must provide the good at either a constant price to all or make it free of cost for users. However, it should be noted that in either of these cases, the body cannot use the market principles of pricing.

66. The answer is (b).

**Justification:** If we look back into the economic history of the world, we see three possible roles for the state/government in the economy which are:

Government acting as regulator of the economic system, where the government takes important economic decisions, announces the required type of economic policies, takes the sole responsibility to get those policies implemented, and controls and punishes those who do not adhere to its economic decisions.

Government as a producer and/or supplier of *private goods and services* that include all those goods and services which constitute the part of market and which will be distributed among the needy according to the principles of the market mechanism. Here the state earns profit as a private enterprise.

Government as a producer and/or supplier of the *public or social goods* that include the goods and services which are essential for social justice and well-being of its citizens. These goods and services include education, drinking water, healthcare, sanitation, nutrition, and caring for the senior citizens and disabled population. These goods

and services are generally distributed free of cost or at subsidized price.

67. The answer is (b).

**Justification:** A public good is a product that one individual can consume without reducing its availability to another individual and from which no one is excluded. For example, clean air, national defence, law and order, flood control system, lighthouses, etc. These goods are ideally provided by the government since private enterprises may not find it economically viable.

Even LPG is subsidized, but it is not a public good. So, (a) is incorrect.

PSEs produce steel, defence equipment and weapons too, but none of them are public goods. So, (c) is also incorrect.

68. The answer is (d).

**Justification:** It is considered to constitute the *standard* reform package promoted for crisis-wracked developing countries by Washington, D.C.-based institutions such as the International Monetary Fund (IMF), World Bank, and the US Treasury Department.

It basically refers to a more general orientation towards a strongly market-based approach such as macroeconomic stabilization, economic opening with respect to both trade and investment, and the expansion of market forces within the domestic economy.

69. The answer is (b).

**Learning:** Class conflict is the tension or the antagonism which exists in society due to competing socioeconomic interests and desires between people of different classes.

The view that the class struggle provides the lever for radical social change for the majority is central to the work of Karl Marx and the anarchist Mikhail Bakunin.

Class conflict can take many different forms: direct violence, such as wars fought for resources and cheap labour; indirect violence, such as deaths from poverty, starvation, etc.

Labour union against capitalists is an important example of class struggle. It is a typical example of class conflict within capitalism. This class conflict is seen to occur primarily between the bourgeoisie and the proletariat, and takes the form of conflict over hours of work, value of wages, division of profits, cost of consumer goods, the culture at work, control over parliament or bureaucracy, and economic inequality.

70. The answer is (d).

**Justification:** Optimal allocation happens when goods and services are distributed according to consumer preferences and needs of corporations.

**Statement 1:** It is possible that by employing all resources, we may reach a stage of disguised unemployment, for example, as common in rural areas.

**Statement 2:** This is distribution based on equity and welfare concerns, which may not be efficient from an economic point of view.

71. The answer is (c).

**Justification:** Communism is an economic system where the collective owns the factors of production. The four factors of production are labour, entrepreneurship, capital goods, and natural resources.

The following form the major features of the communist economies.

- Abolition of property in land and application of all rents of land to public purposes
- A heavy progressive or graduated income tax
- Abolition of all rights of inheritance

72. The answer is (b).

**Justification:** The question essentially refers to a mixed economy where both state and the market undertake economic activities.

**Statement 1:** In this case, the act of the state of sub-letting an activity under its economic domain shows a state-market mix approach.

**Statements 2 and 3:** If all factors of production are owned and used by the state, it is a socialist or communist economy.

73. The answer is (a).

**Justification:** In this system, allocation of resources, the mix of output, and the distribution of output among the people (i.e., *what, how, and for whom* problems) are determined centrally in accordance with the predetermined plans and targets.

- Administrative control and regulation from the central planning authority flows in all directions.
- Because of control over the available resources of the country by the state, resources are allocated in such a way that production becomes maximum, people get goods and services in fixed quantities at fixed prices, and welfare of the nation gets maximized.
- Thus, communist China was the purest example of such planning.

74. The answer is (b).

**Justification: Option (a):** Liberalism is a political philosophy or worldview founded on ideas such as freedom of speech, freedom of the press, freedom of religion, free markets, civil rights, democratic societies, secular governments, gender equality, and international cooperation.

**Option (b):** This involves free market economies where each individual tries to maximize his or her own interest.

**Option (c):** This is usually understood to be against the system of capitalism.

**Option (d):** This is essentially Marxism as applied by Lenin. It stands for the achievement of a dictatorship of the proletariat (workforce), as a political prelude to the establishment of socialism (a system that is more or less opposite of capitalism).

75. The answer is (c).

**Justification:** Every economy meets with certain challenges.

One of which is to produce and make available the goods and services needed by the population, as it is difficult to know the need of the population.

For production of these goods and services, there should be adequate investment in capital formation. Apart from this, there should be a proper distribution network, so that goods and services are made available to those in need.

**Statement 3:** But in a state economy the private sector does not play any role and is nationalized by the government.

76. The answer is (c).

**Learning:** Market socialism is a type of economy where the means of production are owned either by the state or by the workers of the company but unlike in socialism, the production is not centrally planned but it is mediated through market.

Market socialism combines the advantages of both market economy and socialist economy.

77. The answer is (a).

**Justification:** Although advocates of socialism are not entirely opposed to the market, they favour some kind of government regulation, planning and control over certain key areas such as education and health care.

