# UGC NET Economics Memory Based Question -7 JAN 2026 SHIFT -1

**Q1.** Which among the following statements is/are correct with respect to the "Paul Sweezy Model" under Oligopoly Market Structure?
1.The marginal revenue (MR) curve is discontinuous at the level of output corresponding to the kink
2.Upper section of the kinked demand curve has lower price elasticity
3.Lower section of the kinked demand curve has higher price elasticity
4.In the upper section of the MR curve, MR > MC
(A). (2) and (3)
(B). (1) and (3)
(C). (1) and (4)
(D). (1) and (2)
**Correct answer : (c)** (1) and (4)
**Explanation :** The kinked demand curve shows **price rigidity** because firms hesitate to change prices fearing competitor reactions. The **upper segment of the demand curve is more elastic** since price increases cause large drops in quantity demanded.
The **lower segment is less elastic** as firms match price cuts, limiting quantity increase.
**Information Booster:**
- **Statement (1):** The **marginal revenue (MR) curve is discontinuous at the kink** — this is a fundamental property of the kinked demand curve. Because the demand curve has two different elasticities (above and below the kink), the MR curve has a vertical gap or discontinuity at that output level. This discontinuity explains price rigidity, as firms face uncertainty about reactions to price changes.
- **Statement (4): In the upper section of the MR curve, MR > MC** can be correct depending on the firm's output decision. Since the MR curve is kinked and discontinuous, the firm can sustain a range of marginal cost (MC) values without changing output or price — in this range, MR can be greater than MC in the upper segment. This aligns with the model's explanation for price rigidity.

**Additional Knowledge:**
- **Statement (2):** The **upper section of the kinked demand curve has higher price elasticity**, not lower. When prices rise above the kink, competitors do not follow, so the quantity demanded falls significantly — indicating higher elasticity. So, (2) is **incorrect**.
- **Statement (3):** The **lower section of the kinked demand curve has lower price elasticity** because competitors match price cuts, resulting in relatively inelastic demand below the kink. So (3) stating **higher elasticity** is **incorrect**.

**Q2.** Arrange the following Chairman of the Finance Commission in chronological order:
(i) K.C. Pant
(ii) K. Brahamananda Reddy
(iii) A.M. Khusro
(iv) K. Santhanam
Codes :
(A). (i), (iii), (ii), (iv)
(B). (ii), (i), (iii), (iv)
(C). (iv), (ii), (i), (iii)
(D). (iii), (ii), (i), (iv)

Answer: c
Solution:
**Correct Option: (C)** (iv), (ii), (i), (iii)
**Explanation:**

- **K. Santhanam (iv):** Chairman of the 2nd Finance Commission, appointed in 1956.
- **K. Brahamananda Reddy (ii):** Chairman of the 6th Finance Commission, appointed in 1972.
- **K.C. Pant (i):** Chairman of the 10th Finance Commission, appointed in 1992.
- **A.M. Khusro (iii):** Chairman of the 11th Finance Commission, appointed in 1998.

**Additional Knowledge:**

- **Article 280:** The Finance Commission is a constitutional body constituted by the President of India every five years (or earlier) under Article 280.
- **Function:** Its primary job is to recommend the distribution of net tax proceeds between the Centre and the States (vertical devolution) and among the States (horizontal devolution).
- **16th Finance Commission:** As of 2024-25, the 16th Finance Commission has been constituted under the chairmanship of Dr. Arvind Panagariya.
- **First Chairman:** The 1st Finance Commission was headed by K.C. Neogy (appointed in 1951).

