

# Macroeconomics and Circular Flow of Income

## PART 1

### Objective Questions

#### • Multiple Choice Questions

1. Which of the following is the main problem addressed in macroeconomics?
- Determination of output of a firm
  - Determination of price of a product
  - Determination of income and employment level in an economy
  - All of the above

**Ans.** (c) Determination of income and employment level in an economy

2. The study of macroeconomics deals with which of the following questions of an economy?
- Will prices as a whole rise or come down?
  - Is the employment condition of the country getting better or is it worsening?
  - What all factors act as a stimulant towards achieving higher growth rate?

#### Alternatives

- (i) and (ii)
- (ii) and (iii)
- (i) and (iii)
- (i), (ii) and (iii)

**Ans.** (d) Study of economic problems at the level of country as a whole is called macroeconomics. Understanding macroeconomic indicators such as inflation, unemployment, GDP, trade flows etc. comes under the purview of macroeconomics.

3. Intermediate goods are those goods
- which have not yet crossed the boundary line of production
  - which are purchased by one firm from the other firm for resale
  - which are not included in the estimation of national product
  - All of the above

**Ans.** (d) All of the above

4. Which of the given pair is incorrectly matched?

Column I	Column II
A. Non-durable consumer goods	(i) Goods that are used-up in a single act of consumption
B. Capital goods	(ii) Goods used as fixed assets by the producers in the production of other goods and services
C. Consumption goods	(iii) Goods which are not used in the production of other goods
D. Final goods	(iv) Goods which have not yet crossed the boundary line of production

#### Codes

- (a) A-(i)      (b) B-(ii)      (c) C-(iii)      (d) D-(iv)

**Ans.** (d) Final goods are those which have crossed the boundary line of production and are ready for use by their final users. e.g., car used by the households, machine used by the producer, etc.

5. Which of the following is the cause of unexpected obsolescence?

- Natural calamities
- Change in demand
- Change in technology
- Both (a) and (c)

**Ans.** (a) Natural calamities

6. Money flow refers to the

- flow of goods across different sectors of the economy
- flow of services across different sectors of the economy
- flow of money across different sectors of the economy
- flow of income across different sectors of the economy

**Ans.** (c) flow of money across different sectors of the economy

7. Depreciation is the

- loss in the value of fixed assets in use due to normal wear and tear
- loss of value of fixed assets in use due to normal rate of accidental damages
- loss of value of fixed assets in use due to foreseen obsolescence
- All of the above

**Ans.** (d) All of the above

8. Which of the following is not an example of depreciation?
- A plant producing rubber shoes becomes obsolete when demand shift from rubber shoes to leather shoes
  - A plant producing black and white televisions becomes obsolete when technology is discovered to produce coloured televisions
  - Fall in the market value of assets during the period of economic downturn
  - Fall in the value of your residential apartment

**Ans.** (c) Fall in the market value of assets during the period of economic downturn

9. "Expected obsolescence is included in depreciation". The given statement is (CBSE 2020)
- True
  - False
  - Partially true
  - Partially false

**Ans.** (a) Expected obsolescence is the normal wear and tear in fixed assets.

10. ₹ 200 note lying in the pocket of Rohini, a student, is an example of .....
- stock variable
  - flow variable
  - Both stock and flow
  - None of the above

**Ans.** (a) stock variable

11. The rate of interest is
- a flow variable
  - a stock variable
  - the ratio of a flow variable to a stock variable
  - the ratio of a stock variable to a flow variable

**Ans.** (a) Rate of interest is a flow variable as it relates to a period of time, e.g. 6% per annum or 2% per month.

12. Economic activities cover
- only activities that result in products that are exchanged in markets
  - only activities that people engage in for profit
  - only activities that are or can potentially be delegated to someone else
  - only activities that are entered into the national accounts

**Ans.** (a) An activity which is related to the use of scarce resources is called an economic activity. These activities are classified as production, consumption, investment, exchange and distribution.

13. If an economy produces GDP of ₹ 30 billion per year with a capital stock of ₹ 135 billion, then capital output ratio is a
- stock variable with a value of ₹ 4.5 billion.
  - stock variable with a value of 4.5 years.
  - flow variable with a value of ₹ 4.5 billion.
  - flow variable with a value of 4.5 as pure number.