Here we talk about the Indian version of socialism and why is it the way it is.

In India, the eminent socialist thinker Rammanohar Lohia identified five kinds of inequalities that need to be fought against simultaneously: inequality between man and woman, inequality based on skin colour, caste-based inequality, colonial rule of some countries over others, and, of course, economic inequality.

This might appear a self-evident idea today. But during Lohia's time it was common for the socialists to argue that class inequality was the only form of inequality worth struggling against. Other inequalities did not matter or would end automatically if economic inequality could be ended.

78. The answer is (a).

**Justification:** Rolling back means that private sector has been given more space to operate and the state has reduced its role from that of a regulator to that of a facilitator.

This will occur most likely in a capitalist or socialist economy and least in a communist economy where the state is the chief architect of the economy.

79. The answer is (b).

**Justification:** There are a very large number of buyers and sellers in a perfectly competitive market and since there is no monopoly of a single firm, all firms jointly take the prices.

Marginal cost means the cost of producing one additional unit of a product. Marginal revenue is the price that every additional unit will fetch in the market. This is based on the demand of the buyers.

The equilibrium market price of goods is a point where marginal cost becomes equal to the marginal revenue.

This is one the most fundamental concepts of economic theory and is used by many industrial firms in deciding the amount of output and prices.

80. The answer is (d).

**Justification:** Classical thought is also known as the non-interventionist school. As per classical economists, markets function best without government interference.

They observe that markets generally regulate themselves, when free of coercion. Adam Smith referred to this as a metaphorical *invisible hand*, which moves markets toward their natural equilibrium.

In contrast to Classical economics, Keynesian economics supports policies such as government

intervention, deficit spending, control of the money supply, and a progressive income tax to counter recession and income inequality.

Most classical economists reject these ideas. They assert that state intervention makes situations of economic slowdown worse.

81. The answer is (b).

**Justification: Statements 1 and 2:** Private property, capital accumulation, wage labour, voluntary exchange, a price system, and competitive markets are some of the major features of capitalism.

Capitalism is an economic system based upon private ownership of the means of production and their operation for profit.

In capitalism, decision-making and investment to be made are determined by private players/market. The prices and the distribution of goods and services are determined by competition in markets.

**Statement 3:** This is a feature of either communism or extreme socialism.

82. The answer is (d).

**Justification:** A mixed economic system allows a level of private economic freedom in the use of capital, but also allows for governments to interfere in economic activities in order to achieve social aims.

In mixed economy, there can be private ownership of the means of production with profit-seeking enterprise, the dominance of markets for economic coordination and the accumulation of capital remaining the fundamental driving force behind economic activity. But unlike a free-market economy, the government would wield indirect macroeconomic influence over the economy through fiscal and monetary policies.

83. The answer is (c).

**Learning:** A person holds his wealth in different forms such as land, bonds, and money.

- When they invest in bonds, different people have different expectations regarding the future movements in the market rate of interest based on their private information regarding the economy.
- When the interest rate is very high, everyone expects it to fall in future and hence anticipates capital gains from bond-holding. Thus, people convert their money into bonds due to which speculative demand for money is low.
- When interest rates are low, everyone expects them to rise in future which prompts them to

increase their money holdings in view of capital loss from existing bonds. So, speculative money demand is high.

84. The answer is (c).

**Learning:** Crony capitalism is a description of a capitalist society as being based on the close relationship between business people and the state.

- The success of a business in crony capitalism, is dependent on the favouritism that is shown to it by the ruling government in the form of tax breaks, government grants, etc., instead of success being determined by a free market as seen in capitalism.
- The alleged coal block allocation and 2G spectrum scams are the important examples of the same that benefit private players at the cost of public money.
- India is ranked at ninth position in crony-capitalism with crony sector wealth accounting for 3.4 per cent of the gross domestic product (GDP), according to a new study by The Economist.

85. The answer is (a).

**Learning:** Classical economic theory is rooted in the concept of a laissez-faire economic market. A laissez-faire market, also known as free-market requires little to no government intervention. It also allows individuals to act according to their own self-interest regarding economic decisions. This ensures economic resources are allocated according to the desires of individuals and businesses in the marketplace.

Keynesian economic theory relies on spending and aggregate demand to define the economic marketplace. Keynesian economists believe that the aggregate demand is often influenced by public and private decisions. Public decisions represent government agencies and municipalities. Private decisions include individuals and businesses in the economic marketplace. Keynesian economic theory relies heavily on the fact that a nation's monetary and fiscal policy can affect its economy significantly.

86. The answer is (b).

**Learning:** John Maynard Keynes argued that free market system, led by absolute capitalism, does not always lead to full employment, economic stability, and welfare of citizens.

He advocated the intervention of government in the economy for stabilizing prices, employment and output.

A key element of this revolution was fiscal stimulus and the role of investment in reviving demand.

This was against the laissez-faire free market system advocated by Adam Smith.

87. The answer is (d).

**Justification: Option (a):** India is a mixed economy, and we produce all kinds of goods, whether consumer goods (example, soap), or intermediary goods (example, steel), or capital goods (example, machinery). So, (a) is wrong.

**Option (b):** This is not a general feature of any economic system; however, on an explicit contract in a PPP arrangement, there can be a provision like this. To that extent it can be a feature of a capitalistic society also. So, (b) is incorrect.

**Option (c):** They are disinvested for strategic reasons such as gaining more efficiency, managerial pool and capital infusion, which may vary from case to case. But it is not a part of a mixed economy as a general rule. So, (c) is incorrect.

