12th Economics Lesson 4 Questions in English

4] Consumption and Investment Functions

1. What is the primary objective of the macroeconomics?

   a) Growth in per capita income
   b) To make Gross happiness Index high
   c) Growth in National Income
   d) All the above

Explanation

The primary macroeconomic objective is acceleration of growth of national income. This chapter deals with consumption function and the investment function which play a vital role in influencing national income.

2. Which of the following has close correlation?

   1) investment
   2) consumption
   3) national income
      a) 1, 2
      b) 1, 3
      c) 2, 3
      d) All the above

Explanation

The national income comprises of consumption goods (C) and investment (I) goods. There is close correlation between investment and national income.

3. Which of the following statement is correct?

   1) The multiplier refers to the change in national income resulting from change in investment.
   2) The consumption function is the relationship between consumption expenditure and the national income
   3) The relationship between consumption expenditure and the capital expenditure is explained by the principle of accelerator.
      a) 1, 2
      b) 1, 3
      c) 2, 3
      d) All the above

Explanation

The multiplier refers to the change in national income resulting from change in investment. The value of multiplier itself depends on consumption function or marginal propensity to consume. The consumption function is the relationship between consumption expenditure and the national income. The unspent portion of national income is called saving which becomes investment and thereby capital. The relationship between consumption expenditure and the capital expenditure is explained by the principle of accelerator. All these variables are closely interconnected.

4. Assertion(A): The consumption function or propensity to consume refers to income consumption

   relationship.

   Reason(R): It is a "functional relationship between two aggregates viz., total consumption and

   gross national income."

   a) **Both (A) and (R) are correct, but (R) does not explain (A)**

   b) Both (A) and (R) are wrong

   c) Both (A) and (R) are correct and (R) explains (A)

   d) (A) is Correct and (R) is wrong

Explanation

The consumption function or propensity to consume refers to income consumption relationship. It is a "functional relationship between two aggregates viz., total consumption and gross national income." Symbolically, the relationship is represented as C= f (Y)

5. What does the Y represent in CONSUMPTION FUNCTION?

   C= f (Y)

   a) Consumption
   b) Function
   c) **Income**
   d) All the above

Explanation

Symbolically, the CONSUMPTION FUNCTION relationship is represented as,

C= f (Y)

Where, C = Consumption Y = Income f = Function Thus the consumption function indicates a functional relationship between C and Y, where C is the dependent variable and Y is the independent variable, i.e., C is determined by Y.

6. Which of the following statement is correct?

1) Consumption Function relationship is based on the ceteris paribus (other things being same) assumption, as only income consumption relationship is considered and all possible influences on consumption are held constant

2) consumption function is a schedule of the various amounts of consumption expenditure corresponding to different levels of income

   a) 1 alone
   b) 2 alone
   c) **1, 2**
   d) None

Explanation

Consumption Function relationship is based on the ceteris paribus (other things being same) assumption, as only income consumption relationship is considered and all possible influences on consumption are held constant. In fact, consumption function is a schedule of the various amounts of consumption expenditure corresponding to different levels of income.

7. _____ is the ratio of consumption expenditure to any particular level of income

   a) **Average Propensity to Consume**
   b) Marginal Propensity to Consume
   c) Average Propensity to Save
   d) Marginal Propensity to Save

Explanation

The average propensity to consume is the ratio of consumption expenditure to any particular level of income."

$APC = C / Y$

Algebraically it may be expressed as under: Where, C= Consumption Y = Income

8. The marginal propensity to consume may be defined as the ratio of_____

   a) consumption expenditure to any particular level of income
   b) ratio of saving to income
   c) **change in the consumption to the change in income**
   d) change in saving to a change in income

Explanation

The marginal propensity to consume may be defined as the ratio of the change in the consumption to the change in income. Algebraically it may be expressed as under:

9. The Marginal Propensity to Consume ratio varies between____

    a) 0 < MPC < infinity
    b) 0 < MPC < 1
    c) 0 < MPC < 10
    d) 0 < MPC < 2

Explanation

The Marginal Propensity to Consume = $\Delta C / \Delta Y$

Where, ΔC= Change in Consumption ΔY = Change in Income MPC is positive but less than unity

$0 < \Delta C / \Delta Y < 1$

10. The ratio of total saving by the total income is called as_____

    a) Marginal Propensity to Save
    b) Marginal Propensity to Consume
    c) Average Propensity to Save
    d) Average Propensity to Consume

Explanation

The average propensity to save is the ratio of saving to income. APS is the quotient obtained by dividing the total saving by the total income. In other words, it is the ratio of total savings to total income. It can be expressed algebraically in the form of equation as under

APS = S / Y

Where, S= Saving Y=Income

11. _____ is the ratio of change in saving to a change in income.

    a) Marginal Propensity to Save
    b) Marginal Propensity to Consume
    c) Average Propensity to Save
    d) Average Propensity to Consume

Explanation

Marginal Propensity to Save is the ratio of change in saving to a change in income. MPS is obtained by dividing change in savings by change in income. It can be expressed algebraically as