**Ans.** (d) Capital output ratio establishes a relationship between capital employed and units produced. It is a flow variable as it relates to a period of time and it is a unit free measure, therefore it is represented as a pure number. It is calculated as  $\frac{\text{Capital Stock}}{\text{GDP}}$ .

14. Which of the following is not a leak from the circular flow of income/expenditure?

- Taxes
- Transfers
- Net imports
- Savings

**Ans.** (b) Transfers are not a leak from the circular flow of income/ expenditure, as they merely represent movement from one head to another.

15. The fiscal deficit is a

- flow variable
- stock variable
- the ratio of a flow variable to a stock variable.
- the ratio of a stock variable to a flow variable.

**Ans.** (a) Fiscal deficit is a flow variable as it is defined with reference to a period of time.

16. The phases of circular flow of income includes

- phase of production
- phase of income generation
- phase of disposal

#### Alternatives

- (i) and (ii)
- (ii) and (iii)
- (i) and (iii)
- (i), (ii) and (iii)

**Ans.** (d) Every type of circular flow of income has three phases which are connected in a circular form. The process starts with production, which generates income and distribution of income leads to expenditure. Expenditure further generates demand for production.

17. A car purchased by a household is a .....

(CBSE 2020)

- single use capital good
- single use consumer good
- durable consumer good
- semi-durable consumer good

**Ans.** (c) A car purchased by a household is a final good and a durable consumer good because the household is the final user of the car and no value is to be added to the car.

18. Which of the following is a stock variable?

- Interest on capital
- Distance between Delhi and Goa
- Expenditure on money
- All of the above

**Ans.** (b) Distance between Delhi and Goa

19. Which of the following statements is/are correct?

- Flow of factor services rendered by the households to the producers is real flow.
- Depreciation reserve fund refers to the fund which the producers keep to cope with depreciation losses in the process of production.

**Alternatives**

- (a) Both are true (b) Both are false  
 (c) (i) is true, but (ii) is false (d) (i) is false, but (ii) is true

**Ans.** (a) Flow of factor services rendered by the households to the producers are real flows because these flow involve the movement of goods and services from one sector to the other.

**20.** Match the correct combination between the following columns.

Column I	Column II
A. Electric goods like tubelights and bulbs	(i) Capital goods
B. Milk and ice-cream used by households	(ii) Semi-durable consumer goods
C. Tractors used by the farmers	(iii) Intermediate goods
D. Wood purchased by a timber merchant for resale	(iv) Consumption goods

**Codes**

- |         |      |      |       |         |       |       |     |
|---------|------|------|-------|---------|-------|-------|-----|
| A       | B    | C    | D     | A       | B     | C     | D   |
| (a)(ii) | (iv) | (i)  | (iii) | (b)(iv) | (ii)  | (iii) | (i) |
| (c)(ii) | (i)  | (iv) | (iii) | (d)(i)  | (iii) | (ii)  | (i) |

**Ans.**(a) (ii) (iv) (i) (iii)

• **Assertion–Reasoning MCQs**

**Directions** (Q. Nos. 1 to 7) *There are two statements marked as Assertion (A) and Reason (R). Read the statements and choose the appropriate option from the options given below.*

- (a) Both Assertion (A) and Reason (R) are true and Reason (R) is the correct explanation of Assertion (A)  
 (b) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A)  
 (c) Assertion (A) is false, but Reason (R) is true  
 (d) Both of the statements are false

**1. Assertion (A)** Microeconomics and Macroeconomics are interdependent upon each other. One cannot study the two in isolation.

**Reason (R)** Microeconomics has a smaller degree of aggregation while Macroeconomics has greater degree of aggregation.

**Ans.** (a) Both Assertion (A) and Reason (R) are true and Reason (R) is the correct explanation of Assertion (A)

**2. Assertion (A)** LED TV is an example of durable consumer goods.

**Reason (R)** LED TV can be repeatedly used for several years and is of relatively high value.

**Ans.** (a) Both Assertion (A) and Reason (R) are true and Reason (R) is the correct explanation of Assertion (A)

**3. Assertion (A)** All producer goods are capital goods.

**Reason (R)** Producer goods are those which are used in the production of other goods whereas capital goods are the fixed assets of the producers.

**Ans.** (c) Producer goods are those which are used for further production. These may be used either as raw material or as fixed assets. Capital goods are fixed assets of the producers which are repeatedly used in the production of other goods and services and are of high value. Therefore, all producer goods are not capital goods.

