

Question Paper

Economics (CFA520): January 2009

- Answer all 81 questions.
- Marks are indicated against each question.

Total Marks : 100

[<Answer>](#)

1. Refer to the following table:

Price per Kg. (Rs.)	Quantity Demanded (Kg.)	Quantity Supplied (Kg.)
2.80	1,000	7,000
2.50	2,000	6,000
2.20	3,000	5,000
1.90	4,000	4,000
1.60	5,000	3,000

Using the numbers in this table, which of the following is **true**?

- (a) If the price is Rs.2.20, there would be a shortage of 2,000 Kg.
 - (b) If the price is Rs.1.60, there would be a surplus of 2,000 Kg.
 - (c) If the price is Rs.2.80, there would be a shortage of 6,000 Kg.
 - (d) If the price is Rs.2.50, there would be a shortage of 4,000 Kg.
 - (e) The equilibrium price is Rs.1.90.
2. A book publishing company has found that the demand for its fiction book is given by the following equation:

$$Q_f = 20,000 - 500P_a + 5I + 500P_t$$

Where Q_f = Quantity demanded of fiction books,
 P_a = Price of fiction book,
 I = Income,
 P_t = Price of textbook.

Given the price of fiction book as Rs.10, income as Rs.10,000 and price of textbook as Rs.20, find the quantity of fiction books demanded ?

- (a) 50,000 units
 - (b) 60,000 units
 - (c) 65,000 units
 - (d) 75,000 units
 - (e) 70,000 units.
3. A decrease in supply, accompanied by a decrease in demand
- (a) Reduces the equilibrium quantity, but price may either increase or decrease or remain the same
 - (b) Reduces the equilibrium price, but quantity may either increase or decrease or remain the same
 - (c) Definitely reduces both the equilibrium price and quantity
 - (d) Definitely increases both the equilibrium price and quantity
 - (e) Increases the equilibrium quantity, but price remains the same.
4. A substantial rise in the production of door bell would tend to
- (a) Raise the price of door bells
 - (b) Lower the price of door bells
 - (c) Leave the price of door bells unchanged
 - (d) Raise or lower the price of door bells depending on the magnitude of the change in the demand of substitute goods
 - (e) Increase the cost of production of door bells.

(1 mark)

[<Answer>](#)

(1 mark)

[<Answer>](#)

(1 mark)

[<Answer>](#)

(1 mark)

[<Answer>](#)

5. Ceteris Paribus, an increase in equilibrium rental prices of new apartments in Hyderabad city indicates that there is

- (a) An increase in the supply of new apartments coupled with an increase in demand for new apartments
- (b) Cost of construction is becoming cheaper in city
- (c) A fall in the rate of interest on housing loans in the city
- (d) An increase in construction of new apartments in the city
- (e) A fall in the income of the buyers.

(1 mark)

[<Answer>](#)

6. For a product, industry demand and supply functions are estimated to be

$$Q_d = 500 - 10P$$

$$Q_s = 300 + 10P$$

If government puts a price ceiling of Rs.9 for the product

- (a) Equilibrium output for the industry is 410
- (b) Equilibrium output for the industry is 400
- (c) Equilibrium output for the industry is 390
- (d) There will be excess supply in the industry
- (e) There will be shortage of supply in the industry.

(1 mark)

[<Answer>](#)

7. When the value of elasticity of supply is less than one but greater than zero, it is known as

- (a) Perfectly elastic supply
- (b) Relatively elastic supply
- (c) Unitary elastic supply
- (d) Perfectly inelastic supply
- (e) Relatively inelastic supply.

(1 mark)

[<Answer>](#)

8. The demand function of a product is estimated to be

$$Q_X = 40,000 - 3P_X + 2P_Y + 40A_X - 20A_Y$$

Where	Q_X	=	Sales in units of brand X
	P_X	=	Price of brand X = Rs.5,000
	P_Y	=	Price of brand Y = Rs.5,500
	A_X	=	Number of advertising messages for brand X
	A_Y	=	Number of advertising messages for brand Y

The manufacturer of brand X decides to increase the advertising messages from the current level of 375 to 500 units. With the increase in number of messages for brand X, it is expected that the number of messages for brand Y will also increase by the same number. Current advertising for Y is 500 messages. If per unit cost of production of brand X is Rs.2,000 and cost of an advertising message is Rs.200, how will the advertising with regard to brand X affect the profits?

Note: The unit cost and the price remain same.

- (a) Profits increase by Rs.64,75,000
- (b) Profits increase by Rs.74,75,000
- (c) Profits increase by Rs.84,75,000
- (d) Profits increase by Rs.94,75,000
- (e) Manufacturer incurs a loss.

(2marks)

[<Answer>](#)

9. The equilibrium price of commodity X is Rs.10 per unit. At this price 200 units of the commodity is supplied and demanded. Suppose there is shift in supply and demand schedules and quantity supplied and demanded increases to 400 units. The new equilibrium price will be

- (a) Rs. 40.00
- (b) Rs. 20.00
- (c) Rs. 10.00
- (d) Rs. 2.00
- (e) Rs. 5.00.

(1 mark)

[<Answer>](#)

10. The supply and demand function for a product is as follows:

$$Q_d = 6,000 - 3P$$
$$Q_s = 3,000 + 4.5P$$

The Government imposes a sales tax of Rs.20 per unit. The proportion of tax that is borne by the producer is

- (a) 80%
- (b) 70%
- (c) 60%
- (d) 50%
- (e) 40%.

(2marks)

[<Answer>](#)

11. In which of the following situation(s) is the entire tax borne by the consumer?

- I. If the demand curve is perfectly inelastic, the price rises by the full amount of the tax and the supply remains unchanged.
- II. If the supply curve is perfectly inelastic, there will be no increase in the price or decrease in supply.
- III. If the demand curve is perfectly elastic, the price does not rise at all.

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

(1 mark)

[<Answer>](#)

12. You can buy any amount of rice at Rs.15 per kg in the local market. The demand curve for rice is

- (a) Vertical
- (b) Downward sloping
- (c) Horizontal
- (d) Upward sloping
- (e) Data insufficient.

(1 mark)

[<Answer>](#)

13. A 25% increase in income caused a selection of Indian consumers to increase their purchase of cars from 500 to 525 units. The possible income elasticity of demand for cars for this group will be

- (a) 0.20
- (b) 0.40
- (c) 2.50
- (d) 5.00
- (e) 20.00.

(1 mark)

[<Answer>](#)

14. Assume that a 20% increase in the price of normal good Y causes a 10% decline in the quantity demanded of normal good X. The coefficient of cross elasticity of demand will be

- (a) Negative and therefore these goods are substitutes
- (b) Negative and therefore these goods are complements
- (c) Negative and therefore these goods are independent
- (d) Positive and therefore these goods are substitutes
- (e) Positive and therefore these goods are complements.

(1 mark)

[<Answer>](#)

15. Consider two points A and B on a linear demand curve. The price and quantity demanded associated with the two points are given below:

Point	Price (Rs.)	Quantity Demanded
A	8.50	2000
B	10.00	1500

The absolute value of arc price elasticity of demand for an increase in price from Rs.8.50 to Rs.10.00 is

- (a) 1.33
- (b) 0.85
- (c) 1.13
- (d) 1.76
- (e) 0.71.

(2marks)

[<Answer>](#)

16. For a product the absolute value of the price elasticity of demand is estimated to be 3. If marginal revenue is Rs.5, what is the price of the product?

- (a) Rs.2.75
- (b) Rs.4.75
- (c) Rs.5.00
- (d) Rs.6.00
- (e) Rs.7.50.

(1 mark)

[<Answer>](#)

17. The demand and supply functions for pulses are $Q_d = 15 - P$ and $Q_s = 4 + P$ respectively. The Government announces a support price of Rs.6 per Kg of pulses and would like to release pulses to the market only through Food Corporation of India (FCI). Accordingly FCI procures the pulses and off loads the same at a price that clears the procured stock. Assuming support price equals to procurement cost, the loss to FCI is

- (a) Rs. 6
- (b) Rs. 7
- (c) Rs. 8
- (d) Rs. 9
- (e) Rs.10.