MPS = $\Delta S / \Delta Y$

12. MPC+MPS =_____

   a) 1
   b) APS
   c) APC
   d) MPC^2 – MPS^2

Explanation

Since MPC+MPS=1

MPS=1-MPC and MPC = 1 - MPS

Generally, the average i.e. APC is expressed in percentage and the MPC in fraction

13. When Income and consumption is 120, what will be the percentage of APC?

   a) 0
   b) 1
   c) 100
   d) 50

Explanation

Income	Consumption	APC %	APS %	MPC	MPS
Y	C	C/Y	S/Y	ΔC/ΔY	ΔS/ΔY
120	120	(120/120)100 = 100	(0/120)0	-	-
180	170	(170/180)100 = 94	(10/180)100	50/60 = 0.83	0.17

14. Which of the following statement is correct?

   1) Keynes propounded the fundamental Psychological Law of Consumption which forms the basis of the consumption function
   2) His law implies that there is a tendency on the part of the people to spend on consumption less than the full increment of income.
      a) 1 alone
      b) 2 alone
      c) 1, 2
      d) None

Explanation

Keynes propounded the fundamental Psychological Law of Consumption which forms the basis of the consumption function. He stated that "The fundamental psychological law upon which we are entitled to depend with great confidence both prior from our knowledge of human nature and from the detailed facts of experience, is that men are disposed as a rule and on the average to increase

their consumption as their income increases but not by as much as the increase in their income." The law implies that there is a tendency on the part of the people to spend on consumption less than the full increment of income.

15. According to Ceteris paribus consumption depends on_____

   a) income distribution
   b) tastes
   c) **Income**
   d) habits

Explanation

Ceteris paribus (constant extraneous variables): The other variables such as income distribution, tastes, habits, social customs, price movements, population growth, etc. do not change and consumption depends on income alone.

16. Assertion: The law holds good under normal conditions

   Reason(R): Under abnormal and extraordinary circumstances the law will not operate

   a) Both (A) and (R) are correct, but (R) does not explain (A)

   b) Both (A) and (R) are wrong

   c) **Both (A) and (R) are correct and (R) explains (A)**

   d) (A) is Correct and (R) is wrong

Explanation

Keynes's Psychological Law of Consumption holds good under normal conditions. If, however, the economy is faced with abnormal and extraordinary circumstances like war, revolution or hyperinflation, the law will not operate. People may spend the whole of increased income on consumption.

17. Which of the following statement about Keynes's Psychological Law of Consumption is correct?

   1) The law operates in a rich Socialist economy where there is government intervention
   2) People should be free to spend increased income.
   3) In the case of regulation of private enterprise and consumption expenditures by the State, the law breaks down.
        a) 1, 2
        b) 1, 3
        c) **2, 3**
        d) All the above

Explanation

Existence of a Laissez-faire Capitalist Economy:

Keynes's Psychological Law of Consumption operates in a rich capitalist economy where there is no government intervention. People should be free to spend increased income. In the case of regulation of private enterprise and consumption expenditures by the State, the law breaks down.

18. Assertion(A): consumption expenditure increases with increase in income but less than

    Proportionately

  Reason(R): The reason is that as income increases, our wants are satisfied side by side, so that

    the need to spend more on consumer goods diminishes

    a) Both (A) and (R) are correct, but (R) does not explain (A)

    b) Both (A) and (R) are wrong

    c) **Both (A) and (R) are correct and (R) explains (A)**

    d) (A) is Correct and (R) is wrong

Explanation

When income increases, consumption expenditure also increases but by a smaller amount. The reason is that as income increases, our wants are satisfied side by side, so that the need to spend more on consumer goods diminishes. So, the consumption expenditure increases with increase in income but less than proportionately

19. Assertion(A): The increased income will be divided in some proportion between consumption

    expenditure and saving.

  Reason(R): consumption and saving will always move together

    a) **Both (A) and (R) are correct, but (R) does not explain (A)**

    b) Both (A) and (R) are wrong

    c) Both (A) and (R) are correct and (R) explains (A)

    d) (A) is Correct and (R) is wrong

Explanation

The increased income will be divided in some proportion between consumption expenditure and saving. This follows from the first proposition because when the whole of increased income is not spent on consumption, the remaining is saved. In this way, consumption and saving move together.

20. Increase in income always leads to_____

   a) **Increase in both consumption and saving**
   b) decrease in both consumption and saving
   c) Increase in consumption
   d) Increase in saving

Explanation

Increase in income always leads to an increase in both consumption and saving. This means that increased income is unlikely to lead to fall in either consumption or saving. Thus, with increased income both consumption and saving increase.

21. Which of the following statement is correct?

   1) J.M Keynes has divided factors influencing the consumption function into Subjective factors and Objective factors
   2) Subjective factors are the internal factors related to psychological feelings
   3) Keynes lists eight motives which lead individuals to refrain from spending
       a) 1, 2
       b) 1, 3
       c) 2, 3
       d) **All the above**

Explanation

J.M Keynes has divided factors influencing the consumption function into two namely: Subjective factors and Objective factors. Subjective factors are the internal factors related to psychological feelings. Major subjective factors influencing consumption function are given below. Keynes lists eight motives which lead individuals to refrain from spending.