**4. Assertion (A)** High fixed investment is a sign of growth and development.

**Reason (R)** Fixed investment indicates production capacity of a nation. Greater the addition to production capacity (fixed investment), higher the growth and development.

**Ans.** (a) Both Assertion (A) and Reason (R) are true and Reason (R) is the correct explanation of Assertion (A)

**5. Assertion (A)** Expenditure on maintenance of machinery is an intermediate expenditure.

**Reason (R)** All expenditures on repair and maintenance incurred by the firm are treated as part of intermediate consumption.

**Ans.** (a) Both Assertion (A) and Reason (R) are true and Reason (R) is the correct explanation of Assertion (A)

**6. Assertion (A)** Unexpected obsolescence is an element of depreciation.

**Reason (R)** Loss of value of fixed assets owing to an expected obsolescence is called capital loss.

**Ans.** (c) Only expected obsolescence is considered as an element of depreciation, not the unexpected obsolescence.

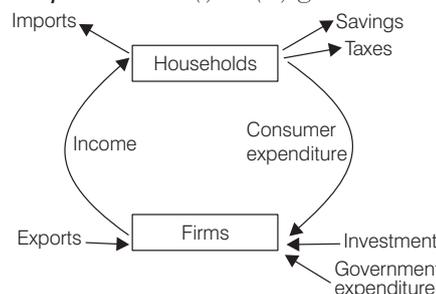
**7. Assertion (A)** Real flow and money flow are one or the same thing, presented in a different form.

**Reason (R)** In money flow, there is no involvement of goods in its physical form.

**Ans.** (d) Real flow and money flow are different in the way that the former is based upon the use of goods in the system while the latter uses money. Money flow also involves goods but in exchange of money only.

• **Case Based MCQs**

**1. Direction** *Observe the following picture and answer question no. (i) to (vi) given below.*



(i) The above diagram shows which type of circular flow of income?

- (a) Real flow (b) Physical flow  
(c) Money flow (d) None of these

**Ans.** (c) The above is a case of money flow, as there is payment of money involved in this case.

(ii) Which of the following case is true as per the figure given above?

- (a) The above model is an example of two-sector open economic model  
(b) The above model is an example of two-sector closed economic model  
(c) The above model is an example of three-sector open economic model  
(d) The above model is an example of three-sector closed economic model

**Ans.** (b) The above model is an example of two-sector closed economic model as it only involves household and firms. Exclusion of tertiary sector makes it a closed economic model.

(iii) Government expenditure in the above case is an example of .....

- (a) injections  
(b) leakages  
(c) withdrawals  
(d) Both (b) and (c)

**Ans.** (a) Government expenditure leads to increase in the flow of income into the economy, thus it is considered as an injection.

(iv) Imports in the above model is an example of

- (a) injections (b) leakages  
(c) withdrawals (d) Both (b) and (c)

**Ans.** (d) Imports leads to the outflow of income as we have to pay to the outsiders to buy their goods. It is thus, considered as a leakage.

(v) Which of the following is a leakage from the circular flow of income as per the above diagram?

- (i) Taxes (ii) Savings  
(iii) Imports (iv) Exports  
(v) Government expenditure (vi) Investment

**Alternatives**

- (a) (i), (iii) and (iv)  
(b) (i), (ii) and (iii)  
(c) (iii), (v) and (vi)  
(d) (iv), (v) and (vi)

**Ans.** (b) Taxes, savings and imports are the leakages from the circular flow of income as they lead to decrease in income and slower down the process of growth.

(vi) **Assertion (A)** Intersectoral flows refer to the flow of goods and services as well as flow of money among different sectors of the economy.

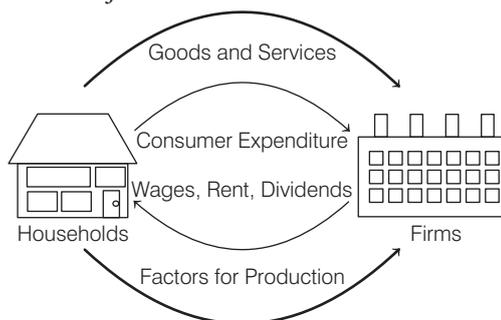
**Reason (R)** Intersectoral interdependences are satisfied through a system of mutual exchanges, and mutual exchanges lead to intersectoral flows of money as well as goods and services.

