UPSC Prelims- 2019

Economics

Questions Asked

Detailed Solutions

Right Approach

PrepMate Economics Book Performance

1. The Chairman of public sector banks are selected by the

(a) Banks Board Bureau

(b) Reserve Bank of India

(c) Union Ministry of Finance

(d) Management of concerned bank

Sol. 1 (a) Banks Board Bureau

Source: PrepMate Economics Book, Chapter 16, Page 247

It is to be noted that Banks Board Bureau recommends the appointment of a particular person as Chairman of a public sector bank. Thus, Chairman of public sector banks is selected by Banks Board Bureau. However, the final appointment is made by Union Government.

The Board, earlier chaired by former Comptroller and Auditor General Vinod Rai, has been reconstituted after its original two-year term expired last month.

About Banking Boards Bureau

The BBB is a body of "eminent" professionals and consists of only one government official. It is a six-member body with at least three former bankers, two professionals and secretary, department of financial services representing government. Vinod Rai, the veteran CAG, has been appointed as head of the BBB.

It will replace the existing system of Appointments Board in which appointments for top-level jobs at public-sector banks are made by an appointments committee led by the RBI Governor. The BBB has been set up to insulate public-sector banks from interference by the government.

Functions

1. The BBB will hold investment in public-sector banks on behalf of the government.
2. The BBB will recommend the appointment of senior-most officials in public-sector banks. The actual appointment is made by Union government.

2. The economic cost of food grains to the Food Corporation of India is Minimum Support Price and bonus (if any) paid to the farmers plus

(a) transportation cost only

(b) interest cost only

(c) procurement incidentals and distribution cost

(d) procurement incidentals and charges for godowns

Sol. 2 (c) procurement incidentals and distribution cost

Source: PrepMate Economics, Chapter 7, Page 126

4 PUBLIC DISTRIBUTION SYSTEM

Operation: The Food Corporation of India (FCI) is the main agency that has the responsibility of procurement, storage, movement, transportation, and distribution of commodities.

The FCI is assisted by state agencies in carrying out its responsibilities of procurement, storage, and distribution, whereas transportation of commodities is undertaken with the help of railways. Procurement of commodities is done at MSPs. The procured commodities are distributed through fair price shops.

The basic objective of PDS is to make available essential consumer goods at subsidized prices to insulate consumers from rising prices of commodities and maintain minimum nutritional status of population.

3. The Service Area Approach was implemented under the purview of

(a) Integrated Rural Programme

(b) Lead Bank Scheme

(c) Mahatma Gandhi National Rural Employment Guarantee Scheme

(d) National Skill Development Mission

Sol. 3 (b) Lead Bank Scheme

Source: Economics book, Chapter 11, Page 175

Lead Bank Scheme

The Lead Bank Scheme, introduced in 1969, envisages assignment of lead roles to individual banks (both in the public and private sectors) for the districts allotted to them. A bank having a relatively large network of branches in the rural areas of a given district has generally been entrusted with the lead responsibility for that district. Accordingly, all the districts in the country have been allotted to various banks. The lead bank acts as a leader for coordinating the efforts of all credit institutions in the allotted districts to increase the flow of credit to agriculture, small-scale industries, and other economic activities included in the priority sector in the rural and semi-urban areas.

4. Consider the following statements:

1. Most of India's external debt is owed by governmental entities.

2. All of India's external debt is denominated in US dollars.

Which of the statements given above is / are correct?

(a) 1 only

(b) 2 only

(c) Both 1 and 2

(d) Neither 1 nor 2

Sol. 4 (d) Neither 1 nor 2

Source: PrepMate Economics Book, Chapter 23, Page 325

Statement 1 is incorrect: Out of India's total external debt, nearly 20% is owed by governmental entities.

Status Report on External Debt

Status Report on External Debt of India at end of March 2017 prepared by the Department of Economic Affairs, Ministry of Finance:

1. India's external debt stock declined by 2.7 percent in the last year and stood at US$ 471.9 billion as on 31st March 2017. External debt has reduced due to the decrease in long-term debt particularly NRI deposits and commercial borrowings.
2. The long-term external debt as on 31st March 2017 was US$ 383.9 billion. Short-term external debt increased to US$ 88.0 billion. The increase in Short term external debt is mainly due to the increase in trade-related credits, a major component of short-term debt with a share of 98.3 per-cent.
3. Government (sovereign) external debt increased from US$ 93.4 billion to US$ 95.8 billion. It constitutes 20.3 percent of the total external debt.