(2marks)

[<Answer>](#)

18. A consumer can maximize his total utility if he allocates his money income so that

- (a) Marginal utility of each product consumed is equal
- (b) Gain in marginal utility from the last rupee spent on each product purchased is the same
- (c) Elasticity of demand is the same for all the products purchased
- (d) Total utility gained from each product consumed is the same
- (e) Marginal utility of each product consumed is zero.

(1 mark)

[<Answer>](#)

19. A consumer consumes three units of a product. Assume that utility can be measured in terms of money, marginal utilities derived from the three units are Rs.200, Rs.175 and Rs.150 respectively. If the price of the good is Rs.100 per unit, the consumer surplus is

- (a) Rs. 50
- (b) Rs. 75
- (c) Rs.100
- (d) Rs.225
- (e) Rs.525.

(1 mark)

[<Answer>](#)

20. A consumer is indifferent between the combinations A and B.

Combination	Good X	Good Y
A	10	14
B	12	13

Absolute value of marginal rate of substitution (MRS_{XY}) for the consumer is

- (a) 0.50
- (b) 1.00
- (c) 1.50
- (d) 2.00
- (e) 2.33.

(1 mark)

[<Answer>](#)

21. Assuming the consumer is in equilibrium consuming commodities X and Y. If marginal utility of commodity X is 175, price of the commodity X is Rs.25, and the price of commodity Y is Rs.40, the marginal utility of Y is

- (a) 175 utils
- (b) 225 utils
- (c) 280 utils
- (d) 320 utils
- (e) 350 utils.

(1 mark)

[<Answer>](#)

22. For a consumer, marginal utilities of two goods consumed, A and B, are

$$\begin{aligned} MU_A &= 25 - X \\ MU_B &= 24 - 2Y \end{aligned}$$

Where, X is the amount spent on Product A, and Y is the amount spent on B. Assume that the consumer has only Rs.100 to spend on both products A and B.

How is the amount best allocated between A and B, if the price of B is half the price of A?

- (a) X = Rs.65.0, Y = Rs.35.0
- (b) X = Rs.35.0, Y = Rs.65.0
- (c) X = Rs.50.0, Y = Rs.50.0
- (d) X = Rs.24.6, Y = Rs.75.4
- (e) X = Rs.75.4, Y = Rs.24.6.

(2marks)

[<Answer>](#)

23. In the figure below, assume that the consumer is initially in an optimum position at point A. If price of good X falls, the substitution effect of the price change is represented by a movement from:

- (a) Point A to point B
- (b) Point B to point A
- (c) Point A to point C
- (d) Point B to point C
- (e) Point C to point B.

(1 mark)

[<Answer>](#)

24. In which of the following demand functions are the goods X and Y substitutes?

- I. $Q_x = 1000 - 2.5P_x + 5P_y$.
- II. $Q_x = 250 - 0.5P_x - 0.5P_y$.
- III. $Q_x = 150 - 3P_x - P_y$.
- IV. $Q_x = 300 - P_x - P_y$.
- (a) Only (I) above
- (b) Only (IV) above
- (c) Both (I) and (IV) above
- (d) Both (II) and (III) above
- (e) (II), (III) and (IV) above.

(1 mark)

[<Answer>](#)

25. Marginal utility (MU) function of Mr. Venkat for product A is given as

$$MU_A = 200 - 10Q_A$$

If price of product A is Rs.20 per unit, at equilibrium, quantity demanded by Mr. Venkat is

- (a) 10 units
- (b) 18 units
- (c) 20 units
- (d) 200 units
- (e) 400 units.

(1 mark)

26. Refer to the diagram below:

The original price line is given as P_1L_1 . Prices of X and income remaining the same, if the price of Y decreases, the new price line will be

- (a) P_1L_2
- (b) P_1L_3
- (c) P_2L_1
- (d) P_3L_1
- (e) Same as earlier i.e. P_1L_1 .

(1 mark)

[<Answer>](#)

27. The income-consumption curve depicts the income effect as the consumer's income changes, when

- (a) Relative prices for the two commodities remain constant
- (b) Price of one commodity remains constant and that of another changes
- (c) Prices of both the commodities remain constant
- (d) Quantity of one commodity remains constant and that of another changes
- (e) Quantities of both the commodities remain constant.

(1 mark)

[<Answer>](#)

28. The law of equi-marginal utility explains that

- (a) Marginal utilities of commodity X and Y are zero
- (b) Marginal utilities of commodity X and Y are equal to me
- (c) Marginal utilities of per rupee spent on commodities X and Y are equal
- (d) Marginal utilities of commodity X and Y are negative
- (e) Marginal utilities of commodity X and Y are positive.

(1 mark)

[<Answer>](#)

29. A cloth merchant, who supplies cotton cloth in both Andhra Pradesh and Tamil Nadu, has the following demand functions:

$$\begin{array}{ll} \text{Andhra Pradesh} & : \quad P_A = 600 - Q_A \\ \text{Tamil Nadu} & : \quad P_T = 400 - Q_T \end{array}$$

$$\frac{15,000}{Q}$$

The average cost function of the merchant is estimated to be $AC = \frac{15,000}{Q} + 100$.

If price discrimination is illegal, what is the profit maximizing price of the cloth merchant?

- (a) Rs.180
- (b) Rs.250
- (c) Rs.275
- (d) Rs.300
- (e) Rs.400.

(2marks)

30. A company is operating in a monopolistically competitive market in the short run. The current demand function for the firm is estimated to be $Q = 20,000 - 2,000P$. If the fixed cost of the firm is Rs.10,000. Average variable cost is constant at Rs. 5, The is maximum possible profit for the firm is [<Answer>](#)
- (a) Rs.1,000
 (b) Rs.1,500
 (c) Rs.2,000
 (d) Rs.2,500
 (e) Rs.3,000. (2marks)
31. A company sells 1,000 units of its product at a price of Rs.750 per unit. It incurs Rs.1,50,000 as its fixed cost and Rs.3,50,000 as its total variable cost which is constant. The profits earned by the firm is [<Answer>](#)
- (a) Rs.2,25,000
 (b) Rs.2,50,000
 (c) Rs.2,75,000
 (d) Rs.3,00,000
 (e) Rs.3,25,000. (1 mark)
32. A firm faces the following average variable cost function [<Answer>](#)
- $$AVC = 300 - 10Q + 0.5Q^2$$
- Fixed costs are Rs.150. What is the minimum possible marginal cost?
- (a) Rs.243.67
 (b) Rs.223.67
 (c) Rs.237.33
 (d) Rs.233.33
 (e) Rs.203.33. (1 mark)
33. A firm having a kinked demand curve indicates that [<Answer>](#)
- I. If the firm reduces the price, competitive firms also reduce the price.
 II. If the firm increases the price, competitive firms also increase the price.
 III. If the firm reduces the price, competitive firms do not reduce the price.
 IV. If the firm increases the price, competitive firms do not increase the price.
- (a) Only (I) above
 (b) Both (I) and (II) above
 (c) Both (II) and (III) above
 (d) Both (I) and (IV) above
 (e) Both (II) and (IV) above. (1 mark)
34. A monopolist is said to be in equilibrium where the elasticity of his average revenue curve is [<Answer>](#)
- (a) Greater than one
 (b) Equal to one
 (c) Less than one
 (d) Zero
 (e) Infinity. (1 mark)
35. A perfectly competitive firm can increase its sales revenue by [<Answer>](#)
- (a) Reducing the price
 (b) Increasing the price
 (c) Increasing the production
 (d) Increasing the expenditure on advertising
 (e) Increasing the sales force. (1 mark)
36. A toy-manufacturing firm in a competitive market has a horizontal demand curve. The total cost of the firm $TC = 500 + 150Q - 20Q^2 + Q^3$. Below what price should the firm shut down? [<Answer>](#)
- (a) Rs.40
 (b) Rs.50
 (c) Rs.60
 (d) Rs.70
 (e) Rs.80. (2marks)

[<Answer>](#)

37. Absence of supply curve is the characteristic feature of

- (a) Perfect competition
- (b) Monopoly
- (c) Monopolistic competition
- (d) Duopoly
- (e) Oligopoly.

(1 mark)

[<Answer>](#)

38. Ampler Ltd. is facing a downward sloping demand curve. What would be the first order condition of profit maximization for the firm in the short-run?