**Alternatives**

- (a) Both Assertion (A) and Reason (R) are true and Reason (R) is the correct explanation of Assertion (A).  
(b) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).  
(c) Assertion (A) is false, but Reason (R) is true  
(d) Both the statements are false

**Ans.** (a) Both Assertion (A) and Reason (R) are true and Reason (R) is the correct explanation of Assertion (A).

**2. Direction** Analyse the following circular flow chart carefully and answer the question no. (i) to (vi) on the basis of the same.



(i) The figure shows ..... flow.

- (a) real (b) money  
(c) Both (a) and (b) (d) None of these

**Ans.** (b) money

(ii) When money moves out of circular flow of income, it is known as .....

- (a) Leakages (b) Injections  
(c) Both (a) and (b) (d) None of these

**Ans.** (a) Leakages

(iii) In an two economic model described above, how many sectors are there?

- (a) Three (b) Two  
(c) Five (d) None of these

**Ans.** (b) Two

(iv) Who are considered as the owner of factors of production in the circular flow of income?

- (a) Firms (b) Household  
(c) Government (d) Rest of the world

**Ans.** (b) Household

(v) The value of Marginal Propensity to Save (MPS) is zero. In this case, the value of Marginal Propensity to Consume (MPC) will be .....

- (a) 1 (b) 0 (c) -1 (d) None of these

**Ans.** (a) 1

(vi) **Assertion (A)** Real and money flows are the essence of modern economic activity.

**Reason (R)** Factor services flow from household to the producers without which production activity is not possible. Likewise, factor incomes flow from producers to the households without which consumption activity is not possible.

**Alternatives**

- (a) Both Assertion (A) and Reason (R) are true and Reason (R) is the correct explanation of Assertion (A).
- (b) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (c) Assertion (A) is false, but Reason (R) is true
- (d) Both the statements are false

**Ans.** (a) Both Assertion (A) and Reason (R) are true and Reason (R) is the correct explanation of Assertion (A).

**3. Direction** Read the following text and answer question no. (i) to (vi) on the basis of the same.

Manish is an entrepreneur who manufactures decorative items. He is at the helm of affairs. He hires wage labour from the market and employs the services of capital and land as well. After hiring the inputs, he undertakes the task of production which involves conversion of raw material into finished products.

His motive is to ensure the optimal utilisation of the available inputs and to produce output for sale in the market and maximise profit.

His products are also available on e-commerce websites and are not limited only to domestic consumers but to consumers of other countries as well thus, ensuring inter-regionalism.

However in this process, he undertakes risks and uncertainties, for example he may not get a right price for his product which in turn would minimise his profit level. There is also a possibility that the goods might damage during shipping process.

- (i) As per the case given above, profit earned by Manish will be referred as .....
- (a) factor income                      (b) transfer income
- (c) unproductive service              (d) non-market service

**Ans.** (a) Profit is earned by the fourth factor of production known as entrepreneur. This income is earned by rendering factor services.

- (ii) Manish sells his goods in countries like America, Belgium and Germany. Trade with these countries includes which of the following sector of an economy?

- (a) Household
- (b) Firms
- (c) Government
- (d) Rest of the world

**Ans.** (d) Trade with the external sector i.e., countries different from the domestic countries are known as rest of the world and demand for domestic goods are known as exports.

- (iii) Choose the correct statement from given below options.

- (a) Manish is involved in production activity
- (b) Manish is involved in distribution of goods
- (c) Manish is involved in disposal of income
- (d) All of the above

**Ans.** (a) Production is the process of converting raw materials into finished goods.

- (iv) Manish is selling in foreign countries as well. If it is to be a model of circular flow of income, which of the following it should be?

- (a) Closed economic model
- (b) Open economic model
- (c) Traditional economic model
- (d) Modern economic model

**Ans.** (b) When a producer or firm trades with the rest of the world, it is considered as an open economy as the country is involved with export and import with rest of the world.

- (v) Export of good to the rest of the world will lead to ..... in circular flow of income.

- (a) increase
- (b) decrease
- (c) no change
- (d) ambiguous

**Ans.** (a) Export of goods leads to inflow of income into the circular flow, this leads to increase in income and hence growth of the nation.

- (vi) **Assertion (A)** One of the way to mitigate the risk of damage or loss is to get the goods insured.

**Reason (R)** Insurance act is an assurance to safeguard and provide some sense of security to the concerned parties involved.