**Option (d):** Most economies are mixed economies, i.e., the government and the market together answer the three questions of what to produce, how to produce, and how to distribute what is produced. In a mixed economy, the market will provide whatever goods and services it can produce well, and the government will provide essential goods and services which the market fails to do.

88. The answer is (c).

**Justification: Statement 1:** The market forces of supply and demand will exist universally as long as some goods are traded (supplied) and some are purchased (demanded). Even if the government guides the economic activity, the provision of certain goods will create supply-demand mismatches and the government will feel the heat (if not in the form of prices for goods that come under administered prices regime). So, 1 is incorrect as it is an extreme statement.

**Statement 2:** This is the guiding principle of a purely capitalistic system.

**Statement 3:** In a socialist society, the government decides what goods are to be produced in accordance with the needs of the society. It is assumed that the government knows what is good for the people of the country and so the desires of individual consumers are not given much importance.

89. The answer is (a).

**Justification:** In distribution networks, there are three models:

**State model:** The state or government takes the responsibility of supplying the goods and services which are essential to the population without

any payments being made by the consumer. For example, the former Soviet Union.

**Market model:** It functions on the basis of price mechanism determined by the market. It is present in USA.

**State-market mix model:** In this model, few goods and services which are essential to citizens are under the control of the government, while the remaining are determined by the market. For example, India.

90. The answer is (c).

**Learning:** It is based on private ownership of the means of production and their operation for profit.

The central characteristics of capitalism are presence of private property, capital accumulation by owners of means of production, wage labour, market exchange, and competitive markets.

91. The answer is (d).

**Justification: Option (a):** Economies of scale and scope are possible in any kind of industry, wherever investments are scaled and diversified.

**Option (b):** A competitive free market economy will have free entry and exit of firms.

**Option (c):** There are usually a large number of firms competing in a competitive free market economy, akin to perfect competition scenario.

**Option (d):** For example, investment (money) is a factor of production which will only go to rich regions where opportunities are many and returns are high, over time this will accentuate inequalities.

92. The answer is (a).

**Justification:** Classical economists observe that markets generally regulate themselves, when free of coercion. Adam Smith referred to this as a metaphorical *invisible hand*, which moves markets toward their natural equilibrium.

So, classical thought is also known as the non-interventionist school. As per it, markets function best without government interference.

In contrast to classical economics, Keynesian economics supports policies such as government intervention, deficit spending, control of the money supply, and a progressive income tax to counter recession and income inequality.

93. The answer is (a).

**Justification:** The theory on capitalistic form of economy was given by Adam Smith and it formed the basis of classical economics.

He stressed on division of labour, laissez-faire, invisible hand, market forces, and competition and that these will bring a state of equilibrium and general well-being of the country.

94. The answer is (b).

**Justification:** In extreme capitalism, markets are left free without regulation. Only those who have the ability to pay can enjoy goods or services.

In such a society, drinking water will also be commodified and sold in the market based on the forces of supply and demand. If a person has zero income, he will not be able to purchase drinking water.

However, this is a hypothetical case, and today many capitalist societies have some or the other form of fundamental social security measures for basic healthcare, water, sanitation, and education.

95. The answer is (c).

**Learning:** A perfectly competitive market means a market place where:

- There is no restriction on entry and exit of firms
- There is perfect information among buyers and sellers of products and their prices
- Products are homogenous and consumers are rational (i.e., buy only lowest priced products)
- All firms incur same cost conditions

In such a situation, standard economic model predicts that in order to remain in the industry, all firms must reduce profits to zero, and bring prices to the exact cost (marginal cost) level.

If they do not do so, other competitors will, and all consumers will start buying from those competitors forcing the firm to shut down.

However, zero economic profits do not mean no profits; it simply means that there are no additional profits apart from what is required to sustain the firm (for example, manager's salary and variable costs).

96. The answer is (d).

**Justification:** Keynesians sometimes argue that private sector decisions can lead to inefficient macroeconomic outcomes. For macroeconomic outcomes, Keynesians argue that active policy responses by the public sector, that is, monetary policy by the central bank and fiscal policy by the government, are required to stabilize output over the business cycle.

Keynesians believe that investment does not depend solely on the rate of interest but on various

factors such as investor's expectations, market conditions, and return on capital. In the absence of state intervention, investment may fluctuate erratically. This may cause aggregate demand to go down and reduce economic growth and employment.

So, Keynesian economics advocates a mixed economy—predominantly private sector, but with a role for government intervention during recessions.

97. The answer is (a).

**Justification:** In 1985, *open door policy* was announced by China. The policy was shift towards market socialism. Market socialism, also called liberal socialism, takes into account the advantages of both socialism and capitalism. Market socialism model of economic system represents a compromise between socialist planning and free enterprise, in which enterprises are publicly owned but production and consumption are guided by market forces rather than by government planning.

98. The answer is (a).

**Justification:** In capitalism, only those consumer goods will be produced that are in demand. These are goods that can be sold profitably either in the domestic or in the foreign markets. This is based on market mechanism.

The capitalistic economy is based on *laissez-faire*, that is, non-intervention or least interference by the government.

99. The answer is (b).

**Justification:** NDP is GDP minus depreciation. Depreciation is the total value of the *wear and tear* that happened in the assets while the goods and services were being produced in an economy.

With more research and development (R&D) activities, the depreciation levels decrease, as R&D increases efficiency of assets and reduces wear and tear.