- (a) $MR = MC$
- (b) $P = MC$
- (c) $MR = AC$
- (d) $MR = TC$
- (e) $MR = TR$.

(1 mark)

[<Answer>](#)

39. An implicit cost can be defined as the

- (a) Payment to the non-owners of the firm for the resources they supply
- (b) Money payment which the self-employed resources could have earned in their best alternative uses
- (c) Costs which the firm incurs but does not disclose
- (d) Costs which do not change over a period of time
- (e) Costs depending on output.

(1 mark)

[<Answer>](#)

40. Consider the following Total Cost function

$$TC = 1000 + 200Q - 9Q^2 + 0.25Q^3$$

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

- (a) The average variable cost function is $\frac{1000}{Q} + 200 - 9Q + 0.25Q^2$
- (b) Fixed cost is Rs.1,000
- (c) Marginal cost function is $200 - 9Q + 0.25Q^2$
- (d) Marginal cost is zero when $Q = 4$
- (e) Average variable $200Q - 9Q^2 + 0.25Q^3$.

(1 mark)

[<Answer>](#)

41.

Production Account			
Dr.			Cr.
Particulars	Rs. in Crore	Particulars	Rs. in Crore
Wages paid to domestic residents	400	Sales to Households	550
Wages paid to foreigners	240	Gross Fixed Investment	85
Interest payments on loans taken from foreign banks	10	Changes in stock	5
Retained profits	20	Exports	90
Corporate tax	10		
Imports	25		
Indirect taxes	15		
Depreciation	10		
	730		730

Assume that there is no government sector in the economy. For the economy, NDP at market prices is

- (a) Rs.650 cr
- (b) Rs.670 cr
- (c) Rs.695 cr
- (d) Rs.640 cr
- (e) Rs.630 cr.

(2marks)

[<Answer>](#)

42. A car produced in 2007 is held in inventory until it is sold in the year 2008. In which year the value of the car will be considered for computing GDP?

- (a) 2007
- (b) 2008
- (c) Both in 2007 & 2008
- (d) Half the value in 2007 and half the value in 2008
- (e) Depends on the accounting policies adopted by the company.

(1 mark)

[<Answer>](#)

43. A motor car purchased by Mr. Anil, owner of a motor car driving school, for his personal use, is considered to be

- (a) Planned investment
- (b) Consumption
- (c) Unplanned investment
- (d) Capital
- (e) Production.

(1 mark)

[<Answer>](#)

44. Consider the following data:

Particulars	MUC
Factor income paid abroad by the business sector	10
Factor income received by household sector	160
Transfers to household sector	20
Wages and salaries paid by the business sector	100
Dividends paid by the business sector (of which 10 MUC is paid abroad)	20
Household savings	60
Factor income received from abroad by the household sector	20

The amount paid by the government to the households towards wages and salaries is

- (a) 10 MUC
- (b) 20 MUC
- (c) 30 MUC
- (d) 40 MUC
- (e) 50 MUC.

(2marks)

[<Answer>](#)

45. Consider the following information:

Particulars	Rs. in Crore
NDP at market prices	77,000
Net factor income from abroad	-700
Depreciation	1,700
Subsidies	6,700
Indirect Taxes	7,700

What is the NDP at factor cost?

- (a) Rs.76,000 Cr
- (b) Rs.78,000 Cr
- (c) Rs.77,700 Cr
- (d) Rs.79,700 Cr
- (e) Rs.77,000 Cr.

(1 mark)

46. Dividends and corporate taxes are part of

[<Answer>](#)

- I. Corporate profits.
- II. National income.
- III. Personal income.
- IV. Personal disposable income.

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

(1 mark)

[<Answer>](#)

47. GDP at factor cost exceeds GDP at market price

- (a) When the net factor income from abroad is negative
- (b) When the net factor income from abroad is positive
- (c) When depreciation of fixed capital exceeds gross investment
- (d) When direct taxes exceed indirect taxes
- (e) When subsidies exceed indirect taxes.

(1 mark)

[<Answer>](#)

48. Gross Domestic Capital formation consists of

- I. Making good the depreciation on existing fixed assets.
- II. Adding to the stock of fixed assets.
- III. Adding to Inventories.

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

(1 mark)

[<Answer>](#)

49. If Mr. X buys a National Small Savings Certificate, which of the following is likely to happen?

- (a) Increase in Government market borrowings
- (b) Increase in the other liabilities of the Government
- (c) Increase in forex reserves
- (d) Increase in Government revenue
- (e) Decrease in Government liability.

(1 mark)

[<Answer>](#)

50. Inter-industry transactions table for an economy is given as follows:

MUC					
Industry	A	B	C	Sales to Household	Total output
A	100	160	60	80	400
B	40	120	100	220	480
C	60	80	120	60	320

Total value added in the country is

- (a) 320 MUC
- (b) 360 MUC
- (c) 400 MUC
- (d) 480 MUC
- (e) 1,200 MUC.

(2marks)

[<Answer>](#)

51. Assume that the GDP of country dreamland is 5,000 MUC and the population is 1 million. For the next year if the economy grows at 8% and the population grows at 1%, what is the growth rate in per capita income?

- (a) 1.93%
- (b) 6.93%
- (c) 7.73%
- (d) 8.23%
- (e) 9.13%.

(1 mark)

52. Economic growth is defined as the expansion of the economy's [<Answer>](#)
- (a) Output
 - (b) Demand
 - (c) Investment
 - (d) Savings
 - (e) Consumption.
- (1 mark)
53. In a hypothetical economy, population is expected to grow at 1.5% p.a. Planners fix a target of per capita GDP growth of 4.5% p.a. If the capital output ratio is 5:1 assuming no depreciation, what should be the rate of investment as a percentage of GDP? [<Answer>](#)
- (a) 7.5%
 - (b) 15.0%
 - (c) 22.5%
 - (d) 30.0%
 - (e) 36.0%.
- (2marks)
54. Which of the following can lead to decrease in Incremental Capital Output Ratio (ICOR)? [<Answer>](#)
- (a) Low managerial efficiency of capital
 - (b) Complicated production procedures
 - (c) Existing capital is less productive
 - (d) Inadequate delegation of powers
 - (e) Improvement in productivity of labor.
- (1 mark)
55. Imperfect information about the labor market leads to [<Answer>](#)
- (a) Structural unemployment
 - (b) Cyclical unemployment
 - (c) Frictional unemployment
 - (d) Disguised unemployment
 - (e) Natural unemployment.
- (1 mark)
56. In the period of recession, employment _____ and aggregate production _____ [<Answer>](#)
- (a) Increases, increases
 - (b) Decreases, decreases
 - (c) Increases, decreases
 - (d) Decreases, increases
 - (e) Remains constant, remains constant.
- (1 mark)
57. Which part of real GDP fluctuates most over the course of the business cycle? [<Answer>](#)
- (a) Consumption
 - (b) Government expenditures
 - (c) Investment
 - (d) Exports
 - (e) Imports.
- (1 mark)
58. A lower interest rate leads to higher investment spending because [<Answer>](#)
- (a) Higher interest rates lower the appropriately discounted return and make more investment projects profitable
 - (b) Lower interest rates lower the appropriately discounted return and make more investment projects profitable
 - (c) Higher interest rates increase the appropriately discounted return and make fewer investment projects profitable
 - (d) Lower interest rates increase the appropriately discounted return and make more investment projects profitable
 - (e) Lower interest rates decrease the appropriately discounted return and make more investment projects unprofitable.
- (1 mark)