**Alternatives**

- (a) Both Assertion (A) and Reason (R) are true and Reason (R) is the correct explanation of Assertion (A).
- (b) Both Assertion (A) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (A).
- (c) Assertion (A) is false, but Reason (R) is true
- (d) Both the statements are false

**Ans.** (a) Both Assertion (A) and Reason (R) are true and Reason (R) is the correct explanation of Assertion (A).

## PART 2

# Subjective Questions

### • Short Answer (SA) Type Questions

1. Giving reasons, classify the following into intermediate goods and final goods.

- (i) Curtain cloth purchased by a household.
- (ii) Machinery installed in an office.

**Ans.** (i) Curtain purchased by a household is a final consumer good because the household is the final user of the curtain cloth and there is no value addition.

- (ii) Machinery installed in an office is a final producer good because machinery is finally and repeatedly used by the office for several years and these are of high value.

2. Giving reasons, classify the following into intermediate goods and final goods.

- (i) Ceiling fan purchased by a tailor for his shop.
- (ii) Chalks, dusters, etc. purchased by a school.

**Ans.** (i) Ceiling fan purchased by a tailor for his shop is a final good because tailor is the final user of the ceiling fan and no value is to be added to the ceiling fan. This will be deemed as investment expenditure because ceiling fan is used by the tailor for several years and is of high value.

- (ii) Chalks, dusters, etc. purchased by a school are intermediate goods as these are used up in the process of value addition during the year.

3. Which among the following are final goods and which are intermediate goods? Give reasons.

- (i) Milk purchased by a tea stall
- (ii) Bus purchased by a school
- (iii) Juice purchased by a student from the school canteen  
(CBSE 2018)

**Ans.** (i) 'Milk purchased by a tea stall' is an intermediate goods.  
**Reason** It will be used as a raw material for making tea and involves value addition.

- (ii) 'Bus purchased by a school' is final good.  
**Reason** School purchases bus as long-term durable product and it is an investment for school. It is not for re-sale.

(iii) 'Juice purchased by a student from school canteen' is final good.

**Reason** Here juice is purchased for direct satisfaction of student's need, i.e., juice is being consumed by its end user.

4. What is the difference between microeconomics and macroeconomics? (NCERT)

**Ans.** Difference between microeconomics and macroeconomics

Basis	Microeconomics	Macroeconomics
Meaning	It studies economic problems at an individual level.	It studies economic problems at the level of an economy as a whole.
Determines	It determines the output and price for an individual firm.	It determines an aggregate output and general price level in the whole economy.
Tools	Demand and supply are its main tools.	Aggregate demand and aggregate supply are its main tools.
Dependence	It assumes all the macrovariables to be constant as national income, consumption, saving, etc.	It assumes all the microvariables to be constant as demand of households, supply of firms, prices of individual products, etc.

5. "Final goods include only those goods which are consumed by the households." Defend or refute the given statement with valid reason. (CBSE 2020)

**Ans.** Final goods include only those goods which are consumed by the households. The given statement is refused as final goods are the goods which have crossed the boundary line of production and are ready to use by consumers and producers (includes capital goods). These goods can be further classified as final consumer goods and final producer goods.

6. Distinguish intermediate goods from final goods with the help of suitable examples. (CBSE 2019)

**Ans.** Differences between intermediate goods and final goods

Basis	Intermediate Goods	Final Goods
Boundary Line	These goods remain within the boundary line of production and are not ready for use by their final users.	These goods are outside the boundary line of production and are ready for use by their final users.
Resale	These goods may be reproduced or resold by firms for making profit.	These goods are not resold by firms for making profit.
Value Addition	Value is yet to be added to these goods.	Value is not to be added to these goods.

**7.** Explain with the help of an example, the basis of classifying goods into final goods and intermediate goods. (All India 2017; Delhi 2010)

**Ans.** The basis of classification is the end-use of the product. Goods which are used by the producers in the process of production such as raw material or goods purchased for resale, are known as intermediate goods, e.g. shirt purchased by a firm for resale. These goods are still within the production boundary.

Goods which are outside the boundary line of production and are ready for use by their final users are called final goods, e.g. shirt purchased by a consumer.

**8.** 'All producer goods are not capital goods'. Do you agree?

**Ans.** Yes, I agree that all producer goods are not capital goods, because producer goods includes

- (i) Goods which are used as raw material like wood, used to make furniture.
- (ii) Goods which are used as fixed assets like plant and machinery.