Statement 2 is incorrect. India's External debt is denominated in multiple currencies. As on 31st December, 2017, 48.2% of debt was denominated in US dollars. The rest of debt is denominated in Indian Rupee (for instance- masala bonds), Special Drawing rights, Japanese Yen, Euro and other currencies.

5. Which of the following is **not** included in the assets of a commercial bank in India?

(a) Advances

(b) Deposits

(c) Investments

(d) Money at call and short notice

Sol. 5 (b) Deposits

Source: Economics book, Chapter 3, Page 59

Deposits are liabilities of banks

The deposits made into a bank are the liabilities of the bank. Fixed and recurring account deposits constitute time liabilities of the bank because banks are required to return the deposits made in these accounts after the expiry of the fixed period of time.

On the other hand, savings and current account deposits constitute demand liabilities of the bank because banks are required to return the deposits made in these accounts whenever a depositor demands return of funds.

6. In the context of India, which of the following factors is/are contributor/ contributors to reducing the risk of a currency crisis?

1. The foreign currency earnings of India's IT sector

2. Increasing the government expenditure

3. Remittances from Indians abroad

Select the correct answer using the code given below.

(a) 1 only

(b) 1 and 3 only

(c) 2 only

(d) 1, 2 and 3

Sol. 6 (b) 1 and 3 only

Source: PrepMate Economics book, Chapter 21, Page 306

This question is based on understanding of basic economics and knowledge of current affairs. Currency crisis in the present context refers to depreciation of rupee. Any foreign exchange transaction which generates demand of rupee can help in arresting the depreciation of rupee.

Statement 1 is correct. Foreign currency earnings of India's IT sector generate supply of dollar and demand of Indian rupee. Thus, this transaction helps in arresting the depreciation of rupee.

Statement 2 is incorrect. Increase in government expenditure doesn't directly affects the demand and supply of rupee.

Statement 3 is correct. Remittances from Indians abroad generate supply of dollar and demand of Indian rupee. Thus, this transaction helps in arresting the depreciation of rupee.

Thus, Statements 1 and 3 are correct.

Causes of Depreciation in Rupee

The following can be the causes behind depreciation of domestic currency:

- **Rise in imports:** In the case of rise in imports, importers would require more foreign currency to pay for imports. Demand for foreign currency (and corresponding supply of domestic currency) leads to depreciation of the domestic currency.
- **Fall in exports:** In case of fall in exports, foreign exchange earnings reduce. Thus, demand for domestic currency in lieu of foreign exchange reduces, leading to depreciation of domestic currency.
- **Fall in remittances:** Fall in remittances from Indians working abroad leads to lesser foreign exchange availability in India. The recipient of foreign exchange, therefore, demands less amount of rupee to replace dollar.
- **Withdrawal of foreign investment:** When a foreign investor withdraws investment from India, he/she demands foreign currency in place of rupee. Thus, there is supply of rupee but demand of foreign currency.
- **Foreign loan repayment:** Foreign loan repayment and withdrawal of foreign investment function in the similar manner and have similar foreign exchange rate implications.

7. Which of the following is issued by registered foreign portfolio investors to overseas investors who want to be part of the Indian stock market without registering themselves directly?

(a) Certificate of Deposit

(b) Commercial Paper

(c) Promissory Note

(d) Participatory Note

Sol. 7 (d) Participatory Note

Source: PrepMate Economics, Chapter 24, Page 343

There is a direct question in practice set given at end of chapter which is similar to this question. A participatory note, commonly known as a P-note or PN, is a certificate issued by a registered foreign institutional investor (FII) to an overseas investor who invests in Indian stock markets. FII is registered with SEBI directly, but overseas investor is not required to register themselves with SEBI. Thus, overseas investor invests in Indian stock market through a registered foreign institutional investor. As proof of investment, a certificate is issued by FII to the overseas investor.

5. Participatory notes (PNs) are associated with which one of the following?

(a) Consolidated Fund of India

(b) Foreign institutional investors

(c) United Nations Development Programme

(d) Kyoto Protocol

8. With reference to India's Five-Year Plans, which of the following statements is/are correct?

1. From the Second Five-Year Plan, there was a determined thrust towards substitution of basic and capital good industries.