22. Match the following

I.	motive of precaution	1. desire to enjoy for improving standard of living
II.	motive of foresight	2. Desire to build up a reserve against unforeseen contingencies
III.	motive of improvement	3. purely miserly instinct
IV.	motive of avarice	4. desire to provide for anticipated future needs

   a) 3, 2, 1, 4
   b) 4, 2, 1, 3
   c) **2, 4, 1, 3**
   d) 2, 3, 1, 4

Explanation

Keynes lists eight motives which lead individuals to refrain from spending, they are: 1. The motive of precaution: To build up a reserve against unforeseen contingencies. Eg. Accidents, sickness 2.

The motive of foresight: The desire to provide for anticipated future needs. Eg. Old age 3. The motive of calculation: The desire to enjoy interest and appreciation. 4. The motive of improvement: The desire to enjoy for improving standard of living. 5. The motive of financial independence. 6. The motive of enterprise (desire to do forward trading). 7. The motive of pride. (desire to bequeath a fortune) 8. The motive of avarice. (purely miserly instinct)

Keynes sums up the motives as Precaution, Foresight, Calculation, Improvement, Independence, Enterprise, Pride and Avarice

23. What are the motives of Government, institutions and business corporations and firms?

1) motive of enterprise
2) motive of liquidity
3) motive of financial prudence
4) motive of improvement
   a) 1, 2, 3
   b) 1, 3, 4
   c) 2, 3, 4
   d) All the above

Explanation

The Government, institutions and business corporations and firms may also consume mainly because of the following four motives: 1. The motive of enterprise: The desire to obtain resources to carry out further capital investment without incurring debt. 2. The motive of liquidity: The desire to secure liquid resources to meet emergencies, and difficulties. 3. The motive of improvement: The desire to secure a rising income and to demonstrate successful management. 4. The motive of financial prudence: The desire to ensure adequate financial provision against depreciation and obsolescence and to discharge debt. According to Keynes, the subjective factors do not change in the short run and hence consumption function remains stable in the short period.

24. Which of the following statement about Objective factors by Keynes is incorrect?

1) Objective factors are the internal factors which are real and measurable
2) These factors can be easily changed in the long run.
   a) 1 alone
   b) 2 alone
   c) 1, 2
   d) None

Explanation

Objective factors are the external factors which are real and measurable. These factors can be easily changed in the long run. Major objective factors influencing consumption function.

25. Which of the following statement is correct?

1) If there is large disparity between rich and poor, the consumption is low because the rich people have low propensity to consume and high propensity to save
2) The community with more equal distribution of income tends to have high propensity to consume.
3) This view has been corroborated by J.M. Keynes
   a) 1, 2
   b) 1, 3
   c) 2, 3
   d) All the above

Explanation

If there is large disparity between rich and poor, the consumption is low because the rich people have low propensity to consume and high propensity to save. The community with more equal distribution of income tends to have high propensity to consume. This view has been corroborated by V.K.R.V. Rao.

26. Assertion(A): Price level plays an important role in determining the consumption function

   Reason(R): When the price falls, real income goes up; people will consume more and propensity to save of the society increases.

   a) Both (A) and (R) are correct, but (R) does not explain (A)

   b) Both (A) and (R) are wrong

   c) Both (A) and (R) are correct and (R) explains (A)

   d) (A) is Correct and (R) is wrong

Explanation

Price level plays an important role in determining the consumption function. When the price falls, real income goes up; people will consume more and propensity to save of the society increases.

27. Which of the following statement is correct?

1) Wage level plays an important role in determining the consumption function and there is positive relationship between wage and consumption.
2) Consumption expenditure increases with the rise in wages.
3) Similar is the effect with regard to windfall gains.
   a) 1, 2
   b) 1, 3
   c) 2, 3
   d) All the above

Explanation

Wage level plays an important role in determining the consumption function and there is positive relationship between wage and consumption. Consumption expenditure increases with the rise in wages. Similar is the effect with regard to windfall gains.

28. _____will encourage people to save more money and reduces consumption

    a) **Higher rate of interest**
    b) Lower rate of interest
    c) Both a and b
    d) None

Explanation

Rate of interest plays an important role in determining the consumption function. Higher rate of interest will encourage people to save more money and reduces consumption.

29. When government reduces the tax which of the following will increase?

    a) disposable income
    b) price
    c) propensity to consume of community
    d) **both a and c**

Explanation

When government reduces the tax the disposable income rises and the propensity to consume of community increases. The progressive tax system increases the propensity to consume of the people by altering the income distribution in favour of poor.

30. Which of the following statement is correct?

    1) The availability of consumer credit at easy instalments will encourage households to buy consumer durables like automobiles, fridge, computer.
    2) Ceteris paribus, the larger the size of the family, the grater is the consumption
    3) Families with children of college education stage spend more than those of primary education and urban families spend more than rural families
       a) 1, 2
       b) 1, 3
       c) 2, 3
       d) **All the above**

Explanation

The availability of consumer credit at easy instalments will encourage households to buy consumer durables like automobiles, fridge, computer. This pushes up consumption. Ceteris paribus, the larger the size of the family, the grater is the consumption. Besides size of family, stage in family life cycle, place of residence and occupation affect the consumption function. Families with children of college education stage spend more than those of primary education and urban families spend more than rural families.