59. Acceleration coefficient in an economy is 2. Investment in a period is equal to 75% of the difference between the desired capital stock and the existing capital stock. If income in period 't' is expected to increase by 200 MUC, investment during the period 't' will be [<Answer>](#)
- 200 MUC
 - 300 MUC
 - 400 MUC
 - 500 MUC
 - 600 MUC.
- (1 mark)
60. According to Keynes, the actual expenditure in an economy can differ from the planned expenditure. Which of the following is **true** if the actual expenditure is less than the planned expenditure in the economy? [<Answer>](#)
- There will be positive fixed investment in the economy
 - There will be negative fixed investment in the economy
 - There will be positive inventory investment in the economy
 - There will be negative inventory investment in the economy
 - There will be no change in inventory investment in the economy.
- (1 mark)
61. As the MPC gets close to 1, the value of the multiplier approaches [<Answer>](#)
- 0
 - 1
 - ∞
 - 1
 - 0.5.
- (1 mark)
62. Assume that for Mr. X, MPC and MPS are equal. If his income increases by Rs.1,000, the amount of increased income to be saved by him is [<Answer>](#)
- Rs.400
 - Rs.500
 - Rs.600
 - Rs.550
 - Rs.450.
- (1 mark)
63. Assume that the MPC is 0.75. Assume that there is a multiplier effect and the total crowding-out effect is Rs.6 billion. An increase in government purchases of Rs.10 billion results in a net [<Answer>](#)
- Decrease in aggregate demand by Rs.24 billion
 - Decrease in aggregate demand by Rs.36 billion
 - Increase in aggregate demand by Rs.34 billion
 - Increase in aggregate demand by Rs.36 billion
 - Decrease in aggregate demand by Rs.12 billion.
- (2marks)
64. At a level of income of Rs.20,000, the entire income is consumed. Given that the Marginal propensity to consume is 0.7, the autonomous consumption is [<Answer>](#)
- Rs.4,900
 - Rs.5,000
 - Rs.6,000
 - Rs.7,000
 - Rs.8,000.
- (1 mark)
65. Consider a three sector economy consisting of firms, government and households. Which of the following statement is **true** at equilibrium? [<Answer>](#)
- Savings of the households is equal to taxes collected by the government
 - Gross investment plus expenditure of the government is equal to depreciation plus household savings
 - Savings of the households is not equal to net investment of the firms
 - Household savings minus taxes plus depreciation equals gross investment plus government spending
 - Household savings plus taxes equals net investment plus government spending.
- (1 mark)

[<Answer>](#)

66. Consider the following information for a country called 'Dream Land':

Autonomous consumption	:	100 MUC
Marginal propensity to consume	:	0.75
Planned investment	:	50 MUC
Government purchases	:	150 MUC
Net Exports	:	20 MUC

The equilibrium level of output for 'Dream Land' is

- (a) 80 MUC
- (b) 183 MUC
- (c) 427 MUC
- (d) 880 MUC
- (e) 1,280 MUC.

(2marks)

[<Answer>](#)

67. Which of the following **does not** affect the balance sheet of Reserve Bank of India?

- (a) Central government's borrowings from RBI
- (b) Loan taken by one commercial bank from the other commercial banks
- (c) Refinancing of NABARD loans
- (d) Increase in reserves of commercial banks
- (e) Increase in net foreign exchange assets.

(1 mark)

[<Answer>](#)

68. In the short run, if the price level falls, the real wage rate will be

- (a) Less than the equilibrium real wage rate and employment will fall
- (b) Less than the equilibrium real wage rate and employment will rise
- (c) Higher than the equilibrium real wage and employment will fall
- (d) Higher than the equilibrium real wage rate and employment will rise
- (e) Equal to the equilibrium real wage rate and employment will stay constant.

(1 mark)

[<Answer>](#)

69. The aggregate demand curve shows that an increase in the

- (a) Money supply causes the aggregate quantity of goods and services demanded to increase
- (b) Money supply causes the aggregate quantity of goods and services demanded to decrease
- (c) Price level causes the aggregate quantity of goods and services demanded to increase
- (d) Price level causes the aggregate quantity of goods and services demanded to decrease
- (e) Price level causes the aggregate quantity of goods and services demanded to remain constant.

(1 mark)

[<Answer>](#)

70. Which of the following is **not** one of the basic Postulates of the Keynesian Model?

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

(1 mark)

[<Answer>](#)

71. "Crowding out" occurs when government purchases is followed by

- (a) Increase in interest rate
- (b) Increase in investment
- (c) Increase in public savings
- (d) Increase in national savings
- (e) Increase in taxes.

(1 mark)

[<Answer>](#)

72. A contractionary fiscal policy combined with a tight monetary policy results in

- I. A lower level of output.
 - II. A higher level of output.
 - III. A lower interest rate.
 - IV. A higher interest rate.
 - V. A lower or higher interest rate depending on the relative magnitude of fiscal and monetary policy measures.
- (a) Both (I) and (III) above
 - (b) Both (I) and (IV) above
 - (c) Both (II) and (V) above
 - (d) Both (II) and (IV) above
 - (e) Both (I) and (V) above.

(1 mark)

[<Answer>](#)

73. An increase in government expenditure will

- (a) Shift both IS and LM curves to the right
- (b) Shift both IS and LM curves to the left
- (c) Not affect the position of LM curve but shift IS curve to the left
- (d) Not affect the position of IS curve but shift LM curve to the right
- (e) Not affect the position of LM curve but shift IS curve to the right.

(1 mark)

[<Answer>](#)

74. As on September 30, 2008 monetary liabilities of the central bank are 1,200 MUC and government money is 50 MUC. If the currency deposit ratio is 0.20 and the central bank specifies a reserve ratio of 5%, money supply in the economy will be

- (a) 5,000 MUC
- (b) 5,500 MUC
- (c) 6,000 MUC
- (d) 6,550 MUC
- (e) 6,600 MUC.

(2marks)

[<Answer>](#)

75. Automatic stabilizers refer to

- (a) Inherent mechanisms in the stock market that automatically cause stock market gains to be cancelled out by losses, which make expected long-run returns equal to zero
- (b) The invisible hand mechanisms which automatically bring the economy out of a recession
- (c) Government revenue and expenditure items that change automatically in response to changes in economic activity
- (d) Discretionary monetary policy maneuvers designed to keep inflation under control automatically
- (e) Discretionary monetary policy designed to keep price level under control automatically.

(1 mark)

[<Answer>](#)

76. Budget particulars for the year 2008 was given below:

Particulars	Rs. in Crore
Tax Revenue (net to Centre)	1,84,169
Non-tax revenue	69,766
Recoveries of Loans	18,023
Other Receipts	13,200
Borrowings and other Liabilities	1,53,637
Non-plan Expenditure	
On Revenue Account	2,89,384
(of which Interest Payments is Rs.1,23,223 cr.)	
On Capital Account	28,437
Plan Expenditure	
On Revenue Account	76,843
On Capital Account	44,131

The estimated revenue deficit for the year 2008 was

- (a) Rs.1,13,292 cr
- (b) Rs.1,12,392 cr
- (c) Rs.1,12,292 cr
- (d) Rs.1,19,292 cr
- (e) Rs.1,19,922 cr.

(2marks)

[<Answer>](#)

77. Consider an economy described by the following equations:

Government spending (G)	=	1,000 MUC
Taxes (T)	=	1,000 MUC
Consumption (C)	=	$500 + 0.75Y_d$
Investment demand (I)	=	$100 - 50i$
Transaction demand for money (M_t/P)	=	$0.25Y$
Speculative demand for money (M_a/P)	=	$125 - 50i$
Money supply (M_s/P)	=	500 MUC

The amount of domestic saving in the economy is

- (a) Zero
- (b) (52.5) MUC
- (c) (137.5) MUC
- (d) (102.5) MUC
- (e) 102.5 MUC.

(2marks)

[<Answer>](#)

78. Calculate the change in the foreign exchange reserves from the given data:

Particulars	Rs. in Crore
Primary sector exports	1,500
Automobile exports	650
Fighter plane imports	1,200
Earnings of Indian consultants from abroad	300
Dividends to foreigners	250
Aid from abroad	150
Investment in shares abroad	180
Short-term loans to abroad	120
Foreign direct investment in the country	200

- (a) Rs. 750 Crore
- (b) Rs. 625 Crore
- (c) Rs. 950 Crore
- (d) Rs. 1,050 Crore
- (e) Rs. 1,250 Crore.

(2marks)

[<Answer>](#)

79. If a country has a Balance of Payments surplus and the Central Bank is following floating exchange rate system, then the foreign exchange rate for its currency would

- (a) Increase, its exports would increase and its imports would decrease
- (b) Increase, its exports would decrease and its imports would increase
- (c) Decrease, its exports would increase and its imports would decrease
- (d) Decrease, its exports would decrease and its imports would increase
- (e) Be stable.