Capital goods include only fixed assets of the producers. These are durable goods. On the other hand, goods used as raw material are not capital goods as these are not repeatedly used in the process of production. Thus, all producers goods are not capital goods.

**9.** Distinguish between consumption of fixed capital and capital loss.

**Ans.** Consumption of fixed capital refers to depreciation of fixed assets. It refers to loss of value of fixed assets while these are being used in the process of production. It occurs on account of normal wear and tear, accidental damages and expected obsolescence.

On the other hand, capital loss is the loss of value of fixed assets when these are not being used. It occurs on account of natural calamities (like earthquake, floods, or fire) and fall in the market value of the assets during periods of economic recession.

**10.** How is depreciation different from depreciation reserve fund?

**Ans.** Difference between depreciation and depreciation reserve fund

Basis	Depreciation	Depreciation Reserve Fund
Concept	It is the loss of value of fixed assets in use, on account of normal wear and tear.	It is a provision of funds created by producers to cope up with depreciation losses.
Effect	It leads to correct computation of profit.	These funds are used for the replacement of fixed assets when these are worn out.
Reason	Expected or foreseen obsolescence, normal wear and tear.	Obsolete/outdated assets need to be replaced.

**11.** Distinguish between stock and flow. Between net investment and capital which is a stock and which is a flow? Compare net investment and capital with flow of water into a tank. (NCERT)

**Ans.** Stock is that quantity of an economic variable which is measured at a particular point of time. Stock has no time dimension. Flow is the quantity of an economic variable which is measured during the period of time. Flow has a time dimension as per hour, per day or per month.

Net investment is a flow variable and capital is a stock variable. Flow of water in a tank is flow because it is measured as per unit of time period. Whereas, stock of water in a tank is stock because it is measured at a point of time. Capital is like a stock of water in the tank at a point of time.

**12.** Give reasons and categorise the following into stock and flow. (Delhi 2013)

- (i) Capital
- (ii) Saving
- (iii) Gross domestic product
- (iv) Wealth

**Ans.** (i) **Capital** It is a man-made means of production. It is a stock because it is measured at a given point of time.

(ii) **Saving** It is the surplus of production over consumption. It is a flow as it is measured during a period of time.

(iii) **Gross Domestic Product** It is a flow as it is the market value of final goods and services produced within the domestic territory measured during a period of time.

(iv) **Wealth** It is a stock as it is measured at a particular point of time.

**13.** Distinguish between money flows and real flows.

**Ans.** Flow of income refers to flow of goods and services (or their money value) across different sectors of the economy. It is called real flow in case it occurs in the form of goods and services, e.g., households rendering their factor services to the producers and in return producers offering final goods and services to the households. It is called money flows because there is a flow of money value from one sector to the other, e.g., producers make factor payments to the households and households make payments to the producers for the purchase of goods and services.

**14.** How money flows are opposite to real flows? Explain with the help of an example.

**Ans.** Money flows are opposite to real flows because money flows in response to the real flows. For example, There is a real flow of goods and services from the producers to the households. It is in response to it, that the households make payments to the producers. So, money flows from the households to the producers in terms of consumption expenditure.

Likewise, there is a real flow of factor services from the households to the producers. It is in response to it, that the producers make payments to the households. So, money flows from producers to the households in terms of factor payments.

**15.** Why is the flow of income and product called a circular flow?

**Ans.** It is because of the following reasons that the flow of income and product is called a circular flow

- (i) Corresponding to each real flow to one direction, there is money/income flow from the opposite direction. For example Corresponding to the flow of factor services (which is a real flow) from household to the producer sector, there is a flow of factor payments (which is a money flow) from producer to the household sector.
- (ii) In a two sector economy, receipts of one sector are equal to payments to other sector. In case receipts are less than the payments (or payments are less than the receipts), circularity is bound to stop at one point or the other.
- (iii) Activities of production, income generation and expenditure never stop in the economy. They keep chasing one another in a circular manner.

**16.** Describe the four major sectors in an economy according to the macroeconomics point of view. (NCERT)

**Ans.** An economy is generally classified into the following four sectors

- (i) **Household Sector** It is engaged in the consumption of goods and services.
- (ii) **Producing Sector** It is engaged in the production of goods and services.
- (iii) **Government Sector** It is engaged in such activities which are related to taxation and subsidies as well as consumption and production.
- (iv) **Rest of the World** It is engaged in exports and imports.