31. Assertion(A): The consumption expenditure depends not only on his current income but also past income and standard of living.

   Reason(R): As the individuals are accustomed to a particular standard of living, they continue to spend the same amount on consumption even though the current income is reduced

   a) Both (A) and (R) are correct, but (R) does not explain (A)

   b) Both (A) and (R) are wrong

   c) **Both (A) and (R) are correct and (R) explains (A)**

   d) (A) is Correct and (R) is wrong

Explanation

The consumption expenditure depends not only on his current income but also past income and standard of living. As the individuals are accustomed to a particular standard of living, they continue to spend the same amount on consumption even though the current income is reduced.

32. Which of the following statement is correct?

   1) Consumption is influenced by demonstration effect
   2) The consumption standards of low-income groups are influenced by the consumption standards of high- income groups
   3) In other words, the rich people want to imitate the consumption pattern of poor
       a) **1, 2**
       b) 1, 3
       c) 2, 3
       d) All the above

Explanation

Consumption is influenced by demonstration effect. The consumption standards of low income groups are influenced by the consumption standards of high income groups. In other words, the poor people want to imitate the consumption pattern of rich. This results in spending beyond their income level.

33. Unexpected changes in the stock market tend to shift the consumption function_____

a) Upwards
b) Downwards
c) **Either a or b**
d) Stock market doesn't have effect on consumption function

Explanation

Windfall Gains or losses: Unexpected changes in the stock market leading to gains or losses tend to shift the consumption function upward or downward.

34. Which of the following has inverse relationship?

1) rate of interest
2) consumption
3) investment
    a) 1, 2
    b) 2, 3
    c) **1, 3**
    d) All the above

Explanation

The investment function refers to investment -interest rate relationship. There is a functional and inverse relationship between rate of interest and investment. The investment function slopes downward.

$I = f (r)$

I= Investment (Dependent variable) r = Rate of interest (Independent variable)

35. Which of the following are forms of investment?

1) purchase of stocks and shares
2) debentures
3) government bonds
    a) 1, 2
    b) 1, 3
    c) 2, 3
    d) **All the above**

Explanation

The term investment means purchase of stocks and shares, debentures, government bonds and equities. According to Keynes, it is only financial investment and not real investment. This type of investment does result in an addition to the stock of real capital of the nation. In the views of Keynes, Investment includes expenditure on capital investment.

36. Which of the following statement about Autonomous Investment is correct?

   1) Autonomous Investment dependents on the national income
   2) It is Mainly done with the welfare motive and not for making profits
   3) It is Not affected by rise in raw materials or wages of workers
       a) 1, 2
       b) 1, 3
       c) 2, 3
       d) All the above

Explanation

Autonomous Investment

● Investment that is not dependent on the national income

● Mainly done with the welfare motive and not for making profits

● Examples : Construction of road, bridges, School, Charitable houses

● Not affected by rise in raw materials or wages of workers

● Essential to development of nation and out of depression

37. Autonomous investment is independent of_____

   1) change in income
   2) rate of interest
   3) rate of profit
       a) 1, 2
       b) 1, 3
       c) 2, 3
       d) All the above

Explanation

Autonomous investment is the expenditure on capital formation, which is independent of the change in income, rate of interest or rate of profit. This investment is independent of economic activity. Autonomous investment is income-inelastic, the volume of autonomous investment is the same at all levels.

38. Which of the following statement is correct?

1) In the times of economic depression, the governments try to boost the autonomous investment
2) autonomous investment is one of the key concepts in welfare economics
3) Government makes autonomous investment because of the welfare consideration
    a) 1, 2
    b) 1, 3
    c) 2, 3
    d) All the above

Explanation

In the times of economic depression, the governments try to boost the autonomous investment. Thus, autonomous investment is one of the key concepts in welfare economics. Generally, Government makes autonomous investment because of the welfare consideration.

39. Which of the following statement about induced investment is correct?

1) Induced investment is the expenditure on fixed assets and stocks which are required when level of income and demand in an economy goes up.
2) Induced investment is profit motivated.
3) It is not related to changes of national income
    a) 1, 2
    b) 1, 3
    c) 2, 3
    d) All the above

Explanation

Induced investment is the expenditure on fixed assets and stocks which are required when level of income and demand in an economy goes up. Induced investment is profit motivated. It is related to the changes of national income.

40. Assertion(A): Decreases in national income leads to decrease in induced investment and vice

versa.

Reason(R): The relationship between the national income and induced investment is positive

a) Both (A) and (R) are correct, but (R) does not explain (A)

b) Both (A) and (R) are wrong

c) Both (A) and (R) are correct and (R) explains (A)

d) (A) is Correct and (R) is wrong

Explanation

The relationship between the national income and induced investment is positive; decreases in national income leads to decrease in induced investment and vice versa. Induced investment is income elastic.

