

ED, DD & Corr. - Reason-Based (Comp. of Sub)

Q.1. In the situation of underemployment equilibrium, there is no unutilised capacity in the economy.

Ans. False. Underemployment equilibrium refers to that situation in the economy when $AS = AD$ but without fuller utilisation of resources. Accordingly, there is unutilised capacity or excess capacity in the economy.

Q.2. Full employment implies there is zero unemployment in the economy.

Ans. False. Full employment does not imply that there is zero unemployment in the economy. Some people may not be willing to work at all, or not willing to work at the existing wage rate. Also, some natural rate of unemployment always exists in the economy.

Q.3. The economy fails to create enough jobs under involuntary unemployment.

Ans. True. Involuntary unemployment occurs when some people are not getting work, even when they are willing to work at the existing wage rate. In such a situation, the economy fails to create enough jobs because planned output is lower than the full employment level of output. This may be owing to the lack of aggregate demand.

Q.4. The problem of unemployment means the problem of voluntary unemployment.

Ans. False. The problem of unemployment means the problem of involuntary unemployment. It refers to those people who are able to work and are willing to work at the existing wage rate, but are not getting work.

Q.5. In a situation of deficient demand, there is underemployment equilibrium in the economy.

Ans. True. Because owing to deficient AD, equilibrium between desired AD and desired AS is struck at a lower level of GDP, lower than full employment in the economy. This is a situation of underemployment equilibrium.

Q.6. Under deflationary gap, voluntary unemployment occurs in the economy.

Ans. False. Under deflationary gap, involuntary unemployment occurs in the economy.

Q.7. Excess demand refers to the situation when $AD > AS$, corresponding to underemployment in the economy.

Ans. False. Excess demand refers to the situation when aggregate demand (AD) is in excess of aggregate supply (AS) corresponding to full employment in the economy.

Q.8. Excess demand raises the market value of the output.

Ans. True. Excess demand raises the market value of the output. Because in a situation of excess demand, output level remaining constant, higher demand (higher than the supply) leads to a rise in the general price level. Implying a situation when market value of the output increases in the economy.

Q.9. Price and output increase in a situation of inflationary gap.

Ans. False. Inflationary gap is the excess of AD over and above its level required to maintain full employment equilibrium in the economy. Inflationary gap generates extra pressure on the existing flow of goods and services at the level of full employment. Accordingly, prices tend to rise but output will not increase. Output remains constant corresponding to full employment level in the economy.

Q.10. Fiscal policy focuses on economic stability and economic growth.

Ans. True. Fiscal policy focuses on economic stability and economic growth. Stability is achieved by correcting the situations of excess demand (inflationary gap) and deficient demand (deflationary gap). Growth is achieved by way of lower taxation and higher subsidies to the producers.

Q.11. Excess demand can be corrected by increasing the government expenditure.

Ans. False. Excess demand can be corrected by reducing the government expenditure. A reduction in government expenditure (particularly) non-development expenditure like on defence, law & order and subsidies will cause an overcall cut in aggregate demand. So that excess aggregate demand is corrected.

Q.12. Central bank buys government securities in the open market to correct the situation of inflationary gap.

Ans. False. Central bank sells government securities in the open market to correct the situation of inflationary gap. It is by selling the securities that the bank soaks liquidity from the market which is expected to correct the inflationary gap.

Q.13. Repo rate is reduced to correct the situation of deficient demand.

Ans. True. To correct the situation of deficient demand, repo rate is reduced. As a follow-up action, the commercial banks lower the market rate of interest (the rate at which the commercial banks lend money to the consumers and the investors). This increases demand for credit. Consequently, consumption expenditure and investment expenditure are increased. Implying a expansion in aggregate demand, as required to correct deficient demand.

Q.14. SLR is increased to correct the situation of deflationary gap.

Ans. False. SLR is decreased to correct the situation of deflationary gap. Lower SLR increases credit creation capacity of the commercial banks. Because a cut in the SLR raises cash balances with the commercial banks. Accordingly, availability of credit increases in the capital market. This increases aggregate demand and deflationary gap is corrected.