Question Paper
Business Economics – II (MB1B4): January 2009

> • **Answer all 75 questions.**
> • **Marks are indicated against each question.**

Total Marks : 100

<Answer>

1. In a four sector economy, consisting of households, firms, government and foreign sectors, the transfer payments flow from

(a) Government to firms
(b) Firms to households
(c) Households to government
(d) Government to households
(e) Households to foreign sector. **(1 mark)**

<Answer>

2. Which of the following statements is **not true**?

(a) Depreciation is the allowance given for using capital equipment
(b) Net factor income from abroad refers to inflow of factor income from abroad minus the corresponding outflow
(c) National product at factor cost is always higher than national product at market price
(d) GDP at market price is the most comprehensive measure of aggregate income
(e) Net exports are also known as balance of trade. **(1 mark)**

<Answer>

3. The nominal GDP grows faster than the real GDP because of

(a) Indirect taxes
(b) Subsidies
(c) Depreciation
(d) Inflation
(e) Net exports. **(1 mark)**

<Answer>

4. Which of the following will cause the double counting problem in calculation of national income?

I. Transfer incomes.
II. Stock inflation.
III. Intermediary products.

(a) Only (I) above
(b) Only (II) above
(c) Only (III) above
(d) Both (I) and (III) above
(e) All (I), (II) and (III) above. **(1 mark)**

<Answer>

5. According to the Keynesian theory beyond full employment level of output,

(a) The aggregate supply will increase with increase in aggregate demand and prices remain unchanged
(b) The aggregate supply will decrease with increase in aggregate demand and prices remain unchanged
(c) The aggregate supply will increase with increase in aggregate demand and prices also increase
(d) The aggregate supply will decrease with increase in aggregate demand and prices increase
(e) The aggregate supply will remain the same with increase in aggregate demand and prices increase. **(1 mark)**

<Answer>

6. According to Keynes, the consumption function explains the level of aggregate consumption desired at each level of

(a) Aggregate demand
(b) Personal tax
(c) Personal disposable income
(d) Interest rate
(e) Price. **(1 mark)**

<Answer>

7. In a simple economy without government intervention, consumption and investment are the only two components of aggregate demand. Here investment is classified as actual investment and investment demand. Which of the following is/are included in actual investment?

I.   Investment in new plant and equipment during the year.
II. Desired inventories accumulated during the year.
III. Undesired inventories accumulated during the year.

(a)   Only (I) above
(b)   Only (II) above
(c)   Both (I) and (II) above
(d)   Both (I) and (III) above
(e)   All (I), (II) and (III) above.   **(1 mark)**

<Answer>

8. Suppose the Indian economy is facing a situation of recession and you being a public expenditure expert what would you advice the Government of India to bring the economy back to equilibrium?

(a)   Reduce Government spending and increase the taxes
(b)   Reduce Government spending and decrease the taxes
(c)   Increase Government spending and decrease the taxes
(d)   Increase Government spending and increase the taxes
(e)   Keep Government spending constant and increase the taxes.   **(1 mark)**

<Answer>

9. The rate of interest at which the Central bank rediscounts approved bills of exchange is called as

(a)   Cash reserve ratio
(b)   Bank rate
(c)   Discount rate
(d)   Margin requirements
(e)   Statutory liquidity ratio.   **(1 mark)**

<Answer>

10. Which of the following schools of thought advocated that nominal GDP in the short run and prices in the long run are determined by growth of money?

(a)   Classical economist
(b)   Keynesian
(c)   Neo classical economist
(d)   Monetarist
(e)   Supply-side economist.   **(1 mark)**

<Answer>

11. Which of the following monetary policy measure(s), the Central bank can adopt to control inflation in an economy?

I.   Bank Rate.
II. Open market operation.
III. Regulation of consumer credit.
IV. Tax rate.

(a)   Only (I) above
(b)   Only (II) above
(c)   Both (I) and (II) above
(d)   (I), (II) and (III) above
(e)   All (I), (II), (III) and (IV) above.   **(1 mark)**

<Answer>

12. Which of the following is/are objective(s) of fiscal policy in general?

I.   Mobilization of resources.
II. Reduction of disparities of income.
III. Price stability.

(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)**

13. The ratio of total financial claims issued during the year to national income of that year is called as <Answer>

(a) Finance ratio
(b) Financial interrelation ratio
(c) New issues ratios
(d) Intermediation ratios
(e) Cash reserve ratio. **(1 mark)**

14. Which of the following is/are example(s) of non tariff barriers? <Answer>

I. Quotas.
II. Subsidies.
III. Licensing.

(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)**

15. Which of the following explains the relationships between various quantities of output that all people together will buy at various price levels in a defined period? <Answer>

(a) Aggregate demand
(b) Aggregate supply
(c) The Consumption function
(d) The Investment function
(e) The Saving function. **(1 mark)**

16. Which of the following factor(s) affect the size of a nation's income? <Answer>

I. Human resources.
II. Capital resources.
III. Self-sufficiency.

(a) Only (I) above
(b) Only (III) above
(c) Both (I) and (III) above
(d) Both (II) and (III) above
(e) All (I), (II) and (III) above. **(1 mark)**

17. Tax exemptions to firms making investments in new businesses, new plants and buildings etc. to encourage incentives is suggested by <Answer>