41. Which of the following are the features of induced investment?

1) Planned
2) Income inelastic
3) Profit Motive
    a) 1, 2
    b) 1, 3
    c) 2, 3
    d) All the above

Explanation

Sl. No	Autonomous Investment	Induced Investment
1	Independent	Planned
2	Income inelastic	Income elastic
3	Welfare motive	Profit Motive

42. In reality investment decision depends on_____

1) Rate of interest
2) Political environment
3) Stock of capital goods
4) Policy of the state
    a) 1, 2, 4
    b) 1, 3, 4
    c) 2, 3, 4
    d) All the above

Explanation

The classical economists believed that investment depended exclusively on rate of interest. In reality investment decision depends on a number of factors. They are as follows: 1. Rate of interest 2. Level of uncertainty 3. Political environment 4. Rate of growth of population 5. Stock of capital goods 6. Necessity of new products 7. Level of income of investors 8. Inventions and innovations 9. Consumer demand 10. Policy of the state 11. Availability of capital 12. Liquid assets of the investors

43. Which of the following statement is correct?

1) Private investment is an increase in the capital stock such as buying a factory or machine

2) The marginal efficiency of capital (MEC) states the rate of return on an investment project.
3) If the marginal efficiency of capital is 5% and interest rates is 4%, then it is worth borrowing at 4% to get an expected increase in output of 5%.
   a) 1, 2
   b) 1, 3
   c) 2, 3
   d) **All the above**

Explanation

Keynes contended that business expectations and profits are more important in deciding investment. He also pointed out that investment depends on MEC (Marginal Efficiency of Capital) and rate of interest. i. Private investment is an increase in the capital stock such as buying a factory or machine. ii. The marginal efficiency of capital (MEC) states the rate of return on an investment project. Specifically, it refers to the annual percentage yield (output) earned by the last additional unit of capital. iii. If the marginal efficiency of capital is 5% and interest rates is 4%, then it is worth borrowing at 4% to get an expected increase in output of 5%.

44. Which of the following will reduced due to higher interest rate?

   a) **Investment**
   b) cost of borrowing
   c) both a and b
   d) either a or b

Explanation

The rate of interest influences the level of investment in the economy: Typically, higher interest rates reduce investment, because higher rates increase the cost of borrowing and require investment to have a higher rate of return to be profitable.

45. Assertion(A): Saving money in a bank gives a higher rate of return

    Reason(R): using savings to finance investment has an opportunity cost of lower interest

        payments.

   a) Both (A) and (R) are correct, but (R) does not explain (A)

   b) Both (A) and (R) are wrong

   c) **Both (A) and (R) are correct and (R) explains (A)**

   d) (A) is Correct and (R) is wrong

Explanation

If interest rates are increased then it will tend to discourage investment because investment has a higher opportunity cost. 1. With higher rates, it is more expensive to borrow money from a bank. 2. Saving money in a bank gives a higher rate of return. Therefore, using savings to finance investment has an opportunity cost of lower interest payments. If interest rates rise, firms will need to gain a better rate of return to justify the cost of borrowing using savings.
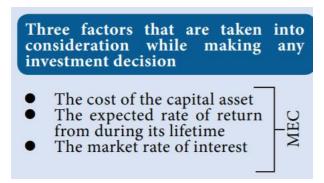
46. Which of the following statement about Marginal Efficiency of Capital is correct?

1) MEC was first introduced by J.M Keynes in 1936 as an important determinant of autonomous investment
2) It may be defined as the highest rate of return over cost expected from the additional unit of capital asset.
3) Meaning of Marginal Efficiency of Capital (MEC) is the rate of discount which makes the discounted present value of expected income stream equal to the cost of capital
   a) 1, 2
   b) 1, 3
   c) 2, 3
   d) **All the above**

Explanation

MEC was first introduced by J.M Keynes in 1936 as an important determinant of autonomous investment. The MEC is the expected profitability of an additional capital asset. It may be defined as the highest rate of return over cost expected from the additional unit of capital asset. Meaning of Marginal Efficiency of Capital (MEC) is the rate of discount which makes the discounted present value of expected income stream equal to the cost of capital.

47. What factors should be taken into consideration while making any investment decision?

1) cost of the capital asset
2) expected rate of return from during its lifetime
3) market rate of interest
   a) 1, 2
   b) 1, 3
   c) 2, 3
   d) **All the above**

Explanation

48. Marginal Efficiency of Capital depends on which factors?

    1) prospective yield from a capital asset
    2) market rate of interest
    3) supply price of a capital asset
        a) 1, 2
        b) 1, 3
        c) 2, 3
        d) All the above

Explanation

MEC depends on two factors: 1. The prospective yield from a capital asset. 2. The supply price of a capital asset. The marginal efficiency of capital is influenced by short - run as well as longrun factors

49. Which of the following statement is correct?

    1) If the market for a particular good is expected to grow and its costs are likely to fall, the rate of return from investment will be high
    2) If the entrepreneurs are holding large volume of working capital, they can take advantage of the investment opportunities that come in their way. The MEC will be high.
    3) The MEC is also influenced by sudden changes in income of the entrepreneurs.
        a) 1, 2
        b) 1, 3
        c) 2, 3
        d) All the above

Explanation

Short - Run Factors of marginal efficiency of capital:

(i) Demand for the product: If the market for a particular good is expected to grow and its costs are likely to fall, the rate of return from investment will be high. If entrepreneurs expect a fall in demand for goods and a rise in cost, the investment will decline. (ii) Liquid assets: If the entrepreneurs are holding large volume of working capital, they can take advantage of the

investment opportunities that come in their way. The MEC will be high. (iii) Sudden changes in income: The MEC is also influenced by sudden changes in income of the entrepreneurs. If the business community gets windfall profits, or tax concession the MEC will be high and hence investment in the country will go up. On the other hand, MEC falls with the decrease in income.