**Q3.** According to the Economic Survey 2024-25, what is the estimated Real GDP growth rate for India in the fiscal year 2024-25 (FY25)?
(A). 8.2%
(B). 7.2%
(C). 6.4%
(D). 5.5%
Answer: b
Solution:
**Correct Option: B.** 7.2%
**Explanation:**
1. The Economic Survey is an annual document presented by the Government of India in Parliament a day before the Union Budget.
2. It reviews the economic developments of the past year and provides an outlook for the coming year.
3. The Economic Survey 2024-25 was presented in July 2024 and contains the government's official growth projection for the ongoing financial year (FY25).
**Information Booster:**
1. The Economic Survey 2024-25 projected India's Real GDP growth for FY25 at 7.2%.
2. This projection was based on robust investment demand, continued momentum in services, and expectations of a normal monsoon supporting agriculture.
3. The estimate of 7.2% positioned India as one of the fastest-growing major economies in the world for FY25.

**Q4. For a Giffen good, the price elasticity of demand is:**
(A). Negative
(B). Zero
(C). Greater than one
(D). Positive

Answer: d

Solution:

**Ans. (d) Positive**

**Solution:**

- When the price of a Giffen good increases, the demand also increases, because the income effect (i.e., consumers' real income effectively decreases) outweighs the substitution effect.
- This results in a **positive price elasticity of demand**, meaning demand increases when the price increases.

**Information Booster:**

- **Giffen good** is a special type of inferior good that violates the **law of demand**. Normally, as the price of a good rises, the quantity demanded decreases, but for Giffen goods, the opposite happens.
- Examples: Historical examples of Giffen goods include bread during periods of economic hardship where it was a staple food. As the price of bread rose, people could no longer afford meat and other substitutes, so they bought more bread.

**Additional Knowledge:**

- Option (a) Negative: Incorrect. For most goods, price elasticity of demand is **negative** (inverse relationship between price and demand).
- Option (b) Zero: Incorrect. Zero elasticity indicates that **quantity demanded doesn't change** with price changes, which is not applicable for Giffen goods.
- Option (c) Greater than one: Incorrect. **Greater than 1** indicates elastic demand, but **Giffen goods** have **positive elasticity** (which is typically **inelastic** in this case).

**Q5.** The "Tragedy of the Commons" describes a situation where:

(A). Private ownership of a resource leads to its overexploitation.

(B). A shared resource is overused and depleted because individuals act in their own self-interest.

(C). International treaties effectively prevent the degradation of global public goods.

(D). Government regulation is always successful in managing environmental resources.

Answer: b

Solution:

**Correct Option: B.** A shared resource is overused and depleted because individuals act in their own self-interest.

**Explanation:**

The "Tragedy of the Commons" is a classic economic problem articulated by **Garrett Hardin.** It describes a scenario where a shared, common-pool resource (like a pasture, fishery, or clean air) is depleted because each individual user has an incentive to consume as much as possible, since the personal benefit of using an additional unit is gained individually, while the cost of its degradation is shared by all.

**Information Booster:**

- **Core Mechanism:** The tragedy arises from a divergence between individual and collective rationality. For each individual, the marginal private benefit of using the resource exceeds their marginal private cost, leading to overconsumption.

- **Key Features:**
  - The resource is rivalrous (one person's use diminishes another's).
  - The resource is non-excludable (it is difficult to prevent anyone from using it).
  - **Classic Example:** A common pasture where each herder is motivated to add more and more grazing animals because they receive all the benefit from their own animals, but the cost of overgrazing is shared by all herders. This leads to the pasture's eventual destruction.

**Additional Knowledge:**

- **Private ownership of a resource leads to its overexploitation:** This is generally not the case. A core proposed solution to the tragedy is precisely the assignment of private property rights, which internalizes the costs and benefits, giving the owner an incentive to manage the resource sustainably.
- **Government regulation is always successful:** While government intervention (quotas, taxes, regulations) is a potential solution, it is not "always successful." It can be fraught with challenges like enforcement costs, inefficiency, and political hurdles.
- **International treaties effectively prevent degradation: This is incorrect**. Managing global commons (like the atmosphere or oceans) often suffers from the tragedy on an international scale, where free-riding by nations can undermine treaties, making them difficult to enforce effectively.