(a) Keynesian economists
(b) Classical economists
(c) Supply side economists
(d) Rational expectations
(e) Monetarists. **(1 mark)**

18. Which of the following refers to the buying or selling of securities such as government securities, banker's acceptances or foreign exchanges by the Central Bank? <Answer>

(a) Bank rate policy
(b) Reserve requirement changes
(c) Rationing of credit
(d) Open market operations
(e) Moral suasion. **(1 mark)**

19. Which of the following is an example of assets of Reserve Bank of India (RBI)? <Answer>

(a) Notes in circulation
(b) Paid-up Capital
(c) Government Deposits
(d) Statutory Reserves
(e) Credit to the Government. **(1 mark)**

20. During recession, there is unexpected reduction in the general level of demand for goods and services. This is an important cause of <Answer>

- (a) Frictional unemployment
- (b) Structural unemployment
- (c) Cyclical unemployment
- (d) Seasonal unemployment
- (e) Disguised unemployment. **(1 mark)**

21. Which of the following curve shows the real value of output that producers are willing and able to bring to market at alternative price levels (ceteris paribus)? <Answer>

- (a) Aggregate supply curve
- (b) Aggregate demand curve
- (c) Philips curve
- (d) IS curve
- (e) LM curve. **(1 mark)**

22. Due to the multiplier effect, a decrease in investment spending <Answer>

- (a) Is greater than the resulting decrease in GDP
- (b) Leads to an even larger decrease in output
- (c) Has a minimal impact on the economy
- (d) Results in increased autonomous consumption
- (e) Causes the money supply to increase. **(1 mark)**

23. Which of the following dampens the growth rate of an economy? <Answer>

- (a) Expansion in money supply
- (b) Increase in the level of investment
- (c) Reduction in the rate of interest
- (d) Steep rise in the tax rates
- (e) Moderate increase in price level. **(1 mark)**

24. What are the marginal propensity to consume and level of autonomous consumption spending for a consumption function of the following form, $C = 1,400 + 0.2Y_d$? <Answer>

- (a) The marginal propensity to consume is 1,400; autonomous consumption spending is Re.0.20
- (b) The marginal propensity to consume is 0.20; autonomous consumption spending is Re.0.20
- (c) The marginal propensity to consume is 0.2; autonomous consumption spending is Rs.1,400
- (d) The marginal propensity to consume is 0.2; autonomous consumption spending is Rs.7,000
- (e) The marginal propensity to consume is 0.2; autonomous consumption spending is Rs.14,000. **(1 mark)**

25. Which of the following is most likely to occur if the RBI sells bonds in an open market operation? <Answer>

- (a) The aggregate expenditure line shifts upward
- (b) The interest rate falls
- (c) The money supply increases
- (d) The equilibrium level of GDP decreases
- (e) The open market operation is said to be expansionary. **(1 mark)**

26. Which of the following is considered as 'Vault cash'? <Answer>

- (a) The RBI currency together with the Government money with commercial banks
- (b) The RBI currency together with the Demand deposits with commercial banks
- (c) The RBI currency together with the Other deposits with RBI
- (d) The RBI currency together with the Government money with RBI
- (e) The RBI currency together with the foreign exchange reserves. **(1 mark)**

27. Which of the following is **true** for aggregate expenditure? <Answer>

- (a) Spending by households, government, and firms on final goods and services
- (b) All types of spending by households
- (c) Spending and savings by households
- (d) Spending by households and governments on final goods and services
- (e) All spending and saving by households, firms, and governments. **(1 mark)**

28. In the short-run, in Keynesian model, when aggregate expenditure is less than equilibrium GDP, output will <Answer>

    (a)   Decline as firms reduces production to stop the buildup of inventories
    (b)   Increase as firms cut their prices to try to stop depletion of inventories
    (c)   Decline as firms increase their prices to stop the buildup of inventories
    (d)   Increase as firms increase production to try to stop depletion of inventories
    (e)   Remain unchanged indefinitely unless government takes action. **(1 mark)**

29. 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? <Answer>

    (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)**

30. 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)**

31. Which of the following is an indirect tax? <Answer>

    (a)   Wealth tax
    (b)   Income tax
    (c)   Estate duty
    (d)   Excise duty
    (e)   Gift tax. **(1 mark)**

32. In the national income accounting, which of the following is termed as investment? <Answer>

    (a)   Purchases of stocks and bonds
    (b)   Purchases of assets such as gold and silver
    (c)   Purchases of new final goods by households
    (d)   Purchases of fixed assets like cars, plant and machinery etc
    (e)   Purchases of intermediate goods by firms. **(1 mark)**

33. Which of the following factors is/are responsible for the increase in public expenditure? <Answer>

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

    (a)   Only (I) above
    (b)   Only (II) above
    (c)   Only (III) above
    (d)   Both (I) and (II) above
    (e)   All (I), (II) and (III) above. **(1 mark)**

34. Under the paper currency system, determination of the exchange rate usually takes into account <Answer>

    (a)   Budget deficit
    (b)   The purchasing power of a national currency
    (c)   The inflation rate in the country
    (d)   The money supply of the country
    (e)   The unemployment rate in the country. **(1 mark)**