**17.** Explain the difference between the concept of injections and leakages in context of circular flow of income.

**Ans.**

Basis	Injections	Leakages
Meaning	These are those flow variables which creates a value addition in the process of circular flow in an economy.	These are those flow variables which causes reduction in the process of production (or the process of income generation in an economy).
Components	Injections include <ul style="list-style-type: none"> <li>• Consumption expenditure by the government</li> <li>• Investment expenditure by the government</li> <li>• Exports</li> </ul>	Leakages include <ul style="list-style-type: none"> <li>• Savings</li> <li>• Taxation</li> <li>• Imports</li> </ul>
Cause	This causes positive multiplier effect on the level of income and employment in the economy.	This causes negative multiplier effect on the level of income and employment in the economy.

### • Long Answer (LA) Type Question

**1.** Explain the circular flow of income in a two sector economy with the help of a diagram.

**Ans.** In a two sector economy, there are only two sectors of economic activity namely households and firms. Households supply factor services to firms and firms hire factor services from households. Households spend their entire income on consumption. Firms sell what is produced to the households.

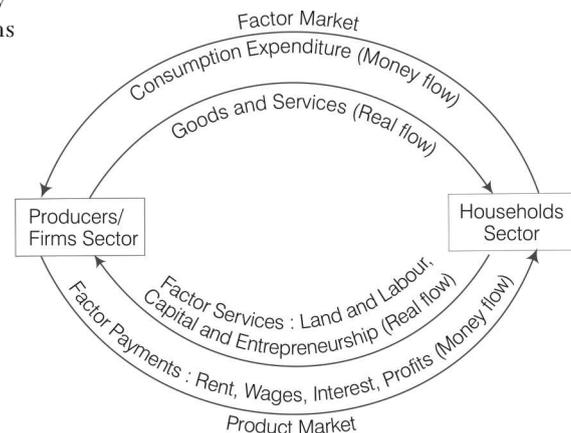
There are two types of markets in this economy

- (i) **Product Market** Market for goods and services.
- (ii) **Factor Market** Market for factors of production.

The above figure shows that

- (i) Total Production of Goods and Services by firms = Total Consumption of Goods and Services by Households
- (ii) Factor Payments by Firms = Factor Incomes of Households
- (iii) Consumption Expenditure of Households = Income of Firms

Thus, Real Flow of Production and Consumption of Firms and Households = Money Flows of Income and Expenditure of Firms and Households



Circular Flow of Income in a Two-sector Economy

# Chapter Test

## Multiple Choice Questions

- Depreciation of fixed capital assets refer to  
(a) normal wear and tear      (b) foreseen obsolescence      (c) Both (a) and (b)      (d) unforeseen obsolescence
- Which of the following statements is/are correct?  
(i) Capital formation is a stock variable.  
(ii) A car covering a distance of 400 km in 5 hours includes both stock as well as flow variable.  
**Alternatives**  
(a) Both are true      (b) Both are false  
(c) (i) is true, but (ii) is false      (d) (i) is false, but (ii) is true
- A thousand rupee note is an example of  
(a) stock variable      (b) flow variable  
(c) Either stock or flow      (d) Neither stock nor flow
- Money flows are reciprocal of  
(a) monetary flows      (b) real flows      (c) circular flows      (d) inventory flows
- Circular flow of income is based upon which of the following assumptions?  
(a) All sectors are self-sufficient and independent  
(b) Income generated in one sector is consumed within the same sector  
(c) One person's expenditure is another person's income  
(d) All economies are closed economies

## Short Answer (SA) Type Questions

- What are the four factors of production and what are the remunerations to each of these called?
- Giving reason, classify the following into capital goods and consumer goods.  
(i) Ice-cream purchased by a consumer.  
(ii) Plant and machinery of XYZ company.
- Give reason and identify whether the following are final expenditures or intermediate expenditures.  
(i) Expenditure on maintenance of an office building.  
(ii) Expenditure on improvement of machine in a factory.
- Distinguish between consumer goods and capital goods.
- Distinguish between stocks and flows. Give two examples of each.

## Long Answer (LA) Type Question

- Explain the circular flow of income.

## Answers

### Multiple Choice Questions

1. (c)    2. (d)    3. (a)    4. (b)    5. (c)