**Q6.** Regarding the 'Optimum Theory of Population':
A. It defines an optimum population size where per capita output is maximized.
B. It is a dynamic concept that changes with technology and resource availability.
C. It suggests that both over-population and under-population can be detrimental to a country's economic welfare.
D. The theory was a direct refutation of all Malthusian principles.
Which of the above statements are correct?
(A). A and C only
(B). B and D only
(C). A, B, and C only
(D). A, B, C, and D
Answer: c
Solution:
**Correct Option : 3.** A, B, and C only.
**Explanation :**
The Optimum Theory of Population, unlike the purely subsistence-focused Malthusian theory, is an economic concept that links population size directly to per capita income and overall economic welfare.
**A. Defines maximum per capita output:** The theory identifies an optimum population (O) as the size where the total output of the country is divided by the population, resulting in the highest possible per capita output (income). This point represents the ideal balance between the workforce and the country's resources → **Statement A is correct.**
**B. A dynamic concept:** While the basic model uses static assumptions (like fixed technology) to determine the optimum at a specific point in time, the theory acknowledges that the optimum level is not fixed. Improvements in technology, discovery of new resources, or increased capital accumulation will shift the ideal population size upwards, making it a dynamic concept over the long run → **Statement B is correct.**

**C. Detrimental nature of deviation:** The theory posits that any deviation from the optimum size is economically detrimental:

- Under-population (population < Optimum) means resources are under-utilized, and the economy fails to achieve economies of scale, resulting in lower per capita income.
- Over-population (population > Optimum) means resources are strained, the Law of Diminishing Returns sets in, and per capita income falls.
- **Statement C is Correct.**

**D. Relationship with Malthus:** The Optimum Theory is generally considered superior to the Malthusian theory because it links population to wealth/total production (not just food supply) and allows for a stage of increasing returns. However, it is not a complete refutation of all Malthusian principles, as it still relies on the Law of Diminishing Returns to explain why over-population leads to falling income.

- **Statement D is Incorrect** as it exaggerates the refutation; the theories share some underlying economic logic.

**Q7.** In an economy real GDP has increased from $ 990 PPP to $ 1080 PPP during 2015 to 2020. The incremental capital output ratio is 2.5. The rate of investment is:

(A). 27.5 Percent

(B). 22.5 Percent

(C). 3.9 Percent

(D). 19.5 Percent

Answer: b

Solution:

**Correct Option: B.** 22.5 percent

**Solution:** Using the fundamental equation derived from the Harrod-Domar Model is: **Rate of Investment = Proportional Growth Rate of GDP × ICOR**

**Given Values:**

**1. Initial Real GDP** ($Y_{2015}$): $990 PPP

**2. Final Real GDP** ($Y_{2020}$): $1080 PPP

**3. Incremental Capital Output Ratio (ICOR)**: 2.5

**Step 1.** Calculate the Proportional Growth Rate of GDP (g);

- The growth rate is the total change in GDP over the period divided by the initial GDP.
- Change in GDP = $Y_{2020}$ - $Y_{2015}$ = $1080 - $990 = $90
- Now, $g = \frac{90}{990} = 0.0909$

**Step 2.** Calculate the Rate of Investment (s);

- Put the values in the formula; **Rate of Investment = Proportional Growth Rate of GDP × ICOR** = 0.0909 × 2.5 = 0.22725
- Hence, to get the percentage, multiply by 100: Rate of investment $0.22725 \times 100 = 22.725\%$ , which is closest to Option B.

**Q8.** The "Big Push" theory, primarily associated with Paul Rosenstein-Rodan, argues that industrialization requires:

(A). A slow, gradual process of capital accumulation.

(B). Widespread, coordinated investment across several industries to create markets for each other.

(C). That a country should first achieve a surplus in its agricultural sector.