35. Which of the following refer to the sequence of events of a contractionary monetary policy? <Answer>

    (a)   Interest rate increase, causing planned investment to decrease, causing aggregate output to decrease, causing money demand to decrease
    (b)   Interest rate increase, causing planned investment to decrease, causing money demand to decrease, causing aggregate output to decrease
    (c)   Planned investment to decrease, causing aggregate output to decrease, causing money demand to decrease, causing interest rate increase
    (d)   Money demand to decrease, causing interest rate increase, causing planned investment to decrease, causing aggregate output to decrease
    (e)   Aggregate output to decrease, causing interest rate increase, causing planned investment to decrease, causing money demand to decrease. **(1 mark)**

36. The long run Phillips curve is vertical because

   (a)   The unemployment rate decreases when the inflation rate increases
   (b)   There is no trade-off between unemployment rate and the inflation rate in the long run
   (c)   The natural unemployment rate only depends on the inflation rate
   (d)   Real GDP does not depend on the unemployment rate
   (e)   There is a direct relationship between the natural unemployment rate and the inflation rate. **(1 mark)**

37. A country's _____ is a systematic record of all economic transactions between that country and the rest of the world.

   (a)   Government annual budget
   (b)   Balance of trade
   (c)   Balance of payments
   (d)   Current account balance
   (e)   Capital account balance. **(1 mark)**

38. Which of the following is a leakage from the circular flow?

   (a)   Imports
   (b)   Consumption
   (c)   Investment expenditures
   (d)   Exports
   (e)   Government expenditures. **(1 mark)**

39. During 'Stagflation' which of the following variable would be high?

  I.   Inflation.
  II.   Growth of real GDP.
  III. Unemployment.
  IV. Aggregate demand.

   (a)   Both (I) and (III) above
   (b)   Both (III) and (IV) above
   (c)   (I), (II) and (III) above
   (d)   (II), (III) and (IV) above
   (e)   All (I), (II), (III) and (IV) above. **(1 mark)**

40. According to monetarism, other things remaining the same, if the velocity of money increases, then

   (a)   The stock of money would increase
   (b)   The nominal GDP would decrease
   (c)   Price level would rise
   (d)   The real GDP would increase
   (e)   The nominal interest rate would increase. **(1 mark)**

41.

Dr.	Production Account		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)**

42. The following information pertains to an economy for the year 2007-2008. <Answer>

Particulars	Rs. in crore
GNP at factor cost	2,10,000
Indirect Taxes	30,000
NDP at market prices	2,60,000
Subsidies	40,000

What is the NDP at factor cost?

(a) Rs.1,80,000 cr
(b) Rs.2,70,000 cr
(c) Rs.2,40,000 cr
(d) Rs.2,60,000 cr
(e) Rs.3,00,000 cr. **(1 mark)**

43. The following information is taken from the National Income Accounts of an economy for the year 2008: <Answer>

Particulars	MUC
Indirect taxes	14,000
NDP at market prices	1,00,422
NNP at market prices	1,00,000
Subsidies	2,000
Corporate profit taxes	6,500
Retained profit	30,000

Personal income for the economy is

(a) 1,24,500 MUC
(b) 1,03,500 MUC
(c) 64,500 MUC
(d) 51,500 MUC
(e) 53,500 MUC. **(2marks)**

44. The following information is extracted from the National Income Accounts of an economy: <Answer>

Particulars	MUC
Consumption	3,000
National income	5,000
Investment	600
Government expenditure	200

Net exports for the economy will amount to

(a) 1,200 MUC
(b) 1,400 MUC
(c) 4,600 MUC
(d) 400 MUC
(e) 800 MUC. **(1 mark)**

45. Consider the following information pertaining to the year 2007-2008: <Answer>

Particulars	MUC
NDP at market prices	77,000
Net factor income from abroad	– 700
Depreciation	1,700
Subsidies	6,700
Indirect Taxes	7,700

National income of the economy is

(a) 76,000 MUC
(b) 75,300 MUC
(c) 77,000 MUC
(d) 77,700 MUC
(e) 79,700 MUC. **(2marks)**

46. Inter-industry transactions table for an economy is given as follows: <Answer>

Industry	A	B	C	Sales to Household	MUC 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>
47. 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%. **(2marks)**

<Answer>
48. The planned savings function of an economy is given as $S = -30 + 0.40Y_d$ and planned investment is 70 MUC, the equilibrium level of disposable income is

(a) 140 MUC
(b) 250 MUC
(c) 280 MUC
(d) 310 MUC
(e) 380 MUC. **(1 mark)**

<Answer>
49. In an economy, the saving function is estimated as $S = -100 + 0.25Y_d$. If savings in the economy is 100 MUC at equilibrium, the equilibrium level of income in the economy is

(a) 750 MUC
(b) 700 MUC
(c) 800 MUC
(d) 950 MUC
(e) 1,050 MUC. **(1 mark)**

<Answer>
50. 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

(a) 200 MUC
(b) 300 MUC
(c) 400 MUC
(d) 500 MUC
(e) 600 MUC. **(2marks)**

<Answer>
51. Assume that in an economy the MPC is 0.75. Assume that there is a multiplier effect and the total crowding-out effect is Rs.4 billion. An increase in government purchases of Rs.10 billion results in a net

(a) Decrease in aggregate demand by Rs.24 billion
(b) Decrease in aggregate demand by Rs.36 billion
(c) Increase in aggregate demand by Rs.34 billion
(d) Increase in aggregate demand by Rs.36 billion
(e) Decrease in aggregate demand by Rs.12 billion. **(2marks)**

52. 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>

(a) Rs.4,900
(b) Rs.5,000
(c) Rs.6,000
(d) Rs.7,000
(e) Rs.8,000.   **(1 mark)**

<Answer>

53. Consider the following information for a country:

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 is

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

<Answer>

54. The 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>

55. The Finance Minister has released the following particulars of Union Budget for the year 2008:

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

What would be the revenue deficit for the year 2008?