2. The Fourth Five-Year Plan adopted the objective of correcting the earlier trend of increased concentration of wealth and economic power.

3. In the Fifth Five-Year Plan, for the first time, the financial sector was included as an integral part of the Plan.

Select the correct answer using the code given below.

(a) 1 and 2 only

(b) 2 only

(c) 3 only

(d) 1, 2 and 3

Sol. 8 (a) 1 and 2 only

Source: PrepMate Economics, Chapter 13, Page 192

This question requires not just understanding of Planning and but also keen analysis.

Statement 1 is correct: The thrust towards substitution of basic and capital good industries is from second five year plan after adoption of Mahalanobis model.

Perfecting Past Prelims

2. (a) Statement 2 is incorrect. The Mahalanobis model (second 5-year plan) provided support to the rationale for replacing imports with domestic production. Thus, import-substitution became the keystone of the development strategy in the late 1950s. The economic rationale put forward for import-substitution strategy was two-fold: (i) self-sufficiency and (2) conserve the scarce foreign exchange.

Statement 2 is correct: In order to correct the trend of increased concentration of wealth and economic power, government carried out nationalization of important industries such as banking, insurance, etc.

Fourth Five-Year Plan (1969–74)

Droughts and Indo–Pak war (1971–72) led to a significant drain on funds. During this plan, the government initiated populist measures involving a large amount of subsidies, which lead to high fiscal deficit.

Nationalization was also carried out at large scale: private sector banks, insurance companies, coal mines, etc. were acquired by the state.

Statement 3 is incorrect: Financial sector includes industries such as banking, insurance which were included from the first plan itself.

9. Consider the following statements:

1. Purchasing Power Parity (PPP) exchange rates are calculated by comparing the prices of the same basket of goods and services in different countries.

2. In terms of PPP dollars, India is the sixth largest economy in the world.

Which of the statements given above is / are correct?

(a) 1 only

(b) 2 only

(c) Both 1 and 2

(d) Neither 1 nor 2

Sol. 9 (a) 1 only

Source: PrepMate Economics, Chapter 1, Page 2

India's Position (February, 2018)

In India, GDP is estimated by the Central Statistics Office (CSO). The economy of India is the seventh largest (the United States, China, Japan, Germany, the United Kingdom, France, and India, in the order) economy in the world, measured by nominal GDP ($2.5 trillion) and the third largest (China, the United States, and India, in the order) by purchasing power parity (PPP) ($9.447 trillion).

What Is Purchasing Power Parity?

Purchasing power parity (PPP) is defined as the number of units of a country's currency required to buy the same amount of goods and services in the domestic market as one dollar would buy in the US.

PPP is an attempt to work out how much currency will be needed to buy the same quantity of goods and services in different countries. It reflects the underlying exchange rate between the two different countries for buying goods and services, and a more accurate reflection of actual living standards in countries.

Often exchange rates do not actually reflect different living costs because some goods are not easily traded. For example, if you live in the United States, it is irrelevant if there is cheaper accommodation elsewhere in the world. What is relevant to you is the price of goods and services at which they are available to you locally.

For example, let us suppose that the market exchange rate between Dollar and Rupee is 66. One Dollar in the US buys 1 liter of milk. One dollar in terms of rupee, i.e., ₹66 can buy 3 liters of milk in India.

Suppose that India's GDP is ₹660. If we consider the market exchange rate, then this amount is equal to $10. If milk is the only commodity produced in the world, one will think that India is producing 10 liters of milk considering India's exchange rate ₹66 and GDP value of ₹660.

However, India produces 30 liters of milk. To overcome this defect, we use the purchasing power parity exchange rate. Under PPP, we measure the GDP of India by comparing the money required to purchase commodities in both the countries. One dollar in the US can purchase one liter of milk, whereas `21 can purchase one liter of milk in India.

10. Among the agricultural commodities imported by India, which one of the following accounts for the highest imports in terms of value in the last five years?

(a) Spices

(b) Fresh fruits

(c) Pulses

(d) Vegetable oils

Sol. 10 (d) Vegetable oils

Source: PrepMate Economics, Chapter 27, Page 382

The top commodity imports are as follows:

Rank	Commodity	Share (%)
1	Oil	38.3
2	Gems, precious metals, coins	13
3	Electronics	6.9
4	Machines, engines, pumps	6.7
5	Organic chemicals	4
6	Plastics	2.6
7	Iron and steel	2.5
8	Animal/vegetable fats and oils	2.3
9	Ores, slag, and ash	1.6
10	Medical and technical equipment	1.5

Among the agricultural commodities imported by India, Vegetable oils constitute significant chunk of imports.