(1 mark)

[<Answer>](#)

80. If a country has surplus in the current account consistently (in balance of payment statement), then it implies that

- I. The savings within the economy exceeded the investment.
- II. The savings within the economy is less than the investment.
- III. The country is sending out its capital for use by other economies.
- IV. The country is getting capital from other economies.

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

(1 mark)

81. India's overall Balance of Payments for the year 2007-08 is given below:

(Rs. in Crore)

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

During the year 2007-08, over all Balance of Payments position for India is

- (a) Rs.18,280 crore (surplus)
- (b) Rs.16,980 crore (deficit)
- (c) Rs.17,280 crore (deficit)
- (d) Rs.17,580 crore (surplus)
- (e) Rs.16,980 crore (surplus).

(2marks)

END OF QUESTION PAPER

Suggested Answers

Economics (CFA520): January 2009

Answer	Reason	
1.	E	(a) If the price were Rs.2.20, there would be a surplus of 2,000 Kg. (b) If the price were Rs.1.60, there would be a shortage of 2,000 Kg. (c) If the price were Rs.2.80, there would be a surplus of 6,000 Kg. (d) If the price were Rs.2.50, there would be a surplus of 4,000 Kg (e)The equilibrium price is Rs.1.90. ≤
2.	D	$Q_f = 20000 - 500(10) + 5(10000) + 500(20)$ $= 20000 - 5000 + 50000 + 10000 = 75,000 \text{ units.}$ ≤
3.	A	A decrease in supply causes the supply curve to shift to the left. Similarly, a decrease in demand causes a demand curve to shift to the left. The new demand and supply curves intersect at a point such that there is a reduction in the equilibrium quantity, but price may either increase or decrease or remain the same. ≤
4.	B	A substantial rise in doorbell production reduces the price of doorbells. ≤
5.	A	If the equilibrium rental prices of new apartments are increasing, people tend to own a house and hence there may be increased construction activity. Increased activity increases the demand and thereby cost of construction. Similarly, other things remaining constant excess demand increases the demand for housing loans and rate of interest. Because of higher demand for land property, the prices of land will increase. Hence the correct answer is (a). ≤
6.	E	$Q_d = 500 - 10P$ $Q_s = 300 + 10P$ Equilibrium price, without government intervention, is $500 - 10P = 300 + 10P$ $20P = 200$ $P = 10.$ Since the price ceiling is less than the equilibrium price, $Q_d > Q_s$. Therefore, there is a shortage in the industry. ≤
7.	E	When the value of elasticity of supply is less than one but greater than zero, it is known as relatively inelastic supply. ≤

8. B At the existing level of 375 advertising messages the quantity sold of brand X will be ≤

$$\begin{aligned} Q_x &= 40,000 - 3(5000) + 2(5500) + 40(375) - 20(500) \\ &= 40,000 - 15,000 + 11,000 + 15,000 - 10,000 \\ &= 41,000 \text{ units} \end{aligned}$$

Profit $TR - TC$

$$TR = P \times Q$$

$$41000 \times 5000 = 205000000$$

$$TC = 41000 \times 2000 + (375 \times 200) = 82075000$$

At 41,000 units of output profit will be

$$205000000 - 82075000 = 12,29,25,000$$

When the advertising message of brand X are raised from 375 to 500, the advertising messages of brand Y will increase from 500 to 625. The quantity sold of brand X after the increase in message will be

$$Q = 40000 - 3(5000) + 2(5500) + 40(500) - 20(625) = 43500$$

Profit at the level of 43500 units will be

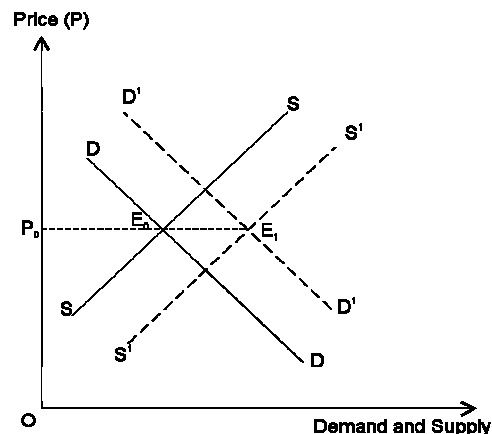
$$= 43,500 \times (5,000 - 2,000) - (500 \times 200)$$

$$= (43500 \times 3000) - 1,00,000$$

$$= 13,05,00,000 - 1,00,000 = 13,04,00,000$$

Therefore increase in profits is $= 13,04,00,000 - 12,29,25,000 = \text{Rs } 74,75,000$.

9. C Initially 200 units of the commodity are supplied and demanded at a price of Rs.10.00. Due to the shift in supply and demand schedules; quantity supplied and demanded increases to 400 units. Here, the equilibrium price remains the same at Rs.10.00. ≤



10. E When a sales tax of Rs. 20 per unit is imposed ≤

$$\begin{aligned} Q_s &= 3,000 + 4.5(P - 20) \\ &= 3,000 + 4.5P - 90 = 2910 + 4.5P \\ 2,910 + 4.5P &= 6,000 - 3P \\ 7.5P &= 3090 \\ P &= 412 \end{aligned}$$

Tax Imposed = Rs. 20

$$\text{Change in price} = 412 - 400 = 12$$

$$\text{Proportion of tax borne by customers} = \frac{12}{20} \times 100 = 60\%$$

$$\text{Proportion of tax borne by producers} = 40\%.$$

11. A If the demand curve is perfectly inelastic, the price rises by the full amount of the tax and the supply remains unchanged. The entire tax is borne by the customers. ≤
12. C The supply curve is horizontal as the producer is willing to supply any amount of rice at a given price. ≤
13. A
$$\frac{5\%}{25\%} = 0.2$$
 Purchase of cars increased by 5% so Income elasticity = 25% = 0.2. ≤
14. B
$$e_{xy} = \frac{\% \Delta Q_x}{\% \Delta P_y} = \frac{-10\%}{20\%} = -0.5$$
 Two goods are substitutes if $e_{xy} > 0$
Complements if $e_{xy} < 0$
Therefore, the answer is (b). ≤
15. D
$$\frac{Q_2 - Q_1}{P_2 - P_1} \times \frac{P_1 + P_2}{Q_1 + Q_2}$$
$$= \frac{1500 - 2000}{10 - 8.5} \times \frac{8.5 + 10}{2000 + 1500}$$
$$= \frac{-500}{1.5} \times \frac{18.5}{3500} = |1.76|$$
 ≤
16. E
$$MR = P \left(1 - \frac{1}{e_p} \right)$$
$$P = \frac{\frac{MR}{\left(1 - \frac{1}{e_p} \right)}}{\left(1 - \frac{1}{3} \right)} = \frac{5}{\left(1 - \frac{1}{3} \right)} = \text{Rs. } 7.50$$
 ≤
17. E If support price is Rs. 6 per unit
 $Q_s = 4 + 6 = 10$ units
Procurement cost for FCI = 6×10 Units = Rs. 60
If FCI would like to dispose off this stock, the price would be:
 $10 = 15 - P$
 $P = \text{Rs. } 5$
If FCI sells 10 Units Rs. 5 per unit so as to sell all the stock procured
Total revenue = $10 \times 5 = \text{Rs. } 50$
Loss for FCI on this transaction = $\text{Rs. } 60 - 50 = \text{Rs. } 10$ ≤

18. B A consumer can maximize total utility (TU) when ≤

$\frac{MU_x}{P_x} = \frac{MU_y}{P_y} = \dots = \frac{MU_n}{P_n}$. This equilibrium condition says that to maximize Total Utility, Marginal Utility for the last rupee spent on all the goods should be equal.

- (a) The consumer may not maximize Total Utility as price of all the goods may not be equal.
- (b) The consumer maximize Total Utility as Marginal Utility for the last rupee spent on all goods is equal.
- (c) Though elasticity of demand is same for all the goods this does not ensure maximum Total Utility as the above condition is not satisfied.
- (d) This may not maximize Total Utility as irrespective of the price paid, Total Utility of every good is same. Further, this does not satisfy the above utility maximizing condition.
- (e) Budget may not permit the consumer to reach the state of maximum Total Utility for each and every good at which point Marginal Utility is equal to zero.