(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)**

56. The following information is extracted from the National Income Accounts of an economy.

<Answer>

Particulars	MUC
NDP at market prices	20,000
NNP at factor cost	16,800
Gross domestic investment	3,200
Corporate profits (profit before tax)	3,000
Subsidies	400
Net domestic investment	2,600
Corporate profit tax	1,400
Personal tax payments	1,400
Indirect taxes	3,800
Factor income paid abroad	500

What is the factor income received from abroad?

(a)   –300 MUC
(b)   300 MUC
(c)   –700 MUC
(d)   700 MUC
(e)   400 MUC.   **(2marks)**

<Answer>

57. The following particulars are available for an economy:

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

The money supply in the economy is

(a)   Rs.10,000 cr
(b)   Rs. 1,000 cr
(c)   Rs.20,000 cr
(d)   Rs.15,000 cr
(e)   Rs. 7,500 cr.   **(2marks)**

<Answer>

58. Compute the non-monetary liabilities of the central bank from the following information:

Particulars	Rs. in crore
Deposits of banks	1,250
Notes in circulation	850
Government deposits	700
Share Capital	5
Reserves	150
Credit to banks	950

(a)   Rs.1,250 cr
(b)   Rs.2,100 cr
(c)   Rs.2,800 cr
(d)   Rs. 855 cr
(e)   Rs.3,905 cr.   **(2marks)**

59. The following information pertains to a commercial bank:

<Answer>

Demand deposits	: Rs.1,000 cr
Time deposits	: Rs.2,000 cr
Capital	: Rs. 100 cr
Reserves	: Rs. 200 cr

What amount of cash the bank is expected to maintain at 4.5% cash reserve requirement?

(a) Rs. 45.00 cr
(b) Rs.135.00 cr
(c) Rs.139.50 cr
(d) Rs.148.50 cr
(e) Rs. 90.00 cr.　　　　　　　　　　　　　　　　　　　　　　　　**(1 mark)**

<Answer>

60. Consider the following details of an economy:

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>

61. 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>

62. Consider the following information:

Multiplier	1.25
Import function	0.16Y
Tax function	0.40Y

What is the marginal propensity to consume?

(a) 0.30
(b) 0.40
(c) 0.60
(d) 1.00
(e) 1.25.　　　　　　　　　　　　　　　　　　　　　　　　**(2marks)**

63. The following data pertains to a hypothetical economy:

Particulars	MUC
Private final consumption expenditure	10,500
Fixed capital formation	3,150
Increase in inventories	700
Government final consumption expenditure	2,240
Exports	560
Imports	150
Money supply	4,250

<Answer>

The velocity of money in the economy is

(a) 3
(b) 4
(c) 5
(d) 6
(e) 7. **(2marks)**

<Answer>

64. The monetary liabilities of the central bank of an economy are 20,000 MUC. The government money in the economy is 200MUC. Currency deposit ratio for the economy is estimated to be 0.2 and reserve ratio imposed by the central bank is 5 percent. If foreign exchange reserves of the country decline by 250MUC, money supply would

(a) Decline by 1,200MUC
(b) Increase by 1,200MUC
(c) Decline by 1,820MUC
(d) Increase by 1,820 MUC
(e) Decline by 1,480MUC. **(2marks)**

<Answer>

65. The following are the excerpts from the balance sheet of the Reserve Bank of India.

Particulars	Rs. in crore
Notes in circulation	400
Other deposits	200
Other non-monetary liabilities	400
Statutory and contingency reserves	1,680
Credit to Central Government	4,480
Shares & loans to financial institutions	2,200
Central bank claims on Commercial banks	1,400
Net foreign exchange assets	600
Other assets	200

If the government money is Rs.100 crore, the high powered money in the economy is

(a) Rs.6,600 crore
(b) Rs.6,800 crore
(c) Rs.6,850 crore
(d) Rs.6,900 crore
(e) Rs.7,000 crore. **(2marks)**

<Answer>

66. The following are the indicators of financial development of an economy for the year 2008:

Finance Ratio	0.25
Intermediation Ratio	0.50

If the Net Physical Capital Formation and the new issues for the year 2008 are 30,000 MUC and 40,000 MUC respectively, the financial interrelation ratio is

(a) 1.0
(b) 1.5
(c) 2.0
(d) 3.0
(e) 6.0. **(2marks)**

67. The consumption function for a two sector economy C = 1,600 + 0.5Y and investment is an autonomous component. If equilibrium income is 4,400 MUC, what is the investment?

<Answer>

(a) 200 MUC
(b) 600 MUC
(c) 2,000 MUC
(d) 4,400 MUC
(e) 7,200 MUC.