In India, Ministry of Commerce and Industry decides and announces the rates by which assets depreciate and a list of the same is published.

100. The answer is (d).

**Justification:** To calculate economic growth, you need to estimate the total actual production of last year and compare it to that of the next year.

**Option (a):** Market cost calculations include inflation, and thus a mere increase in prices will indicate an increase in GDP even if there has

not been an actual production increase. So, (a) is wrong.

**Option (b):** GNP at factor cost is more realistic because it also takes into account the NFIA as well as factor cost (which is the manufacturing cost). But then it does not take into account the depreciation of goods in the economy, which effectively reduces the total effective production of last year.

**Options (c) and (d):** By these means, option (d) is the best choice, as option (c) is calculated at market cost.

101. The answer is (c).

**Learning:** CSO coordinates the statistical activities in the country and evolves statistical standards. It is headed by a Director General assisted by five additional Director Generals.

For example, for the second quarter of 2017-18, as reported by the CSO, GDP has grown at 6.3% year-on-year compared to 5.7% in the first quarter but still lower than 7.5% a year ago.

The manufacturing sector in the second quarter of 2017-18 grew by 7% against 1.2% in the previous quarter. This is really a turnaround. In the corresponding quarter in the previous year, the growth rate was 7.7%.

Agriculture, forestry, and fishing sectors are estimated to have grown by 1.7%.

102. The answer is (b).

The formula for GNP equals GDP + Net income from abroad.

Income from abroad usually includes trade balance, remittances, and interest on external loans.

But it becomes  $GNP = GDP - \text{Income from abroad}$ , in the case of India. India's GNP is generally lower than GDP. This is because usually the income from abroad component of India is negative.

The different uses of the concept of GNP are:

- GNP is used by IMF as *national income* to rank the nations of the world in terms of the volumes—at PPP.
- India is ranked as the third largest economy in terms of PPP, while as per the nominal exchange rate of rupee, India is the sixth largest economy.
- GNP indicates both *quantitative* as well as the *qualitative* aspects of the economy and also the *internal* and *external* strengths of the economy.



It enables us to learn several facts about the production behaviour and pattern of an economy, such as, how much the outside world is dependent on its product and how much it depends on the world for the same (numerically shown by the size and net flow of its *balance of trade*), etc.

**Statement 2:** It is the net national income or NNP or NDP that includes depreciation.

103. The answer is (d).

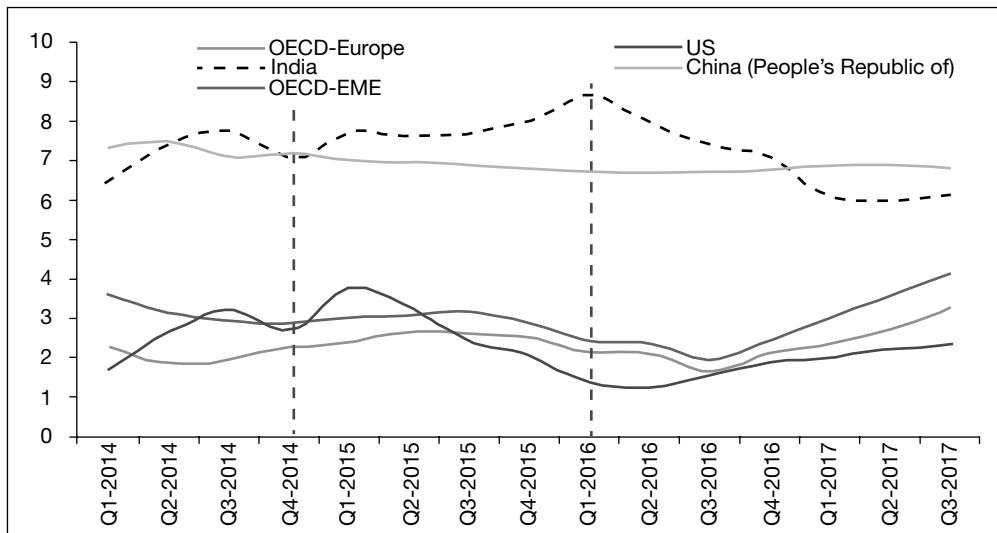
**Justification:** GDP calculates total value of goods and services produced within a year at market prices. It considers production by all three sectors – primary, secondary, and tertiary.

**Statement 1:** Manufacturing activity is considered a part of the secondary sector. Even if the GDP is expanding, it does not mean that manufacturing must expand. The increase can come from services or agricultural sectors as well.

**Statement 2:** If the demand is not growing more than the production of goods and services (owing to an increased GDP), inflation will be under control.

104. The answer is (c).

**Justification:** The graph below shows the growth rate of different countries.



Source: Based on the data from OECD survey calculations. Growth rate of seasonally adjusted real GDP.

105. The answer is (d).

**Learning:** Constant prices are calculated at 2011-12 (base year) prices as per the latest series. Current prices can only be equal to constant prices in the base year, the year from which the series starts, i.e., 2011-12.

106. The answer is (b).

**Learning:** The gross world product (GWP) is the total gross national product of all the countries in the world. While considering world trade, the imports and exports maintain a balance, this also equals the total global GDP.

In 2014, the GWP totalled around US\$107.5 trillion in terms of PPP, and around US\$78.28 trillion in nominal terms. Share of services is

close to 66%, followed by industrial sector and agriculture.