(D). That foreign direct investment alone is sufficient for development.
Answer: b
Solution:
**Correct Option: B.** Widespread, coordinated investment across several industries to create markets for each other.
**Explanation:**
The Big Push theory, proposed by Paul Rosenstein-Rodan in 1943, argues that underdeveloped economies are trapped in a low-income equilibrium due to small market size and lack of incentives for individual investments. A large-scale, synchronized industrialization effort is needed to overcome this by creating demand across sectors.
**Information Booster:**
- **Key Problem:** Indivisibilities in demand and supply — isolated investments fail due to limited markets.
- **Solution:** Simultaneous investment in multiple industries so that workers and firms in each sector become customers for other sectors.

**Additional Knowledge:**
- **Option A: Gradual capital accumulation** is more aligned with classical or neoclassical views, not the Big Push.
- **Option B: Agricultural surplus** first is part of some development strategies (e.g., Lewis model precondition) but not the core of the Big Push.
- **Option C: Foreign direct investment** alone was not seen as sufficient; Rosenstein-Rodan emphasized coordinated domestic investment and planning.

**Q9.** Which of the following is/are true regarding the GST (Goods and Services Tax) in India?
(A) It is a destination-based tax system.
(B) Alcohol for human consumption is fully covered under the purview of GST.
(C) The GST Council is a constitutional body under Article 279A.
Select the correct option:
(A). Only (A)
(B). Only (A) and (C)
(C). Only (B) and (C)
(D). All (A), (B), and (C)
Answer: b
Solution:
**Correct Option: (b)** Only (A) and (C)
**Explanation:**
· **Statement (A) is Correct:** GST is a destination-based tax on consumption. This means the tax accrues to the state where the goods or services are finally consumed, rather than the state where they are manufactured or produced.
· **Statement (B) is Incorrect:** Alcohol for human consumption is constitutionally excluded from the purview of GST. States continue to levy State Excise Duty and VAT on it.

· **Statement (C) is Correct:** The GST Council is a constitutional body established under Article 279A of the Indian Constitution (introduced by the 101st Amendment Act). It makes recommendations to the Union and State Governments on issues related to GST.

**Information Booster:**

· **Petroleum Products:** While Alcohol is permanently out (unless the Constitution is amended), Petroleum products are technically part of GST, but the decision to levy tax on them has been deferred until the GST Council decides to include them.

· **GST Council Structure:** The Council is chaired by the Union Finance Minister and includes the Union State Minister of Revenue or Finance and Ministers in charge of Finance or Taxation of all the States.

**Additional Knowledge:**

· **Dual GST:** India adopted a Dual GST model (Central GST + State GST) because it is a federal country.

· **IGST:** Integrated GST (IGST) is levied on inter-state supply of goods and services and is collected by the Center to ensure the credit chain remains intact.

**Q10.** In welfare economics, the 'Compensation Principle' is central to making potential welfare comparisons. In this context, find out the correct alternative:

(A). The Kaldor-Hicks criterion requires that compensation must actually be paid for a change to be considered an improvement.

(B). A social welfare function is unnecessary for making welfare judgments based on the compensation principles of Kaldor and Hicks.

(C). The Scitovsky paradox highlights a situation where a change satisfies the Kaldor criterion but its reverse also satisfies the Kaldor criterion.

(D). The Rawlsian social welfare function is perfectly aligned with the potential compensation criteria proposed by Kaldor and Hicks.

Answer: c

Solution:

**Correct Option: C.** The Scitovsky paradox highlights a situation where a change satisfies the Kaldor criterion but its reverse also satisfies the Kaldor criterion.

**Explanation:**

The Compensation Principle, developed by economists like **Kaldor and Hicks**, attempts to make welfare judgments without interpersonal utility comparisons. It focuses on whether the "winners" from a change could potentially compensate the "losers" and still be better off.