(1 mark)

<Answer>

68. A consumption survey conducted for an economy revealed the following statistics:

Particulars	Estimates
Tax rate (as % of total income)	25%
Aggregate tax collected	2,500 MUC
Transfer payments	1,000 MUC
Autonomous consumption	20 MUC
Marginal propensity to consume	0.6

The estimated consumption for the economy amounts to

(a) 5,000 MUC
(b) 5,120 MUC
(c) 6,130 MUC
(d) 5,690 MUC
(e) 3,450 MUC.

(2marks)

<Answer>

69. India's overall Balance of Payments for the year 2008 is given below:

(Rs. in million)

Items	Credit	Debit
Merchandise	5,30,000	6,54,740
Foreign Direct Investment	47,900	11,790
Portfolio Investment	75,350	65,910
Errors and Omissions	6,340	–

During the year 2008, trade balance of India was

(a) Rs.1,72,800 million (deficit)
(b) Rs.1,72,800 million (surplus)
(c) Rs.1,82,800 million (surplus)
(d) Rs.1,24,740 million (deficit)
(e) Rs.1,24,740 million (surplus).

(1 mark)

<Answer>

70. On 31st October 2008, Rajesh, a stockbroker, collects Rs.40,000 towards his commission. Over the day, the value of his office equipments depreciated by Rs.3,000. He paid Rs.1,000 to the government as service taxes; retains Rs.7,000 in his business and took home the remaining amount as his wages. From his personal income, he pays Rs.3,000 as income tax. What is the contribution made by Rajesh to national income?

(a) Rs.36,000
(b) Rs.37,000
(c) Rs.20,000
(d) Rs.17,000
(e) Rs.16,000.

(2marks)

71. The following balances are taken from the balance sheet of the Central Bank of a country. <Answer>

Particulars	MUC
Financial Assets	24,000
Other Assets	100
Net worth	1,000
Other non-monetary liabilities	525

The currency/deposit ratio has been ascertained as 0.24. Reserve ratio imposed by the Central Bank is 7%. The amount of Government money is 25 MUC. High powered money in the economy amounts to

(a) 21,600 MUC
(b) 21,800 MUC
(c) 22,400 MUC
(d) 22,600 MUC
(e) 22,800 MUC. **(2marks)**

<Answer>
72. The net export function for the economy is estimated as E = 200 − 0.1Y. The marginal propensity to consume is 0.75 and the tax rate is 20%. Assuming that the investment is autonomous and increases by 1,250MUC during the year, the trade balance deteriorates by

(a)   100 MUC
(b)   200 MUC
(c)   250 MUC
(d) 1,250 MUC
(e) 2,500 MUC. **(2marks)**

<Answer>
73. In an economy, the exogenous investment is 50 MUC, Government spending is 100 MUC and autonomous consumption is 50 MUC. The net export function is 100 − 0.1Y. If an increase in autonomous investment by 40 MUC leads to an increase in equilibrium income and consumption by 100 MUC and 80 MUC respectively, what would be the new equilibrium income for the economy?

(a) 320 MUC
(b) 500 MUC
(c) 800 MUC
(d) 850 MUC
(e) 900 MUC. **(2marks)**

<Answer>
74. In an economy the high-powered money is 500 MUC. The currency deposit ratio is estimated to be 0.40 and the reserve ratio is 10%. If foreign exchange assets with the central bank increase by 10 MUC, what is the new reserve ratio so that the money supply remains at the previous level?

(a)   9%
(b) 10%
(c) 11%
(d) 12%
(e) 13%. **(2marks)**

<Answer>
75. Consider the following information:

High powered money	Rs.5,100 cr.
Currency deposit ratio in the economy	10%
Cash reserve requirement of the central bank	10%

The money multiplier is

(a)   1.10
(b)   7.33
(c)   5.50
(d) 10.00
(e) 15.00. **(1 mark)**

END OF QUESTION PAPER

Suggested Answers
Business Economics – II (MB1B4): January 2009

	ANSWER	**REASON**	
1.	D	In a four sector economy, consisting of households, firms, government and foreign sectors, the transfer payments flow from Government to households.	≤
2.	C	National product at market price is always higher than national product at factor cost because the amount of indirect taxes which increases the prices is always greater than the subsidies which lower the price.	≤
3.	D	Real GDP is a measure of the value of all goods and services produced in a country during a period of time, corrected for inflation. Thus the extent of difference between nominal GDP and real GDP shows the rate of inflation.	≤
4.	E	The following may cause double counting problem while calculating GDP. • Transfer incomes. Stock inflation. Intermediary products.	≤
5.	C	According to the Keynesian theory beyond full employment level of output, the aggregate supply will increase with increase in aggregate demand and prices also increase.	≤
6.	C	According to Keynes, the consumption function explains the level of aggregate consumption desired at each level of personal disposable income	≤
7.	E	Actual investment can be defined as the investment in new plant and equipment. It also includes inventories acquired during the year whether they are desired or undesired inventories.	≤
8.	C	In a situation of recession the government of India should increase its spending and decrease the taxes.	≤
9.	B	The rate of interest at which the Central bank rediscounts approved bills of exchange is called as Bank rate.	≤
10.	D	Monetarist advocated that nominal GDP in the short run and prices in the long run are determined by growth of money.	≤