107. The answer is (d).

**Justification:** All these factors will be neutralized if population growth rate has surpassed economic growth rate.

**Statement 1:** If capital is formed, there can be more production and thus growth. Per capita income may or may not increase. Overall income may increase.

**Statement 2:** Exports boost domestic production.

**Statement 3:** IIP increase signals rise in manufacturing and allied sectors.

**Statement 4:** Higher remittances lead to higher domestic spending and thus higher demand for goods and services.

108. The answer is (b).

**Justification: Statement 1:** It is used to measure consumer welfare, but it is not a good indicator of general economic welfare. For example, in economic theory, consumer welfare usually increases with increased production and a reduction in the amount of the price that a consumer has to pay.

**Statement 2:** It is often argued that GNP includes the environment on the wrong side of the balance

sheet because if someone first pollutes and then another person cleans the pollution, both these activities add to GNP making environmental degradation frequently look good for the economy.

**Statement 3:** GDP includes the value of only produced goods and services, not the natural resources as such.

109. The answer is (b).

As given in the table, the growth rate of service sector has been the highest.

Growth Rate of GVA at Basic Price at Constant (2011–12) Prices (in %)

Industry	2012–13	2013–14	2014–15*	2015–16#	2016–17@	2017–18 (2 <sup>nd</sup> AE)
I. Agriculture	1.5	5.6	-0.2	0.6	6.3	3.0
II. Industry	3.3	3.8	7.0	9.8	6.8	4.8
Mining & quarrying	0.6	0.2	9.7	13.8	13.0	3.0
Manufacturing	5.5	5.0	7.9	12.8	7.9	5.1
Electricity, gas & water supply	2.7	4.2	7.2	4.7	9.2	7.3
Construction	0.3	2.7	4.3	3.7	1.3	4.3
III. Services	8.3	7.7	9.8	9.6	7.5	8.3
Trade, hotels, transport, communication & services related to broadcasting	9.8	6.5	9.4	10.3	7.2	8.3
Financial services, real estate & professional services	9.7	11.2	11.0	10.9	6.0	7.2
Public administration, defence and other services	4.3	3.8	8.3	6.1	10.7	10.1
GVA at basic price	5.4	6.1	7.2	8.1	7.1	6.4

\*: Third Revised Estimates, #: Second Revised Estimates, @: First Revised Estimates, AE: Advanced Estimate

Source: Based on the data from CSO

110. The answer is (a).

The different uses of the concept of GDP are:

- Per annum percentage change in it is the *growth rate* of an economy. For example, if a country has a GDP of ₹107 which is 7 rupees higher than last year, it has a growth rate of 7 per cent. When we use the term a *growing* economy, it means that the economy is adding up its income, i.e., in quantitative terms (does not consider qualitative aspect).
- It is used by the IMF/WB in the comparative analyses of its member nations.
- The amount of income added every year depends on the income of the previous year, if the growth rate is the same. For example, if

the income is ₹1000 and the growth rate is 10% then in the first year, the added income will be ₹100. Then the total income will be ₹1100 and the added income in the next year shall be ₹110 if the growth rate (10%) is the same.

111. The answer is (d).

**Justification: Statement 1:** The rise in GDP may be concentrated in the hands of a very few individuals or firms. For the rest, the income may in fact have fallen.

**Statement 2:** Non-monetary transactions are not taken into consideration such as domestic services women perform at home are not paid for.

**Statement 3:** Externalities such as environmental degradation, which is a negative externality are not accounted for in GDP. In this case, GDP shall be overestimating the actual welfare.

112. The answer is (c).

**Justification: Statement 1:** Rise in GDP may be concentrated in a few hands or firms. For the rest of the population, the income may in fact have fallen. Hence, it cannot be used to measure consumer welfare. In such a case, the welfare of the entire country cannot be said to have increased.

**Statement 2:** It captures spending by all groups as it accounts for all goods and services consumed in the economy. So, 2 is incorrect.

**Statement 3:** Externalities such as environmental degradation, which is a negative externality, are not accounted for in GDP.

For example, the value added to a refinery will be counted as part of the GDP of the economy. But while carrying out production, the refinery may be polluting the nearby river and causing harm to the people dependent on it. Hence, their utility will fall. So, 3 is correct.

113. The answer is (b).

**Learning:** Production, investment, and consumption decisions of individuals or firms often affect people who are not directly involved in the transactions.

But when the effects are large, they can become problematic, and these are called as externalities. Due to these externalities, governments intervene in the economic sphere.

- Pollution is a traditional example of a negative externality, where the polluter makes decisions based only on the direct cost of and profit opportunity from production and does not take into consideration, the indirect costs caused by pollution. The indirect costs include decreased quality of life, say in the case of a home owner near a smokestack, higher healthcare costs, and foregone production opportunities. For example, pollution reduces tourism opportunities.
- Since the indirect costs are not borne by the producer, the social costs of production are larger than the costs of production.
- There are also positive externalities, and here the issue is the difference between private and social gains. For example, research and development (R&D) activities are widely considered to have positive effects beyond those enjoyed by the producer that funded

the R&D—normally, the company that pays for the research.

- This is because R&D adds to the general body of knowledge, which contributes to other discoveries and developments. However, the private returns of a firm selling products based on its own R&D typically do not include the returns of others who benefited indirectly. Hence, when there are positive externalities, private returns are less than social returns.