11. Which one of the following is **not** the most likely measure the Government/RBI takes to stop the slide of Indian rupee?

(a) Curbing imports of non-essential goods and promoting exports

(b) Encouraging Indian borrowers to issue rupee denominated Masala Bonds

(c) Easing conditions relating to external commercial borrowing

(d) Following an expansionary monetary policy

Sol. 11 (d) Following an expansionary monetary policy

Source: PrepMate Economics book, Chapter 21, Page 306 and Chapter 24, Page 345

Options (a), (b) and (c) are adopted to curb the slide of Indian rupee.

Chapter 21, Page 306

Causes of Depreciation in Rupee

The following can be the causes behind depreciation of domestic currency:

- **Rise in imports:** In the case of rise in imports, importers would require more foreign currency to pay for imports. Demand for foreign currency (and corresponding supply of domestic currency) leads to depreciation of the domestic currency.
- **Fall in exports:** In case of fall in exports, foreign exchange earnings reduce. Thus, demand for domestic currency in lieu of foreign exchange reduces, leading to depreciation of domestic currency.
- **Fall in remittances:** Fall in remittances from Indians working abroad leads to lesser foreign exchange availability in India. The recipient of foreign exchange, therefore, demands less amount of rupee to replace dollar.
- **Withdrawal of foreign investment:** When a foreign investor withdraws investment from India, he/she demands foreign currency in place of rupee. Thus, there is supply of rupee but demand of foreign currency.
- **Foreign loan repayment:** Foreign loan repayment and withdrawal of foreign investment function in the similar manner and have similar foreign exchange rate implications.

Causes of Appreciation of Rupee

The appreciation of currency can occur on account of any of the following reasons:

- Fall in imports
- Rise in exports
- Rise in remittances
- Increase in foreign investment
- Receipt of fresh loans from external sources

The causes responsible for appreciation of currency are exactly opposite to the causes responsible for depreciation of currency.

Option (c) is not the answer. Easing conditions relating to external commercial borrowing will encourage fresh loans from external sources.

Option (b) is not the answer.

Source PrepMate Economics book, Chapter 24, Page 345

Note: Masala bonds are bonds issued outside India but denominated in Indian rupees, rather than the foreign currency. The term was used by IFC. Masala bonds were invented in response to sharp depreciation of Indian currency from ₹40 in 2008–09 to ₹60 and above in 2014–15. Thus, external commercial borrowings made in 2008–09 at low exchange rate were required to be repaid at very high exchange rate.

The rupee-denominated bond is an attempt to shield issuers from currency risk and instead transfer the risk to investors buying these bonds. In inter-country fund flows, the currency risk cannot be eliminated. It will either be borne by the issuer or the investor. In case of ECBs, currency risk is borne by the issuer, and in case of rupee bonds, the currency risk is borne by the investor.

Option (d) is the answer. Option (d) will not help in curbing the slide of Indian rupee. Rather, it may even further reduce the value of Indian rupee. If expansionary monetary policy is followed, it leads to increase in money supply. Increase in money supply may lead to inflation, which may further lead to fall in value of rupee.

12. The money multiplier in an economy increases with which one of the following?

(a) Increase in the cash reserve ratio

(b) Increase in the banking habit of the population

(c) Increase in the statutory liquidity ratio

(d) Increase in the population of the country

Sol. 12 (b) Increase in the banking habit of the population

Source: PrepMate Economics, Chapter 3, Page 61

Options (a) and (c) are incorrect. If cash reserve ratio and statutory liquidity ratio reduce (and not increase), then money multiplier increases. Reserve money, which is denominator for calculating money multiplier, includes statutory reserves of banks held with themselves and cash reserves of banks held with the RBI. The lower the value of denominator in a fraction, the higher the value of overall fraction.

Option (d) is not directly related to the question.

Option (c) is the correct answer. M1 and M3, which are numerator for calculating money multiplier, include demand deposits and total deposits by public. The amount of deposits made by people in banks also depends upon the banking habit of the population. Moreover, greater the value of numerator, greater is the value of overall fraction. Thus, increase in the banking habit of the population, increases the money multiplier in the economy.