11.	D	Bank Rate, Open market operation and Regulation of consumer credit are monetary policy measures the Central bank can adopt to control inflation in an economy.	≤
12.	E	Mobilization of resources, Reduction of disparities of income and Price stability are objective(s) of fiscal policy in general.	≤
13.	A	The ratio of total financial claims issued during the year to national income of that year is called as Finance ratio.	≤
14.	E	Quotas, Subsidies and Licensing are called as non tariff barriers.	≤
15.	A	Aggregate demand states the relationships between various quantities of output that all people together will buy at various price levels in a defined period.	≤
16.	E	Human resources, Capital resources and Self-sufficiency affect the size of a nation's income.	≤
17.	C	Tax exemptions to firms making investments in new businesses, new plants and buildings etc. to encourage incentives is suggested by supply side economists.	≤
18.	D	Open market operations refer to the buying or selling of securities such as government securities, banker's acceptances or foreign exchanges by the Central Bank.	≤
19.	E	Credit to the Government is an example of assets of Reserve Bank of India (RBI).	≤
20.	C	During recession, there is unexpected reduction the general level of demand for goods and services. This is an important cause of Cyclical unemployment.	≤
21.	A	Aggregate supply curve is the real value of output producers are willing and able to bring to market at alternative price levels (ceteris paribus).	≤

| 22. | B | Due to the multiplier effect, a decrease in investment spending leads to an even larger decrease in output. | ≤ |

| 23. | D | Steep rise in taxes will dampen the economy and so not the right medicine. So the correct answer is D. All the other measures A, B, C, and E will boost the Economy | ≤ |

(a) Is not the answer because expansion in money supply does not dampen the growth rate of an economy
(b) Is not the answer because increase in the level of investment does not dampen the growth rate of an economy
(c) Is not the answer because reduction in the rate of interest does not dampen the growth rate of an economy
(d) Is the answer because steep rise in the tax rates dampens the growth rate of an economy
(e) Is not the answer because rising prices does not dampen the growth rate of an economy

| 24. | C | In the equations, $C = 1,400 + 0.2Y_d$, the marginal propensity to consume is 0.2; autonomous consumption spending is Rs.1,400. | ≤ |

| 25. | D | If the RBI sells bonds in an open market operation the equilibrium level of GDP decreases | ≤ |

| 26. | A | The RBI currency together with the Government money with commercial banks is considered as vault cash. | ≤ |

| 27. | A | Aggregate expenditure is the spending by households, government, and firms on final goods and services. | ≤ |

| 28. | A | In the short-run, in Keynesian model, when aggregate expenditure is less than GDP, output will decline as firms reduces production to stop the buildup of inventories. | ≤ |

| 29. | 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. | ≤ |

| 30. | B | In the period of recession employment decreases and aggregate production decreases. | ≤ |

| 31. | D | Excise duty is an indirect tax. An indirect tax is imposed on one person but paid wholly or partly by another person. | ≤ |

32.	D	Purchases of fixed assets like cars, plant and machinery etc.	≤
33.	E	Increase in price level, Population growth and Development Basic infrastructures are responsible for the increase in public expenditure.	≤
34.	B	Under the paper currency system, determination of the exchange rate usually takes into account the purchasing power of a national currency.	≤
35.	A	The correct sequence of events of a contractionary monetary policy is interest rate increase, causing planned investment to decrease, causing aggregate output to decrease, causing money demand to decrease.	≤
36.	B	In the long run, the economy is at full employment. So there is no long run trade-off between inflation and unemployment. As a result, the long run Phillips Curve is a vertical line above full employment. The long run Phillips curve, in contrast to the short run curve, does not hold the expected inflation rate constant (but does hold the natural unemployment rate constant). More specifically, the long run Phillips curve shows the relationship between inflation and unemployment when the actual inflation rate equals the expected inflation rate. This curve is vertical at the natural rate of unemployment: any anticipated (and actual) inflation rate is possible at the natural rate of unemployment. When inflation is accurately anticipated, real GDP equals potential GDP, and unemployment is at the natural rate. Expected inflation has no impact on the long run Phillips curve.	≤
37.	C	A country's balance of payment is a systematic record of all economic transactions between that country and the rest of the world.	≤
38.	A	Leakages are factors which tend to decrease the level of national income. Imports tend to decrease the national income.	≤
39.	A	Stagflation refers to a situation where there is high unemployment and high inflation occur simultaneously. Statement I is true as stagflation refers to coexistence of stagnant output and high inflation. Statement II is false because during stagflation, there is no increase in output and hence the output is stagnant. Therefore real GDP is not growing. Statement III is true because during stagflation, the output is stagnant, new employment opportunities are not created and hence unemployment level is high. Statement IV is false as the price are high and there is unemployment, the aggregate demand tends to be low. So the answer is (a).	≤
40.	C	'Velocity of money' refers to the speed at which money changes hands. The ratio of nominal GDP to the money stock defines the income velocity of money (that is, $V = GDP/M = PQ/M$). Thus, the price level in the economy will increase because of rise in velocity of money.	≤

41.	C	NDP at market price	=	NDP at factor cost + Indirect taxes	≤
		NDP at factor cost	=	Wages paid to domestic residents + Wages paid to foreigners + Interest payment on loans taken from foreign banks + Retained profits + Corporate tax	
			=	400 + 240 + 10 + 20 + 10 = 680	
		∴ NDP at market prices	=	680 + 15 = Rs.695 cr.	