114. The answer is (d).

**Justification:** Per capita income =  $\text{NNP at factor cost} / \text{Divided by population}$

$\text{NNP} = \text{GDP} - \text{Depreciation} + \text{Net income from abroad}$ . As these three factors vary, NNP will change. Depreciation can be logical or artificial (state dictated). Though economies fix their rates of depreciation, international bodies fix their own rates of depreciation while ranking nations on the basis of national income.

115. The answer is (c).

**Justification: Statement 1:** If money is ideally sitting in an economy and does not change hands, then it does not generate any output.

A nation that circulates money more, i.e., where money changes more hands will have greater economic activity, and where it is lesser will have lesser economic activity and lesser GDP. So, 1 is correct.

This concept is called velocity of money.

**Statement 2:** Even if circulation of money becomes the same, how much the same unity of labour produces in the two economies can be different.

A low skilled economy will not generate higher outputs, whereas a high skill base will generate more output with the same money wages. So, 2 is also correct.

116. The answer is (b).

**Justification:** If prices change, then there may be difficulties in comparing GDPs. If we measure the GDP of a country in two consecutive years and see that the figure for GDP of the latter year is twice that of the previous year, we may conclude that the volume of production of the country has doubled. But it is possible that only prices of all goods and services have doubled between the two years whereas the production has remained constant.

Therefore, in order to compare the GDP figures (and other macroeconomic variables) of different countries or to compare the GDP figures of

the same country at different points of time, we rely on real GDP and on GDP at current market prices. For comparison we take the help of real GDP. Real GDP is calculated in a way such that the goods and services are evaluated at some constant set of prices (or constant prices). Since these prices remain fixed, if the real GDP changes, we can be sure that it is the volume of production which is undergoing changes. Whereas nominal GDP is simply the value of GDP at the current market prices.

117. The answer is (d).

**Justification: Option (a):** It is not necessary that only a government running a fiscal deficit focuses on infrastructure financing. If the Indian government radically increases its tax collections, it can achieve both a surplus and spending on infrastructure.

**Option (b):** We cannot say. Moreover, the government is not spending excess money and total supply in the economy is increasing.

**Option (c):** If tax yields were low, then a situation of budget surplus may not be achieved. Even if achieved, we cannot surely conclude this is the case.

118. The answer is (a).

**Justification:** The changes in the calculation of headline growth are:

- Revision of base year of national accounts from 2004–05 to 2011–12.
- Headline growth rate will now be measured at GDP at constant market prices. Earlier it was GDP at factor cost at constant prices.
- Sector wise estimates of gross value added will now be given at basic prices instead of at factor cost.

119. The answer is (d).

**Justification:** High fiscal deficit does not impede growth necessarily in the short-run. Only if the fiscal deficit is not augmented by increased supply will it roadblock growth. Loose monetary policy gives stimulus to growth. Liberalizing the external sector gives impetus to FDI and FIIs, pushing growth in the short-run. Inflation in the economy is good is because it indicates that the demand for goods is greater than their supply. More demand will lead to more production and more GDP.

120. The answer is (d).

**Justification:** GNP is basically GDP plus NFIA.

NFIA includes imports, exports, remittances, etc. So any change in them will immediately change the GNP. Moreover, lower interest rates in the

economy encourage consumption and boost capital investment leading to a higher GDP (hence GNP) in the short-run.

121. The answer is (d).

**Justification:** GDP at market prices calculates total value of goods and services produced within a year at market prices.

If it increases, it means there is more production of goods and services in the economy.

**Statement 2:** This can happen even without an increase in actual investment, with the same machinery and labour. So, 2 isn't necessarily correct.

**Statement 1:** If the size of the economy grows proportionately larger each year, while the growth rate is positive, it may not necessarily be increasing. For example, the nation may grow at 1% all the time and have a larger GDP each year, but its growth rate has been constant. So, 1 is incorrect.

122. The answer is (c).

**Justification:** NDP of an economy must be always lower than its GDP for the same year, as depreciation can never be zero. But due to research and development activities, there is decrease in the rate of depreciation.

The different uses of the concept of NDP are:

- It is used to understand the historical situation of the loss due to depreciation and its effect on economy.
- It is used to understand and analyse the sectoral situation of depreciation and areas of focus for R&D.
- To show the achievements of the economy in the area of R&D and innovation, which have decreased the level of depreciation in the economy.

123. The answer is (a).

**Justification:** An intermediate good is a good used to produce a final good or a finished product. Intermediate goods are sold between industries for the production of final goods.

**Statement 1:** Since GDP is a measurement of the market value of final goods produced in an economy, using intermediate goods in the calculation would result in double counting, and thus the GDP figure would be inaccurate. Therefore, the value-added approach is used when calculating intermediate goods. This approach values every stage of production involved in producing a final good.

**Statement 2:** Depreciation is deducted separately. Moreover, it forms part of the calculation of NDP and not GDP.

124. The answer is (a).

**Justification:** NDP is not used in comparative economics, i.e., to compare the economies of the world as the rate of depreciation is set different in different economies. Generally, the rate of depreciation depends on the research and development activities in the economy. The rate is product or good specific.

The rates of depreciation are used by the modern governments as a tool of economic policy making also. Reduction of rate of depreciation will lead to increased sales of that good. For example, in 2000, Government of India increased the rate of depreciation of heavy vehicles from 20 to 40% to increase the sale of heavy vehicles.

125. The answer is (d).

**Justification:** GNP is the GDP of a country added with its *income from abroad*. Here, the trans-boundary economic activities of an economy are also considered.