**Information Booster:**

- **The Scitovsky Paradox:** This is the correct alternative. Economist Tibor Scitovsky identified a critical flaw in the Kaldor-Hicks criterion. The paradox occurs when:
  - A change from State A to State B passes the Kaldor test (winners in B could compensate losers and still be better off).
  - However, a change back from State B to State A also passes the Kaldor test (the new "winners" in A could compensate the new "losers" and still be better off).

This creates an internal inconsistency, showing that the Kaldor-Hicks criterion alone cannot provide a clear, unambiguous ranking of social states.

**Additional Knowledge:**

- **"The Kaldor-Hicks criterion requires that compensation must actually be paid...": This is false.** The core of the Kaldor-Hicks criterion is that compensation is potential, not actual. A change is considered an efficiency improvement if the gainers could compensate the losers, even if they never do. This is why it is often used in cost-benefit analysis.
- **"A social welfare function is unnecessary for making welfare judgments based on the compensation principles...": This is false.** The compensation principles (Kaldor, Hicks, Scitovsky) were developed precisely because economists wanted to make welfare judgments without a specific social welfare function, which requires making ethical choices about income distribution. The principles try to separate "efficiency" from "equity."
- **"The Rawlsian social welfare function is perfectly aligned with the potential compensation criteria...": This is false.** They are fundamentally opposed. The Rawlsian "maximin" principle judges social welfare by the well-being of the worst-off individual. It is deeply concerned with the actual distribution of welfare. In contrast, Kaldor-Hicks ignores the actual distribution and focuses solely on potential, aggregate gains, which can lead to outcomes that make the poorest members of society worse off.

**Q11.** The Solow-Swan neoclassical growth model primarily explains long-run economic growth through:
(A). Endogenous technological progress
(B). Capital accumulation and exogenous technological change
(C). Government intervention and industrial policy
(D). Human capital accumulation and learning-by-doing
Answer: b
Solution:
**Correct Option: B.** Capital accumulation and exogenous technological change
**Explanation:**
The Solow-Swan model, developed by Robert Solow and Trevor Swan, is a cornerstone of neoclassical growth theory. It explains long-run economic growth as primarily driven by exogenous technological progress, with capital accumulation playing a role in growth toward the steady state but not in long-run per capita growth.
**Information Booster:**
- **Core Mechanism:** In the model, capital accumulation is subject to diminishing returns. This means that as an economy accumulates more capital per worker, each additional unit of capital contributes less to output.
- **The Steady State:** Because of diminishing returns, the economy eventually reaches a steady state where capital per worker and output per worker are constant. In this state, investment only covers depreciation and capital-widening for population growth.
- **Role of Technology:** Long-run growth in output per worker can only occur through exogenous technological progress—an unexplained factor that shifts the production function outward over time. The model treats technological change as a "manna from heaven" that it does not attempt to explain.
**Additional Knowledge:**

- **Endogenous technological progress:** This is the focus of Endogenous Growth Theory (pioneered by Paul Romer), which explicitly models technological progress as resulting from factors like R&D investment, human capital, and knowledge spillovers within the model.
- **Government intervention and industrial policy:** While these can influence an economy's growth path, they are not the primary drivers of long-run growth in the Solow model.
- **Human capital accumulation and learning-by-doing:** These are elements incorporated into extensions of the Solow model and are central to endogenous growth models, but they are not the core explanation in the basic Solow-Swan framework.

**Q12.** If all values in a dataset are the same, what will be the standard deviation?
(A). 0
(B). 1
(C). The value itself
(D). Cannot be determined
Answer: a
Solution:
**Correct Option: (1) 0**
Standard deviation is a fundamental statistical measure used to quantify the amount of variation or dispersion in a set of data values. It tells us, on average, how far each data point is from the mean of the dataset.
**Information Booster:**
* When all the values in a dataset are identical, there is no spread or dispersion in the data. For example, in a dataset like {10, 10, 10, 10}, the mean is 10. Every single data point is exactly equal to the mean.
* Since there is no deviation from the mean, the standard deviation is zero. A standard deviation of zero indicates that all values in the dataset are the same and there is no variability.