42. B NDP at factor cost = NDP at market prices − Indirect taxes + Subsidies ≤
= 2,60,000 − 30,000 + 40,000
= Rs.2,70,000 Cr.

43.	D	National Income	=	NNP at factor cost	≤
			=	NNP at market prices − Indirect taxes + Subsidies	
			=	[1,00,000 − 14,000 + 2,000]	
			=	88,000 MUC	
		Personal income	=	National Income − Corporate profit taxes − Retained profit	
			=	88,000 − 6,500 − 30,000 MUC	
			=	51,500 MUC.	

44. A Net exports = Y − C − I − G = 5,000 − (3,000 + 600 + 200) = 1,200 MUC. ≤

45.	B	National Income	=	NNP at factor cost	≤
			=	NDP at factor cost + Net income from abroad	
			=	NDP at market prices − Indirect taxes + Subsidies + Net income from abroad	
			=	(77,000 − 7,700 + 6,700) + (−700)	
			=	76000 + (−700)	
			=	75,300 MUC.	

46. B Value addition = Output − Inputs. ≤

Value addition by industry 'A'	=	400 − (100 + 40 + 60)	=	200 MUC
Value addition by industry 'B'	=	480 − (160 + 120 + 80)	=	120 MUC
Value addition by industry 'C'	=	320 − (60 + 100 + 120)	=	40 MUC
Total Value Addition			=	360 MUC.

47. B
$$\left[\left(\frac{1+0.08}{1+0.01}\right)-1\right] = 6.93\ \%.$$
≤

48. B $S = -30 + 0.40 Y_d$ ≤

Consumption C = Y − S
= Y − (−30 + 0.40Y_d)
= 30 + 0.60 Y_d

Y_d = C + I
= 30 + 0.60 Y_d + 70
= 100 + 0.60 Y_d

0.4 Y_d = 100
Y_d = 250 MUC.

49. C $S = -100 + 0.25\ Y_d$ ≤

When S = 100, 100 = −100 + 0.25 Y_d
or, 200 = 0.25 Y_d
or, Y_d = 800 MUC.
Since the economy is a two sector economy, Y = Y_d (disposable income).

| 50. | B | Investment in period 't' = 0.75 × Designed investment in period 't' | ≤ |
| | | Designed investment in period 't' | |

50. B Investment in period 't' = 0.75 × Designed investment in period 't' ≤
Designed investment in period 't'
= Acceleration co-efficient × change in income = 2 × 200 = 400
∴ Investment in period 't' = 0.75 × 400 = 300 MUC
∴ The answer is (b).

51. D MPC = 0.75 ≤

$$\text{Multiplier} = \frac{1}{1-\text{MPC}} = \frac{1}{1-0.75} = 4$$

Therefore increase in AD = 4 × 10 = Rs.40 billion
As the crowding out effect is Rs. 4 billion, net increase in AD = 40 − 4 = Rs.36 billion.

52. C When Y = 20,000, C = Y = 20,000 ≤
C   = α + βY
20,000 = α + (0.7 × 20,000)
∴ α   = 20,000 − 14,000 = Rs.6,000.

53. 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.

54. 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
∴ Money supply M_s = $\frac{1+Cu}{Cu+r} \times H$
= $\frac{1+0.20}{0.20+0.05} \times 1,250$ = 4.8 × 1,250 = 6,000 MUC.

55. 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.

56. D $NFIA = NNP_{MP} − NDP_{MP}$ ≤
$NNP_{MP} = NNP_{FC}$ + Indirect Taxes − Subsidies = 16800 + 3800 − 400 = 20200
Thus, NFIA = 20200 − 20000 = 200MUC.
Factor income received from abroad = Factor income paid abroad + net factor income earned abroad
= 500 + 200 = 700MUC.

57. B
Velocity of money = $\frac{Y}{\text{Money supply}}$ ≤
Where Y = C + I + G + E − M = 15,000
Money supply = Y/Velocity of money = 15,000/15 = Rs.1,000 cr.

58. D Non-monetary liabilities = Paid-up capital + Reserves + Government deposits ≤
= 5 + 150 + 700 = Rs.855 cr.

59. B $0.045 \times (2{,}000 + 1{,}000) = \text{Rs.}135$ cr.   ≤

60. C   Goods market will be in equilibrium when Y = AD = C + I + G   ≤
$Y = 500 + 0.75(Y - T) + 100 - 50i + 1000$
$\quad = 1600 + 0.75(Y - 1000) - 50i$
$Y = 850 + 0.75Y - 50i$
$0.25Y = 850 - 50i$ ….. 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).

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

Current Account

Dr.				Cr.
Particulars	Amount	Particulars		Amount
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.
Particulars	Amount	Particulars	Amount
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.