The components in income from abroad include:

- **Trade balance:** The trade balance (total exports and imports) of a country may be positive or negative, which is accordingly added to the GDP. If the service sector exports increase, then it will change the trade balance in favour of India.
- **Interest on external loans:** The net outcome on the front of the interest payments, i.e., balance of the inflow and the outflow (on the money lend or borrowed respectively) of the external interests. In India's case, it has been negative as the economy has been a *net borrower* from the world economies.
- **Private remittances:** The net flow of money i.e., inflows and outflows on account of the private transfers made by the Indian nationals working outside the country (to India) and the foreign nationals working in India (to their home countries).

126. The answer is (d).

**Justification:** The different uses of the concept of GNP are:

- IMF uses GNP to rank the nations of the world at the PPP.
- GNP indicates both quantitative as well as qualitative aspects and considers external aspects also such as trade balance, interest on external loans, and private remittances. It shows the financial dependence of an economy over another economy. It shows both internal as well as external strength of the economy.

- It enables us to learn several facts about the production subsidies and pattern of an economy, such as, how much the outside world is dependent on its product and how much it depends on the world for the same (numerically shown by the size and net flow of its *trade balance*); what is the standard of its human resource in international economy, the financial support from and to the world economies (shown in terms of net flow of *interests* on external lending/borrowing).

127. The answer is (b).

**Justification:** The different uses of the concept of NNP are:

- This is the *national income* (NI) of an economy. Even the GDP, NDP, and GNP are *national income*, but they are not written with capitalized *N* and *I*. This is the purest form of the income of a nation.
- When we divide NNP by the total population of the nation we get the *per capita income* (PCI) of that nation, i.e., *income per head per year*. A very basic point should be noted here that this is the point where the rates of depreciation followed by different nations make a difference. Higher the rates of depreciation, lower the PCI of the nation (whatever be the reason for it—logical or artificial as in the case of depreciation being used as a tool of policymaking). Though, economies are free to fix any rate of depreciation for different assets, the rates fixed by them make difference when the NI of the nations is compared by international financial institutions such as the IMF, WB, and ADB.
- NNP considers both internal and external aspects. External aspects is income from abroad.

128. The answer is (a).

**Justification:** The indirect taxes and various subsidies which are given by the governments need to be adjusted while calculating national income. They are added to the national income when calculated based on market cost.

The national income at factor cost can be derived if subsidies are added to national income at market cost. This is because the addition of the subsidies to the prices of goods and services distorts the real value of those goods and services.

Thus, the formula will be:

National income at factor cost = NNP at market cost + Subsidies

Putting indirect taxes and the subsidies both together, NI will be derived with the following formula.

National income at factor cost = NNP at market cost – Indirect taxes + Subsidies

129. The answer is (a).

**Learning:**  $GNP \equiv GDP + \text{Net income from abroad}$ .

If we discount (reduce) depreciation from GNP, the measure of aggregate income that we obtain is called net national product (NNP).

130. The answer is (d).

**Justification:**  $NNP \equiv GNP - \text{Depreciation}$ . It is to be noted that all these variables are evaluated at market prices. Through the expression given above, we get the value of NNP evaluated at market prices. But market price includes indirect taxes, which must be deducted from NNP evaluated at market prices in order to calculate NNP at factor cost. There are subsidies granted by the government on the prices of some commodities. So, we need to add subsidies to the NNP evaluated at market prices to get NNP at factor cost.

$NNP \text{ at factor cost} \equiv NNP \text{ at market prices} - (\text{Indirect taxes} - \text{Subsidies}) \equiv NNP \text{ at market prices} - \text{Net indirect taxes}$

(where Net indirect taxes  $\equiv$  Indirect taxes – Subsidies)

131. The answer is (c).

**Justification:** Net foreign factor income is the difference between the aggregate amount that a country's companies and its citizens earn abroad, and the aggregate amount that foreign companies and foreign citizens earn in that country.

The NFIA level is generally not substantial in most nations, since factor payments earned by their citizens and those paid to foreigners offset each other.

**Statement 1:** If gulf workers send more remittances, India's NFIA will rise. This is because labour is a *factor* of production which has been deployed in a foreign nation.

**Statement 2:** Capital (machinery, investment) is another factor of production. The income coming from this factor becomes a part of NFIA, if either foreign investors invest in India or Indian investors invest abroad.

132. The answer is (d).

**Learning:** The incomes received by the owners of the production for rendering their factor services to the producers are factor income or factor cost.

It is a measure of national income based on output, that is on the cost of factors of production.

In this method, we can remove the effect of any subsidy or indirect tax on final measure.

133. The answer is (d).

**Learning:** The measure of monetary value of the flow of output of goods and services produced in an economy over a period is national income.

There is an income method that is used to estimate the national income.

In income method, incomes that come from the production of goods and services are included in the calculation of GDP.

It is basically Rent + Wages + Profits + Interest (earned on capital goods) – Payments made to resources used in the production process. These correspond to four factors land, labour, entrepreneurship, and capital goods respectively.

134. The answer is (a).

**Justification: Statement 1:** Suppose an economy produces only cars.

If the price of a car this year is ₹1,000, and 2 cars were produced, then the GDP this year is ₹2,000.

Next year if prices increase to ₹3,000 and still 2 cars are produced, GDP will be ₹6,000 without an actual increase in production, thanks to inflation of 200%.

So, when inflation is adjusted in nominal GDP, we get real GDP which shows how much production (without the influence of prices) has actually grown.