50. Assertion(A): current rate of investment in a particular industry is a factor which influences MEC

Reason(R): If in a particular industry, much investment has already taken place and the rate of investment currently going on in that industry is also very large, then the marginal efficiency of capital will be low.

a) Both (A) and (R) are correct, but (R) does not explain (A)

b) Both (A) and (R) are wrong

c) **Both (A) and (R) are correct and (R) explains (A)**

d) (A) is Correct and (R) is wrong

Explanation

Current rate of investment: Another factor which influences MEC is the current rate of investment in a particular industry. If in a particular industry, much investment has already taken place and the rate of investment currently going on in that industry is also very large, then the marginal efficiency of capital will be low.

51. Which of the following statement is correct?

1) The marginal efficiency of capital is also affected by waves of optimism and pessimism in the business cycle.
2) If businessmen are optimistic about future, the MEC will be likely to be low
3) During periods of pessimism the MEC is under estimated and so will be low
   a) 1, 2
   b) **1, 3**
   c) 2, 3
   d) All the above

Explanation

The marginal efficiency of capital is also affected by waves of optimism and pessimism in the business cycle. If businessmen are optimistic about future, the MEC will be likely to be high. During periods of pessimism the MEC is under estimated and so will be low.

52. Assertion(A): Rapid rise in the growth of population will increase the marginal efficiency of

Capital

Reason(R): Marginal efficiency of capital is also influenced by the rate of growth of population.

a) Both (A) and (R) are correct, but (R) does not explain (A)

b) Both (A) and (R) are wrong

c) **Both (A) and (R) are correct and (R) explains (A)**

d) (A) is Correct and (R) is wrong

Explanation

Marginal efficiency of capital is also influenced by the rate of growth of population. If population is growing at a rapid speed, it is usually believed that the demand of various types of goods will increase. So, a rapid rise in the growth of population will increase the marginal efficiency of capital and a slowing down in its rate of growth will discourage investment and thus reduce marginal efficiency of capital.

53. Which industries greatly stimulated development of automobiles in the 20th century?

1) Rubber industries
2) Oil industries
3) Steel industry
    a) 1, 2
    b) 1, 3
    c) 2, 3
    d) **All the above**

Explanation

If investment and technological development take place in the industry, the prospects of increase in the net yield brightens up. For example, the development of automobiles in the 20th century has greatly stimulated the rubber industry, the steel and oil industry etc. So, we can say that inventions and technological improvements encourage investment in various projects and increase marginal efficiency of capital.

54. Which of the following statement is correct?

1) Cheap money policy and liberal tax policy pave the way for greater profit margin and so MEC is likely to be high
2) Political stability, smooth administration, maintenance of law and order help to improve MEC.
3) Cheap and abundant supply of natural resources, efficient labour and stock of capital enhance the MEC
    a) 1, 2
    b) 1, 3

c) 2, 3
d) **All the above**

Explanation

Monetary and Fiscal policies: Cheap money policy and liberal tax policy pave the way for greater profit margin and so MEC is likely to be high. Political environment: Political stability, smooth administration, maintenance of law and order help to improve MEC. Resource availability: Cheap and abundant supply of natural resources, efficient labour and stock of capital enhance the MEC.

55. Which of the following statement about Marginal Efficiency of Investment is correct?

1) MEI is the expected rate of return on investment as additional units of investment are made under specified conditions and over a period of time
2) When cost of borrowing is high, bus1inesses are less motivated to borrow money and make investment on different projects because high cost of borrowing reduces profit margin of the business firms
   a) 1 alone
   b) 2 alone
   c) **1, 2**
   d) None

Explanation

MEI is the expected rate of return on investment as additional units of investment are made under specified conditions and over a period of time. When cost of borrowing is high, businesses are less motivated to borrow money and make investment on different projects because high cost of borrowing reduces profit margin of the business firms.

56. Which of the following statement about Marginal Efficiency of Capital is correct?

1) It is based on a given supply price for capital
2) It is a "flow" concept.
3) It determines the optimum capital stock in an economy at each level of interest rate
   a) 1, 2
   b) **1, 3**
   c) 2, 3
   d) All the above

Explanation

Marginal Efficiency of Capital(MEC)

1) It is based on a given supply price for capital.

2) It represents the rate of return on all successive units of capital without regard to existing capital.

3) The capital stock is taken on the X axis of diagram.

4) It is a "stock" concept.

5) It determines the optimum capital stock in an economy at each level of interest rate.

57. Which of the following statement about Marginal Efficiency of Investment is correct?

1) It is a "stock" concept.
2) The amount of investment is taken on the X - axis of diagram
3) It is based on the induced change in the price due to change in the demand for capital.
    a) 1, 2
    b) 1, 3
    c) 2, 3
    d) All the above

Explanation

Marginal Efficiency of Investment(MEI)

1) It is based on the induced change in the price due to change in the demand for capital.