62.	C	$$\text{Multiplier} = \frac{1}{1-\beta+\beta t+\mu}$$ Where β = mpc. t = 0.40 μ = 0.16 $$\therefore 1.25 = \frac{1}{1-\beta+0.40\beta+0.16}$$ Or, $1.25 = \frac{1}{1.16-0.60\beta}$ Or, $1.45 - 0.75\beta = 1$ Or, $0.75\beta = 0.45$ Or, $\beta = 0.60$ mpc = 0.60.	≤
63.	B	Velocity of money = Y/M_S Y = C + I + G + E – M 10,500 + 3,150 + 700 + 2,240 + 560 – 150 = 17000 $\therefore$ Velocity of money = 17000/4250 = 4.	≤

64.	A	Ms = High-powered money x {(1 + Cu)/(Cu + r)}; where High powered money = monetary liabilities of the central bank + government money.
		 ΔMs = ΔH. m
		 m = (1+Cu) /(Cu + r)
		    = (1+0.2)/ (0.2+0.05)
		    = 4.8
		 When foreign exchange reserves of the country decline by Rs.250 MUC, the monetary liabilities also fall by 250 MUC. Thus, money supply decline by 4.8 × 250 = 1200MUC.
			≤

65.	D	High powered money = Monetary liabilities of central bank + Government money Monetary liabilities of central bank = Financial Assets + Other assets – Non-monetary liabilities Financial Assets = Credit to government + claims on commercial banks + credit to commercial sectors + foreign exchange assets = 4,480+ 1,400 + 2,200+ 600 = 8680 Non-monetary liabilities = 400 + 1,680 = 2080 Monetary liabilities of central bank = 8680 + 200 – 2080 = 6,800 High powered money = 6800 + 100 = Rs.6,900 crore.	≤
66.	C	Intermediation Ratio = Secondary issues/New issues Or, secondary issues = Intermediation ratio x New issues = 0.5 × 40,000 = 20,000 MUC Total issues = New issues + Secondary issues = 40,000 + 20000 = 60,000 MUC Financial Interrelations Ratio = Total issues/Net Physical Capital Formation (NPCF) = 60000 /30000 = 2.0.	≤
67.	B	Y = C + I Y = 1600 + 0.5 Y + I 0.5 × 4400 = 1600 + I I = 600 MUC.	≤
68.	B	We have C = a + b (Y – T + J) where C is the aggregate consumption, a is the autonomous consumption, b is the marginal propensity to consume, Y is the income level, T refers to absolute amount of tax and J refers to transfer payments Substituting, we have C = 20 + 0.6 (10000 – 2,500 + 1,000) = 20 + 0.6(8,500) = 5,120 MUC [Total tax collected = 2500 MUC which is 25 % of total income. So total income = 10,000 MUC].	≤

69.	D	Balance of trade = Merchandise (cr.) – Merchandise (Dr.)	≤
		= 5,30,000 – 6,54,740	
		= –Rs.1,24,740 million	
		= Rs.1,24,740 million (deficit).	

| 70. | A | Contribution to National income = Contribution to GNP at market prices – depreciation – indirect taxes = 40,000 – 3,000 – 1,000 =Rs.36,000. | ≤ |

71.   D

High powered money	=	Monetary Liabilities of RBI + Government Money	≤
Monetary liabilities of RBI	=	Financial Assets + Other Assets – Non-monetary liabilities	
Non-monetary liabilities	=	Other non-monetary liabilities + Net worth	
	=	525 + 1,000 = 1,525 MUC	
∴ Monetary liabilities	=	24,000 + 100 – 1525 = 22,575 MUC	
Government money	=	25 MUC	
∴ High powered money (H)	=	22,575 + 25 = 22,600 MUC.	

72.   C

Multiplier = $1/(1 - MPC + MPC \times t + MPI) = 1/(1 - 0.75 + 0.75 \times 0.2 + 0.10) = 1/0.50 = 2$ ≤

Thus if investment increases by 1250, income increases by 2500. Thus, change in trade balance

$= -0.1 \times 2,500 = (250)$ MUC.

73.   D

Marginal propensity to consume (MPC) $= \Delta C/\Delta Y = 80/100 = 0.8$ ≤

Multiplier $= \Delta Y/\Delta I = 100/40 = 2.5 = 1/(1 - MPC + MPC \times t + MPI)$

$= 1/(0.2 + 0.8t + 0.1) = 1/(0.3 + 0.8t)$

or, $2.5(0.3 + 0.8t) = 1$

or, $0.75 + 2t = 1$

or, $2t = 0.25$

or, $t = 0.125$ or 12.5%

At equilibrium,

$Y = C + I + G + NE = \{50 + 0.8(Y - 0.125Y)\} + 50 + 140 + 100 - 0.1Y$

$Y = 340 + 0.7Y - 0.1Y$

or, $0.4Y = 340$

or, $Y = 850$ MUC.

74.   C

Money supply, $M = \dfrac{1+Cu}{Cu+r} \times H$ ≤

$= \dfrac{1+0.40}{0.40+0.10} \times 500$

$= 2.8 \times 500$

$= 1,400$ MUC

If there is an additional inflow of 10 MUC of foreign exchange assets, H = 500 + 10 = 510

If money supply is to be maintained at 1,400 MUC,

$1,400 = \dfrac{510 \times \dfrac{1.40}{(0.40+r)}}{}$

or, $0.40 + r = \dfrac{510 \times \dfrac{1.40}{1,400}}{}$

or, $0.40 + r = 0.51$

or, $r = 0.11 = 11\%$.

75.   C

Money multiplier $= \left[\dfrac{1+Cu}{Cu+r}\right] = \left[\dfrac{1+0.10}{0.10+0.10}\right] = 5.50$ ≤

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