Money multiplier (m): Money multiplier is the ratio of narrow money (M1) or broad money (M3) to reserve money.

Money multiplier (m) is calculated as follows:

$$m = \frac{M1}{RM}$$

It is also calculated as $m = \frac{M3}{RM}$

where "m" is the money multiplier and "RM" is the reserve money

Thus, it can also be said that supply of money is the product of money multiplier (m) and the amount of high powered money or the reserve money.

How does money multiplier work?

For instance, let us say that a bank receives ₹100 in deposits. The reserve requirement is 20%. Thus, the bank can lend the remaining ₹80. This ₹80 is then deposited by the borrower into another bank, which in turn must also keep 20%, or ₹16, in reserve but can lend out the remaining ₹64.

This cycle continues as more people deposit money and more banks continue to lend it until finally the initial deposit of ₹100 creates a total of ₹500 (₹100/0.2) in deposits. This creation of deposits is the multiplier effect.

Thus, if reserve requirements are reduced or more currency is released in the economy, it has multiple impact on the overall money supply in the economy. In India, the reserve requirements for both SLR and CRR combined together are nearly 26%. Thus, a ₹100 initial deposit creates a total deposit of 100/0.26 = ₹384, approximately.

13. Consider the following statements:

1. According to the Indian Patents Act, a biological process to create a seed can be patented in India.

2. In India, there is no Intellectual Property Appellate Board.

3. Plant varieties are not eligible to be patented in India.

Which of the statements given above is/are correct?

(a) 1 and 3 only

(b) 2 and 3 only

(c) 3 only

(d) 1, 2 and 3

Sol. 13 (c) 3 only

Topic: Economics

All the answer options have Statement 3. Thus, there is no need to evaluate Statement 3.

Statement 2 is incorrect: The Intellectual Property Appellate Board (IPAB) was constituted in 2003 to hear appeals against the decisions of the registrar under the Indian Trademarks Act, 1999 and the Geographical Indications of Goods (Registration and Protection) Act, 1999. IPAB is time and again mentioned in current affairs.

Statement 1 is incorrect: Plants and animals in whole or any part thereof including seeds, varieties and species and biological processes for production or propagation of plants and animals are not patentable in India.

14. In a given year in India, official poverty lines are higher in some States than in others because

(a) poverty rates vary from State to State

(b) price levels vary from State to State

(c) Gross State Product varies from State to State

(d) quality of public distribution varies from State to State

Sol. 14 (b) price levels vary from State to State

Source: PrepMate Economics Book, Chapter 1, Page 13

This question requires understanding of concept of poverty line. Poverty line is based on the ability to meet expenditure to fulfill bare minimum needs. This expenditure varies from state to state because price levels vary from state to state. Price levels are taken into consider through Consumer Price Index.

13 POVERTY ESTIMATES IN INDIA

In 1993, the Planning Commission constituted a task force for the calculation of poverty estimates in India, chaired by Lakdawala. The committee made the following suggestions:

1. Consumption expenditure to be calculated based on calorie consumption, i.e. 2400 in rural areas and 2100 in urban areas.
2. State-specific poverty lines should be constructed and updated using the Consumer Price Index of industrial workers in urban areas and Consumer Price Index of agricultural labourers in rural areas.

Tendulkar Committee, 2005 (Headed by Suresh Tendulkar)

The Tendulkar Committee was constituted by the Planning Commission to address three shortcomings in the previous methods of calculating poverty:

1. Consumption expenditure was linked to the consumption patterns of 1973–74. However, there have been significant changes in consumption patterns since 1973–74. Therefore, the Tendulkar Committee used the recent patterns of consumption to determine consumption expenditure.
2. Earlier, the expenditure on health and education was ignored. The Tendulkar Committee considers expenditure on education as incurred by the state, but it considers health expenditure of ₹30 per annum to seek health cover of ₹30,000.
3. Earlier, poverty estimates were based on uniform reference period, i.e. respondents were asked to detail the consumption made by them over the past 30 days. Whereas under the mixed reference period method, five low-frequency items such as clothing, footwear, durables, education expenditure, and health expenditure are surveyed over 365 days and all other items for previous 30 days.

The below poverty line population on the basis of the Tendulkar Committee report for 2011–12 was 25.7% rural population, 13.7% urban population, and 21.9% overall population.

Rangarajan Committee