19. D Consumer surplus = $(200 - 100) + (175 - 100) + (150 - 100) = \text{Rs. } 225$. ≤

20. A $MRS_{xy} = \frac{\Delta Y}{\Delta X} = \frac{-1}{2.0} = |0.5|$ ≤

21. C ≤

At equilibrium $\frac{MU_x}{P_x} = \frac{MU_y}{P_y}$

$$\frac{175}{25} = \frac{MU_y}{40}$$

$$\therefore MU_y = \frac{175}{25} \times 40 = 280 \text{ utils.}$$

$\therefore$ The answer is (c).

22. E ≤
- The best allocation = $\frac{MU_A}{P_A} = \frac{MU_B}{P_B}$
- $MU_A = 25 - X$
- $MU_B = 24 - 2Y$
- $X + Y = 100$
- We know $P_B = P_A/2$
- $$\frac{25 - X}{P_A} = \frac{24 - 2Y}{\frac{P_A}{2}}$$
- Therefore,
- $$\frac{25 - X}{P_A} = \frac{24 - 2(100 - X)}{\frac{P_A}{2}}$$
- $$25 - X = 2(24 - 200 + 2X)$$
- $$377 = 5X$$
- $$X = \text{Rs.} 75.4$$
- Therefore $Y = 100 - 75.4 = \text{Rs.} 24.6$.
23. C ≤
- The movement from A to B is price effect. From A to C it is substitution effect and from C to B it is income effect.
24. A ≤
- I. $Q_x = 1000 - 2.5 P_x + 5P_y$.
In this case, if the P_y increases, Q_x also increases and vice versa. So good X and Y are substitutes.
- II. $Q_x = 250 - 0.5 P_x - 0.5P_y$.
In this case, if the P_y increases, Q_x decreases and vice versa. So good X and Y are complements.
- III. $Q_x = 150 - 3P_x - P_y$.
In this case, if the P_y increases, Q_x decreases and vice versa. So good X and Y are complements.
- IV. $Q_x = 300 - P_x - P_y$.
In this case, if the P_y increases, Q_x decreases and vice versa. So good X and Y are complements.
- (a) Is the answer because good X and Y are substitutes in I above.
- (b) Is not the answer because good X and Y are not substitutes in IV above.
- (c) Is not the answer because good X and Y are substitutes in I above, but complements in IV above.
- (d) Is not the answer because good X and Y are complements in II and III above.
- (e) Is not the answer because good X and Y are complements in II, III and IV above.
25. B ≤
- If MU can be measured in rupees, the consumer can maximize his total utility by consuming the good until $MU = P$.
- ∴ Equilibrium quality is
- $$200 - 10 Q_A = 20$$
- $$10 Q_A = 180$$
- $$Q_A = 18 \text{ units.}$$
- ∴ The individual would demand 18 units. Hence the answer is (b).

26. C Prices of X and income remaining the same if the price of Y decreases, the slope of the price line changes. The new price line will be P_2L_1 ≤
27. C The income consumption curve shows the effect of the change in income on the equilibrium quantities purchased of the two commodities, while prices of both the commodities remain constant. ≤
28. C According to the law of equi-marginal utility, given the income of the consumer and the market prices of goods, the marginal utility of the last rupee spent on the goods is always the same. ≤
29. D When price discrimination is not allowed, then $P_A = P_T$ and $Q_A + Q_T = Q$ (total output). ≤
 It can be written as
 $Q_A = 600 - P_A = 600 - P$
 $Q_T = 400 - P_T = 400 - P$
 Or, $Q = Q_A + Q_T = 600 - P + 400 - P = 1000 - 2P$
 Or, $P = 500 - 0.5Q$
 At profit maximization, $MR = MC$
 $MC = \partial TC / \partial Q$
 Where, $TC = AC \times Q = (15000/Q + 100) Q = 15000 + 100Q$
 And, $MC = 100$
 $TR = (500 - 0.5Q) Q = 500Q - 0.5 Q^2$
 Thus, $MR = 500 - Q$
 At equilibrium, $MR = MC$
 $500 - Q = 100$
 Or, $Q = 400$
 Or, $P = 500 - 0.5 (400) = \text{Rs. } 300$.
30. D $FC = 10000$ $AVC = 5$ $TVC = 5Q$ $QTC = FC + TVC = 10000 + 5Q$ $MC = 5$ ≤

$$P = \frac{20,000 - Q}{2,000}$$
 Demand function $Q = 20000 - 2000P$ $P = 10 - 0.0005Q$
 $TR = PQ = 10Q - 0.0005Q^2$ $MR = 10 - 0.001Q$
 To maximize profit $MC = MR$
 $5 = 10 - 0.001Q$
 $Q = 5000$
 $P = 10 - 0.0005(5000) = \text{Rs. } 7.5$
 Profit = $TR - TC$
 $= 5000 \times 7.5 - [10000 + 5(5000)]$
 $= 37500 - 35000 = \text{Rs. } 2500$.
31. B Profits = $TR - TC$ ≤
 $TR = (1000 \times 750) = 7,50,000$
 $TC = 1,50,000 + 3,50,000 = 5,00,000$
 Profits = $7,50,000 - 5,00,000 = \text{Rs. } 2,50,000$

32. D $AVC = 300 - 10Q + 0.5Q^2$ ≤
 $VC = Q \times AVC = 300Q - 10Q^2 + 0.5Q^3$
 Fixed cost = 150
 $TC = FC + VC = 150 + 300Q - 10Q^2 + 0.5Q^3$
 $MC = \frac{dTC}{dQ} = 300 - 20Q + 1.5Q^2$
 Minimum possible MC is where
 $\frac{dMC}{dQ} = 0$
 $\frac{dMC}{dQ} = -20 + 3Q = 0$
 $3Q = 20$
 $Q = 6.67$
 $MC = 300 - 20(6.67) + 1.5(6.67)^2$
 $= 300 - 133.4 + 66.73 = \text{Rs.}233.33$
33. D The kinked demand curve model is based on the assumption that when a firm increase price other firms in the industry do not follow and if the firm decrease price other firms also decrease the price. ≤
34. A A monopolist is said to be in equilibrium where the elasticity of his average revenue curve is greater than one. ≤
35. C An individual firm in perfect competition is a price taker. The level of market price is determined by the market supply and demand. A perfectly competitive firm has control over only on quantity. So sales revenue can be increased by increasing the production only. (a) Is not the answer because a perfectly competitive firm cannot increase its sales revenue by reducing the prices. (b) Is not the answer because a perfectly competitive firm cannot increase its sales revenue by increasing the prices. (c) Is the answer because a perfectly competitive firm can increase its sales revenue by increasing the production. (d) Is not the answer because a perfectly competitive firm cannot increase its sales revenue by increasing the expenditure on advertising. Because all firms produce a homogeneous product. The technical characteristics of the product as well as the services associated with its sale and delivery are same. A buyer can't differentiate among products of differentiate firms. (e) Is not the answer because a perfectly competitive firm cannot increase its sales revenue by increasing the sale force. ≤
36. B $MC = dTC / dQ = 150 - 40Q + 3Q^2$ ≤
 The average variable cost equation is
 $AVC = dTC/dQ = (150Q - 20Q^2 + Q^3)/Q = 150 - 20Q + Q^2$
 The shut down point is where the price equals minimum average variable cost. But profit maximization is at the point where $P = MC$
 Thus by setting $MC = AVC$ $150 - 40Q + 3Q^2 = 150 - 20Q + Q^2$
 Rearranging returns gives: $2Q^2 - 20Q = 0$
 Which can be rewritten as $2Q(Q - 10) = 0$
 Solving the equation we get, $Q = 0$ or $Q = 10$ substituting $Q = 10$ into the MC equation gives $P = MC = 150 - 40(10) + 3(100) = 50$. So, shut down is the point where, price goes below Rs.50.