**Statement 2:** GDP means an estimate of both goods and services, so 2 is wrong.

135. The answer is (b).

**Justification:** GDP grows when the present market value of this year's produce is more than that of last year.

But growth in total market value can also be because of high inflation and no rise in production. So, real GDP indicator is used to determine whether there has been an actual growth in production or not.

At a constant base price (2011–12—base year) in India, increase in total value is calculated. So, real GDP will only increase if there has been even a slight growth in production irrespective of inflation or deflation in the economy.

136. The answer is (a).

**Justification:** National disposable income = NNP at market prices + Other transfers from rest of the world.

Where transfers from the government are part of private income and not national disposable income.

Private income = Factor income from NDP accruing to the private sector + National debt interest + Current transfers from government + Net factor income from abroad + Other net transfers from rest of the world.

137. The answer is (a).

**Learning:** The total domestic and foreign output claimed by residents of a country, consisting of GDP plus factor incomes earned by foreign residents, minus income earned in the domestic economy by non-resident, is gross national income (GNI).

GNI measures income received by a country from both domestic and overseas sources. GNI is similar to GNP, which measures output from the citizens and companies of a particular nation, regardless of whether they are located within its boundaries or outside.

GNI has gradually replaced GNP in international statistics as they are conceptually identical, but calculated differently.

138. The answer is (a).

**Justification:** A part of the capital goods produced every year goes for replacement of existing capital goods and is not an addition to the stock of capital goods already existing. Its value needs to be subtracted from gross investment for arriving at the measure for net investment. Depreciation is the deletion made from the value of gross investment in order to accommodate regular wear and tear of capital goods.

Net investment or new capital formation of an economy is measured as:

Net investment = Gross investment – Depreciation

So higher the depreciation, lower the net investment will be. Depreciation is thus an annual allowance for wear and tear of a capital good. But it is NOT related only to the wear and tear of a capital good.

Depreciation does not consider sudden or unexpected destruction or disuse of capital, which can happen due to accidents, natural calamities or any other extraneous circumstances. We are

making a rather simple assumption here that there is a constant rate of depreciation based on the original value of the asset. There can be other methods to calculate depreciation

139. The answer is (b).

**Justification:** Net domestic product = Gross domestic product – Depreciation.

Basically, NDP is GDP minus the total value of the *wear and tear*, i.e., depreciation.

So, if the depreciation levels are low, it indicates the level of research and development activities and its achievement. These activities cut depreciation rates. So if the technology is advanced, then the difference between NDP and GDP will be very less.

140. The answer is (d).

**Justification:** Apart from the product method (also called value added method), there are two other ways of GDP calculation.

- **Income Method:** Under this method, national income is measured as a flow of factor incomes such as wages of labour, interest for capital, rent on land, and profit on entrepreneurship. The sum total of all these factor incomes (wages, interest, rent, and profit) is called NDP at factor costs.
- **Expenditure method:** In this method, national income is measured as a flow of expenditure which can be both private and government expenditure. GDP is the sum total of government consumption expenditure, private consumption expenditure, gross capital formation (private and government), and net exports (import and export).

141. The answer is (d).

**Justification:** CSO is responsible for coordination of statistical activities in the country, which include:

- National income accounting
- Conduct of annual survey of industries
- Economic censuses
- Compilation of index of industrial production
- Consumer price indices

The data is compiled by various central and state ministries, independent departments, and other governmental organizations and is provided to CSO for statistical purposes.

142. The answer is (a).

**Justification:** Option (a) is also the financial year of India. Since the annual budget is also pre-

pared, presented, approved, and passed during the starting of this period, it is appropriate to calculate GDP in that period.

143. The answer is (c).

**Justification:** Intermediary goods are used to make final goods. If the value of intermediary goods is counted along with final goods, it will be double counting. And only those goods and services, which are produced in the territory of the country are included in the calculation of GDP.

144. The answer is (a).

**Learning:** In the product method, the sum total of market value of all FINAL goods and services produced within an economy in a financial year in the GDP.

- The value added for a good is the difference between the final good and the value of intermediary inputs used at each stage of production. When the value added by all goods and services is added up, it gives us the final GDP.
- Gross value added adjusted for depreciation, and indirect taxes (and subsidies) becomes the net domestic product at factor cost.
- Value added estimate is useful to track sectoral growth trends in the economy, i.e., whether agriculture is contributing more to growth or if industry is doing so.

145. The answer is (d).

**Justification:** GDP is the value of all the final goods and services produced within a country within a financial year.

Option (c) is wrong, since consumption also includes imports from abroad, and all residents are not citizens. Moreover, consumption expenditure is only one component of GDP.

Option (b) is wrong, since Indian nationals living abroad do not contribute to India's GDP. They do however, contribute to India's GNP.

Option (a) is wrong as investment is just one component of GDP.

146. The answer is (b).

**Justification:** Economies across the world are currently divided into four income groupings which are low, lower-middle, upper-middle, and high. This categorization is based on GNI per capita (in US dollars, converted from local currency using the Atlas method).

The World Bank data shows that India's gross national income per person rose to \$1,670 in 2016 and it would take India more than a decade to rise from its current *lower middle income* category to the *upper middle income* level.

As of July 1, 2017, the new thresholds for classification by income are:

Threshold	GNI/Capita (current US\$)
Low-income	< 1,005
Lower-middle income	1,006 – 3,955
Upper-middle income	3,956 – 12,235
High-income	> 12,235