2) It shows the rate of return on just those units of capital over and above the existing capital stock.

3) The amount of investment is taken on the X - axis of diagram.

4) It is a "flow" concept.

5) It determines the net investment of the economy at each interest rate given the capital stock.

58. Who developed the concept of multiplier in terms of employment?

a) J.M. Keynes
b) J.M. Llyod
c) R.F. Khan
d) Walt Whitman

Explanation

The concept of multiplier was first developed by R.F. Khan in terms of employment. J.M Keynes redefined it as investment multiplier.

59. What is the ratio of Multiplier?

   a) **change in national income to change in investment**
   b) change in investment to change in national income
   c) change in investment to Change in savings
   d) change in savings to change in investment

Explanation

The multiplier is defined as the ratio of the change in national income to change in investment. If ΔI stands for increase in investment and ΔY stands for resultant increase in income, the multiplier K =ΔY/ΔI. Since ΔY results from ΔI, the multiplier is called investment multiplier.

60. Which of the following assumptions to be made for working of Keynes's theory of the multiplier?

   1) There is change in autonomous investment
   2) There are changes in prices
   3) There are no time lags in the multiplier process.
   4) Consumption is a function of current income
      a) 1, 2, 4
      b) **1, 3, 4**
      c) 2, 3, 4
      d) All the above

Explanation

Keynes's theory of the multiplier works under certain assumptions which limit the operation of the multiplier. They are as follows: 1. There is change in autonomous investment. 2. There is no induced investment 3. The marginal propensity to consume is constant. 4. Consumption is a function of current income. 5. There are no time lags in the multiplier process. 6. Consumer goods are available in response to effective demand for them. 7. There is a closed economy unaffected by foreign influences. 8. There are no changes in prices. 9. There is less than full employment level in the economy.

61. Which of the following statement is correct?

   1) The propensity to consume refers to the portion of income spent on consumption.
   2) The MPC refers to the relation between change in consumption (C) and change in income(Y).
   3) The value of multiplier depends on MPC
      a) 1, 2

b) 1, 3
c) 2, 3
d) **All the above**

Explanation

The propensity to consume refers to the portion of income spent on consumption. The MPC refers to the relation between change in consumption (C) and change in income(Y).

Symbolically, MPC = $\Delta C/\Delta Y$

The value of multiplier depends on MPC Multiplier (K) = 1/1-MPC

The multiplier is the reciprocal of one minus marginal propensity to consume. Since marginal propensity to save is 1 - MPC. (MPC+MPS =1). Multiplier is 1/ MPS. The multiplier is therefore defined as reciprocal of MPS. Multiplier is inversely related to MPS and directly with MPC

62. If the value of MPC is 0.75, what will be the value of MPS and k?

a) **0.25, 4**
b) 4, 0.25
c) 0.35, 7
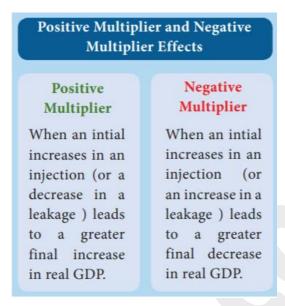d) 7, 0.35

Explanation

Numerically if MPC is 0.75,

MPS is 0.25 and k is 4.

Using formula k = 1/1- MPC

= 1/1-0.75

=1/0.25 = 4

63. Which of the following statement is correct?

1) When an intial increases in an injection (or a decrease in a leakage) leads to a greater final increase in real GDP.
2) When an intial increases in an injection (or an increase in a leakage) leads to a greater final decrease in real GDP
   a) 1 alone
   b) 2 alone
   c) **1, 2**
   d) None

Explanation

Positive Multiplier and Negative Multiplier Effects

Positive Multiplier	Negative Multiplier
When an intial increases in an injection (or a decrease in a leakage) leads to a greater final increase in real GDP.	When an intial increases in an injection (or an increase in a leakage) leads to a greater final decrease in real GDP.

64. What is the other name of Dynamic multiplier?

   a) sequence multiplier
   b) simultaneous multiplier
   c) timeless multiplier
   d) logical multiplier

Explanation

Dynamic multiplier is also known as 'sequence multiplier'. In real life, income level does not increase instantly with investment. In fact, there is a time lag between increase in income and consumption expenditure.

65. What are the other names of static multiplier?

   1) sequence multiplier
   2) simultaneous multiplier
   3) timeless multiplier
   4) logical multiplier
         a) 1, 2, 3
         b) 1, 3, 4
         c) 2, 3, 4
         d) All the above

Explanation

Static multiplier is otherwise known as simultaneous multiplier, timeless multiplier, and logical multiplier. Under static multiplier the change in investment and the resulting change in income

are simultaneous. There is no time lag. There is also no change in MPC as the economy moves from one equilibrium position to another.