37. B The supply curve in a market shows how much output a firm will produce at various given prices of product. Thus, the supply curve of product by a firm traces out the unique price-output relationship. Absence of supply curve is the characteristic feature of Monopoly, because the producer exercises control over the price as he is the price-maker. The portion of MC curve that lies above AVC curve is the supply curve of a perfectly competitive market. Hence the correct answer is (b). ≤
38. A To maximize profit, a firm has to satisfy two conditions. The first order condition requires that MR should be equal to MC. ≤
39. B Implicit cost is also known as opportunity cost. These costs are not paid out-of-the pockets. It refers to income that could have been earned by factor input in their best alternative use. Payments to the non-owners of the firm for the resources they supply constitute an out-of-the-pocket cost. Hence (a) is not correct. Implicit cost is also known as opportunity costs. It refers to income that could have earned by factor input in their best alternative use. Money payment, which the self-employed resources could have earned in their best alternative employment, signifies opportunity cost of self-employed resources. An undisclosed cost does not constitute implicit costs. Fixed cost is the cost that remains same during a period of time. Fixed costs consist of both implicit and explicit costs. (e) is not the answer because (b) is correct. ≤
40. B In the given equation fixed cost is equal to Rs.1,000. ≤
41. C
$$\begin{aligned} \text{NDP at market price} &= \text{NDP at factor cost} + \text{Indirect taxes} \\ \text{NDP at factor cost} &= \text{Wages paid to domestic residents} + \text{Wages paid to} \\ &\quad \text{foreigners} + \text{Interest payment on loans taken from foreign} \\ &\quad \text{banks} + \text{Retained profits} + \text{Corporate tax} \\ &= 400 + 240 + 10 + 20 + 10 = 680 \\ \therefore \text{NDP at market prices} &= 680 + 15 = \text{Rs.695 cr.} \end{aligned}$$
 ≤
42. A Value of the car will be included in GDP for the year 2007 because the production has taken place during this period. As we already know, GDP is the value of final goods and services produced during the period. ≤
43. B As per national income accounting, if a car is purchased for personal use, it is treated as personal consumption spending. If the same car is purchased for business purpose, then it is considered as investment. Planned investment refers to those investments that are planned to meet the demand for goods and services. On the contrary, unplanned investments are those investments that are made without planning. Unplanned investment results in increase of inventory in the economy. ≤
44. C
$$\begin{aligned} \text{Wages and salaries paid by the government} &= \text{Factor income received by households} \\ &\quad - (\text{wages and salaries paid by the business sector} + \text{Dividends paid to house holds} + \\ &\quad \text{Factors income received from abroad by household sector}) \\ &= 160 - 100 - 10 - 20 = 30 \text{ MUC.} \end{aligned}$$
 ≤

45. A NDP at factor cost = NDP at market prices – Indirect Taxes + subsidies $\leq$
 $= 77,000 - 7,700 + 6,700 = \text{Rs.}76,000 \text{ Cr.}$
46. A By definition dividends and corporate taxes are part of corporate profits. $\leq$
 National income refers to the factor income earned by the residents of a country and it includes profits earned by entrepreneurs. Profit includes dividends and corporate tax. Hence dividends and corporate tax are part of national income.
 Hence dividends and corporate taxes are part of corporate profits and national income.
 (a) On the basis of the above reason, dividends and corporate taxes are part of corporate profits (I) and National Income (II). Hence this is true option.
 (b) Dividends and corporate taxes are not part of personal income, hence not the correct option.
 (c) On the basis of above reason, the option is not correct.
 (d) As given in the reason, dividends and corporate taxes are not part of personal income and personal disposable income. Hence not correct option.
47. E GDP at factor cost = GDP at market prices – Indirect taxes + Subsidies. Hence when $\leq$
 subsidies exceed indirect taxes, GDP at factor cost exceed GDP at market prices.
48. E Gross Domestic Capital formation consists of making good the depreciation on $\leq$
 existing fixed assets, adding to the stock of fixed assets and Adding to Inventories.
49. B If somebody buys National Small Saving Certificate, it increases in the other $\leq$
 liabilities of the government.
 (a) Is not the answer because if Mr.X buys a National Small Saving Certificate, it will not increase Government borrowings.
 (b) Is the answer because if Mr.X buys a National Small Saving Certificate, it will increase in the other liabilities of the Government.
 (c) Is not the answer because if Mr.X buys a National Small Saving Certificate, it will not increase in forex reserves.
 (d) Is not the answer because if Mr.X buys a National Small Saving Certificate, it will not increase Government revenue.
 (e) Is not the answer because if Mr.X buys a National Small Saving Certificate, it will not decrease Government liability.
50. B Value addition = Output – Inputs. $\leq$
 Value addition by industry 'A' = $400 - (100 + 40 + 60) = 200 \text{ MUC}$
 Value addition by industry 'B' = $480 - (160 + 120 + 80) = 120 \text{ MUC}$
 Value addition by industry 'C' = $320 - (60 + 100 + 120) = 40 \text{ MUC}$
 Total Value Addition = 360 MUC
51. B $\left[\left(\frac{1+0.08}{1+0.01} \right) - 1 \right] = 6.93 \%$ $\leq$

52. A Economic growth is defined as the expansion of the economy's output. ≤
53. D Growth = $1.5 + 4.5 = 6\%$ ≤
Rate of investment = $5 \times 6 = 30\%$
54. E (a) Low managerial efficiency of capital leads decrease in productivity; this would mean that more input (capital) is required to produce a unit of output. Hence ICOR increases. ≤
(b) As the production process becomes complicated, i.e. complex leads to time consuming procedures which leads time over runs. This reduces productivity and hence ICOR increases.
(c) Since the existing capital is less productive, it means the returns on the capital are also low and hence ICOR will be high
(d) Inadequate delegation of powers lead to delay in decision making which result in cost and time over runs. This increased costs leads to more capital inputs required to produce an unit of output i.e., higher ICOR
(e) As the productivity of labour increase, less units of input will be required to produce one unit of output. Hence ICOR will decrease Hence this option is correct.
55. C Unemployment caused by imperfect information about the available jobs and skills in the market is called frictional unemployment. ≤
56. B In the period of recession employment decreases and aggregate production decreases. ≤
57. C Investment fluctuates most over the course of the business cycle. ≤
58. D A lower interest rate leads to higher investment spending because lower interest rates increase the appropriately discounted return and make more investment projects profitable. ≤
59. B Investment in period 't' = $0.75 \times$ Designed investment in period 't' ≤
Designed investment in period 't'
= Acceleration co-efficient $\times$ change in income = $2 \times 200 = 400$
 $\therefore$ Investment in period 't' = $0.75 \times 400 = 300$ MUC
 $\therefore$ The answer is (b).

60. C In the Keynesian model, actual expenditure and planned expenditure is same at the equilibrium level of output. When the actual expenditure is less than the planned expenditure in the economy, there will be a positive inventory investment in the economy. ≤
- (a) Is not the answer because there will not be a positive fixed investment in the economy
- (b) Is not the answer because there will not be a negative fixed investment in the economy
- (c) Is the answer because there will be positive inventory investment in the economy.
- (d) Is not the answer because there will not be negative inventory investment in the economy
- (e) Is not the answer because there will be change in the inventory investment in the economy.
61. C As the MPC gets close to 1, the value of the multiplier approaches infinity. ≤
62. B $MPC + MPS = 1$ ≤
 Given $MPC = MPS = X$ (say)
 $\therefore X + X = 1$
 $2X = 1$
 $X = \frac{1}{2}$
 $\therefore MPS = 0.5$
 Increased Savings = $MPS \times \text{Increase income}$
 $= 0.5 \times 1000 = \text{Rs.}500$
63. C $MPC = 0.75$ ≤
- Multiplier = $\frac{1}{1 - MPC} = \frac{1}{1 - 0.75} = 4$
 Therefore increase in AD = $4 \times 10 = \text{Rs.}40$ billion
 As the crowding out effect is Rs. 6 billion, net increase in AD = $40 - 6 = \text{Rs.}34$ billion.
64. C When $Y = 20,000$, $C = Y = 20,000$ ≤
 $C = \alpha + \beta Y$
 $20,000 = \alpha + (0.7 \times 20,000)$
 $\therefore \alpha = 20,000 - 14,000 = \text{Rs.}6,000$.
65. E An economy is said to be in equilibrium, when saving is equal to investment. When there is government sector, taxes are equal to government spending. So, household saving plus taxes equals net investment plus government spending. ≤

66. E $Y = C + I + G + NX$ ≤
 $C = a + bY$
 Or, $C = 100 + 0.75Y$
 $Y = C + I + G + NX$
 Or, $Y = 100 + 0.75Y + 50 + 150 + 20$
 Or, $0.25 Y = 320$
 Or, $Y = \frac{320}{0.25} = 1,280$ MUC
67. B The balance sheet of Reserve Bank of India contains particulars of Bank's current assets and liabilities. ≤
 (a) Is not the answer because Central government's borrowings from RBI constitutes assets of RBI. It will affect the balance sheet.
 (b) Is the answer because loan taken by one commercial bank from the other is a inter bank loan. It will not affect the balance sheet of the Reserve Bank of India. It is neither a liability nor an asset to the RBI.
 (c) Is not the answer because refinancing of NABARD loans constitutes assets of RBI.
 (d) Is not the answer because increase in reserves of commercial banks increases the liabilities of RBI.
 (e) Is not the answer because increase in net foreign exchange assets increases the assets of RBI.
68. C In the short run, if the price level falls, the real wage rate will be higher than the equilibrium real wage rate and employment will fall. ≤
69. D The downward slope of the aggregate demand curve shows that an increase in the price level causes the aggregate quantity of goods and services demanded to decrease. ≤
70. E (a) Is not the answer because Keynes considered the existence of full employment as a special case. The Keynesian underemployment equilibrium is reflecting real life situations. ≤
 (b) Is not the answer because aggregate demand or effective demand indicates the total quantity of goods and services that people want to buy. According to Keynes, effective aggregate demand determines the level of employment and output.
 (c) Is not the answer because Keynes argues that State intervention is essential as full employment is not possible in an economy.
 (d) Is not the answer because Keynes argues that an economy facing recession, budget deficit is an important tool to overcome recession.
 (e) Is the answer because in the Keynesian model, monetary policy is not effective as compared to fiscal policy. Rather it is the fiscal policy, which is very effective and powerful. Keynes argues that government should maintain an active stance with a combination of tax and expenditure policies to maintain the desired levels of output and employment through manipulation of effective demand.

71. A An increase in government purchases causes the interest rate to increase and investment to decrease. Government purchases are said to crowd out investment. ≤
- (a) The increase in government purchases must be met by an equal decrease in investment. To induce investment fall, the interest rate must rise. Hence this option is true.
 - (b) Since the increased government purchases have to met by equal decrease in investment, investment will decrease.
 - (c) As the government is financing its expenditure through borrowing, the public savings will reduce.
 - (d) Same reason as above, national savings will decrease as the consumption has increased.
 - (e) Since government has decided to borrow instead of taxing the people, the taxes are constant.
72. E Contractionary (tight) fiscal policy involves increasing tax rate and/or decreasing the government spending to bring down the aggregate demand and price level in the economy. Reduced government spending reduces the public borrowings, and thereby interest rate and output in the economy. The tight monetary policy, conversely, reduces the money supply and thereby increases the interest rate in the economy. Increased interest rate reduces both consumption and investment and thereby reduces output in the economy. Thus, we can say that the combined effect of tight fiscal policy and tight monetary policy lowers the output. But, the direction of change in interest rate is not known unless we know the magnitude of influence of fiscal and monetary policies on interest rate. ≤
73. E An increase in government expenditure results in an increase in the level of income and an increase in the interest rate. It will shift the IS curve to the right. But LM curve remain unchanged because an increase in government expenditure, a fiscal policy measure, has no impact initially in the asset markets. ≤
- (a) Is not the answer because an increase in government will not shift both IS and LM curve to the right.
 - (b) Is not the answer because an increase in government will not shift both IS and LM curve to the left.
 - (c) Is not the answer because an increase in government will not shift IS curve to the left.
 - (d) Is not the answer because an increase in government will affect IS curve.
 - (e) Is the answer because an increase in government will not shift the position of LM curve but shift IS curve to the right.
74. C Stock of high powered money (H) ≤
- = Monetary liabilities of the central bank + government money = 1,250 MUC
- Current deposit ratio (Cu) = 0.20
- Reserve ratio (r) = 0.05
- $$\therefore \text{Money supply } M_s = \frac{1 + Cu}{Cu + r} \times H$$
- $$= \frac{1 + 0.20}{0.20 + 0.05} \times 1,250 = 4.8 \times 1,250 = 6,000 \text{ MUC}$$

75. C Every economy goes through cyclical fluctuations in output, employment and prices. This will have an automatic impact on certain government expenditures and revenues. The changes in the government spending and revenues that results automatically as the economy fluctuates are called non-discretionary fiscal policy. Automatic stabilizers are features of the government budget that automatically adjust net taxes to stabilize aggregate demand as the economy expands or contracts. ≤
- (a) Is not the answer because an automatic stabilizer is not a mechanism in the stock market that automatically cause stock market gains to be cancelled out by losses.
- (b) Is not the answer because automatic stabilizer is not the invisible hand mechanisms, which automatically bring the economy out of a recession.
- (c) Is the answer because automatic stabilizer refers to Government revenues and expenditures that change automatically in response to changes in economic activity. When the economy is in a contraction phase, these stabilizers increase transfer payments and reduce tax collections in order to stimulate aggregate demand. On the other hand, when the economy begins to expand, the automatic stabilizers increase tax collections and reduce transfer payments in order to restrain growth in the aggregate demand.
- (d) Is not the answer because automatic stabilizer is a discretionary fiscal policy.
76. C Revenue deficit ≤
- = Revenue expenditure – Revenue receipt
- Revenue Expenditure
- = Non plan revenue expenditure + Plan revenue expenditure
- = 2,89,384 + 76,843 = 3,66,227
- Revenue receipts = Tax revenue + Non. Tax revenue
- = 1,84,169 + 69,766 = 2,53,935
- ∴ Revenue Deficit = 3,66,227 – 2,53,935 = Rs.1,12,292 cr.
77. C Goods market will be in equilibrium when $Y = AD = C + I + G$ ≤
- $Y = 500 + 0.75(Y - T) + 100 - 50i + 1000$
- $= 1600 + 0.75(Y - 1000) - 50i$
- $Y = 850 + 0.75Y - 50i$
- $0.25Y = 850 - 50i$ IS curve
- Money market will be in equilibrium when:
- Money supply (M_s) = Money demand (M_d)
- $500 = 0.25Y + 125 - 50i$
- $375 = 0.25Y - 50i$
- $0.25Y = 375 + 50i$ LM curve
- Thus, at simultaneous equilibrium,
- $850 - 50i = 375 + 50i$
- $475 = 100i$
- $i = 4.75$
- When $i = 4.75$, $0.25Y = 375 + 50(4.75) = 612.5$
- Or, $Y = 612.5/0.25 = 2450$.
- i. Private saving = $Y - T - C = 2450 - 1000 - [500 + 0.75(2450 - 1000)]$
- = $1450 - [500 + 1087.5] = (137.5)$
- ii. Public saving = $T - G = 1000 - 1000 = 0$
- iii. Domestic saving = Private saving + Public saving = $(137.5) + 0 = (137.5)$

78. D Change in foreign exchange reserves = Balance on current account + Balance on capital account ≤

Current Account

Dr.		Cr.	
Fighter plane imports	1,200	Primary sector exports	1,500
Dividends paid to foreigners	250	Automobile exports	650
Surplus on current account	1,150	Earnings of Indian consultants abroad	300
		Aid from abroad	150
	2,600		2,600

Capital Account

Dr.		Cr.	
Investment in shares abroad	180	FDI	200
Short-term loans	120	Balance on capital account	100
	300		300

Change in foreign exchange reserves = 1,150 – 100 = Rs.1050 crore.

79. B If a country has a balance of payments surplus and the Central Bank is following floating exchange rate system, then the foreign exchange rate for its currency would rise. As a result of this exports would decrease and its imports would increase. ≤

80. C The savings within the economy exceeded the investment and The country is sending out its capital for use by other economies. ≤

81. E Overall balance of payment ≤
- = Total Credit of the Bop – Total debit of the Bop
- = 1,46,559 – 1,29,579
- = Rs.16,980 crore (surplus)

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