66. Which of the following statement is correct?

1) The multiplier assumes that those who earn income are likely to spend a proportion of their additional income on consumption
2) But in practice, people tend to spend their additional income on other items
3) Such expenses are known as leakages
   a) 1, 2
   b) 1, 3
   c) 2, 3
   d) All the above

Explanation

The multiplier assumes that those who earn income are likely to spend a proportion of their additional income on consumption. But in practice, people tend to spend their additional income on other items. Such expenses are known as leakages.

67. If a portion of the additional income is used for repayment of old loan, the MPC is____

a) Increased
b) Reduced
c) No change
d) Vary either increase or decrease

Explanation

Payment towards past debts. If a portion of the additional income is used for repayment of old loan, the MPC is reduced and as a result the value of multiplier is cut.

68. Which of the following statement is correct?

1) If income is used in purchase of existing wealth such as land, building and shares money is circulated among people and never enters into the consumption stream.
2) As a result the value of multiplier is affected.
3) Income spent on imports of goods or services flows out of the country and has little chance to return to income stream in the country.
   a) 1, 2
   b) 1, 3
   c) 2, 3
   d) All the above

Explanation

Purchase of existing wealth: If income is used in purchase of existing wealth such as land, building and shares money is circulated among people and never enters into the consumption stream. As a result the value of multiplier is affected.

Import of goods and services: Income spent on imports of goods or services flows out of the country and has little chance to return to income stream in the country. Thus imports reduce the value of multiplier.

Non availability of consumer goods: The multiplier theory assumes instantaneous supply of consumer goods following demand. But there is often a time lag. During this gap (D>S) inflation is likely to rise. This reduces the consumption expenditure and thereby multiplier value.

Full employment situation: Under conditions of full employment, resources are almost fully employed. So, additional investment will lead to inflation only, rather than generation of additional real income.

69. What are the uses of Multiplier?

   1) Multiplier highlights the importance of investment in income and employment theory
   2) It also helps in bringing the equality between S and I
   3) It helps to reduce unemployment and achieve full employment
        a) 1, 2
        b) 1, 3
        c) 2, 3
        d) **All the above**

Explanation

Uses of multiplier 1. Multiplier highlights the importance of investment in income and employment theory. 2. The process throws light on the different stages of trade cycle. 3. It also helps in bringing the equality between S and I. 4. It helps in formulating Government policies. 5. It helps to reduce unemployment and achieve full employment.

70. Which of the following is not a type of multiplier?

   a) Tax multiplier
   b) Employment multiplier
   c) **Savings multiplier**
   d) Investment Multiplier

Explanation

KINDS OF MULTIPLIER

1. Tax multiplier
2. Employment multiplier
3. Foreign Trade multiplier
4. Investment Multiplier

71. Who among the following made systematic development of the simple accelerator model?

   a) J.M. Keynes
   b) **J.M. Clark**
   c) Bickerdike
   d) J.M. Llyod

Explanation

The origin of accelerator principle can be traced back in the writings of Aftalion (1909), Hawtrey (1913) and Bickerdike(1914). However, the systematic development of the simple accelerator model was made by J.M. Clark, in 1917. It was further developed by Hicks, Samuelson and Harrod in relation to the business cycles.

72. Which of the following statement is correct?

   1) A given increase in the demand for consumption goods in the economy generally leads to an accelerated demand for machineries
   2) Accelerator is the numerical value of the relation between an increase in consumption and the resulting increase in investment
        a) 1 alone
        b) 2 alone
        c) **1, 2**
        d) None

Explanation

A given increase in the demand for consumption goods in the economy generally leads to an accelerated demand for machineries (investment goods). Accelerator is the numerical value of the relation between an increase in consumption and the resulting increase in investment.

73. The accelerator coefficient is the ratio between_____

   a) **induced investment and an initial change in consumption**
   b) induced investment and an final change in consumption
   c) initial change in consumption and induced investment
   d) final change in consumption and induced investment

Explanation

"The accelerator coefficient is the ratio between induced investment and an initial change in consumption." Assuming the expenditure of ₹50crores on consumption goods, if industries lead to an investment of ₹ 100 crores in investment goods industries, we can say that the accelerator is 2.

Accelerator = 100/50 = 2

74. Who combined the k and β mathematically and given it the name of the Super Multiplier?

   a) J.M. Keynes
   b) J.M. Llyod
   c) Hicks
   d) David Schimmer

Explanation

In order to measure the total effect of initial investment on income, Hicks has combined the k and β mathematically and given it the name of the Super Multiplier. The super multiplier is worked out by combining both induced consumption and induced investment.

75. Which of the following are not included in super multiplier?

   1) autonomous investment
   2) induced investment
   3) supporting investment
         a) 1, 2
         b) 1, 3
         c) 2, 3
         d) All the above

Explanation

The super multiplier is greater than simple multiplier which includes only autonomous investment and no induced investment, while super multiplier includes induced investment.

76. The combined effect of the multiplier and the accelerator is also called_____

   a) leverage effect
   b) super multiplier
   c) special multiplier
   d) all the above

Explanation

The combined effect of the multiplier and the accelerator is also called the leverage effect which may lead the economy to very high or low level of income propagation. Symbolically

Y= C + IA + Ip

Y = Aggregate income. C = Consumption expenditure IA= autonomous investment IP= induced private investment.