**Q13. Put the following concepts in chronological order:**
1. Pareto's Ordinal Utility Concept
2. Marshall's Consumer Surplus
3. Hicks & Allen's Indifference Curves
4. Samuelson's Revealed Preference

(A). 2 – 1 – 3 – 4
(B). 1 – 2 – 3 – 4
(C). 2 – 3 – 1 – 4
(D). 4 – 3 – 2 – 1
Answer: a
Solution:

**Ans. (a) 2 – 1 – 3 – 4**
**Solution:**
- Marshall Consumer Surplus (1890)
- Pareto Ordinal Utility (1906)

- Hicks & Allen Indifference Curves (1934)
- Samuelson Revealed Preference (1938)

**Information Booster:**

- Marshall's concept of **Consumer Surplus** was introduced in 1890. According to Marshall, consumer surplus is the difference between the total amount that consumers are willing to pay for a good and the total amount they actually do pay.
- **Pareto Ordinal Utility**, introduced by **Vilfredo Pareto** in 1906, emphasizes the ranking of preferences or utilities rather than measuring them in absolute terms.
- **Hicks and Allen Indifference Curves** (1934) illustrates consumer preferences for different combinations of two goods while maintaining the same level of satisfaction or utility.
- S**amuelson's Revealed Preference Theory (1938)** was an alternative approach to understanding consumer choice. According to Samuelson, if a consumer chooses one bundle of goods over another when both are available, it reveals that the consumer prefers the first bundle over the second, and thus their preference can be "revealed" through observed actions rather than stated preferences.

**Q14.** Presence of asymmetric information in the market causes which of the following?

A. Adverse selection

B. Marginal benefits of an additional unit of resources diminish with an increasing number of unit of resources

C. Efficiency wages

D. Principal-Agent problem

Choose the correct answer from the options given below:

(A). A, B and D only

(B). B, C and D only

(C). A and D only

(D). A and C only

Answer: c

Solution:

**Correct Option: C:** A and D only

**Explanation:**

Asymmetric information occurs when one party in a transaction has more or better information than the other. This leads to market failures such as:

**A. Adverse selection** – Occurs before the transaction (e.g., in insurance, risky individuals are more likely to buy insurance, but the insurer cannot distinguish them).

**D. Principal-Agent problem –** Arises when the agent (e.g., manager) has more information than the principal (e.g., owner) and may not act in the principal's best interest.

**Additional Knowledge:**

**B. Diminishing marginal benefits –** This is a general principle of economics related to utility or returns, not caused by asymmetric information.

**C. Efficiency wages –** These are higher wages paid to increase productivity or reduce shirking; while they can be a response to asymmetric information (to mitigate moral hazard), they are not themselves caused by it. They are a solution, not a direct result.

**Q15.** The Harrod-Domar growth model primarily emphasizes the following factors as essential for achieving sustained economic growth:

A. Technological progress

B. Capital accumulation

C. Savings rate

D. Labor force growth

E. Capital-output ratio

Choose the correct answer from the options given below:

(A). B, D, and E Only

(B). A, B, and D Only

(C). B, C, and E Only

(D). A, C, and E Only

Answer: c

Solution:

**Correct Option: 3.** B, C, and E Only

**Explanation:**

The Harrod-Domar growth model is a classical model that focuses on the role of capital accumulation in driving economic growth. The key variables in the model are the savings rate and the capital-output ratio.

**Information Booster:**

- **Core Equation:** The growth rate (g) in the Harrod-Domar model is given by: $g = \frac{s}{v}$
  - where: s = savings rate (B & C) , v = capital-output ratio (E)
- **Mechanism:**
  - Savings (C) provide the funds for investment.
  - Investment leads to capital accumulation (B).
  - The capital-output ratio (E) determines how efficiently capital is converted into output.
- **Key Drivers:** Higher savings and lower capital-output ratio lead to higher growth.

**Additional Knowledge:**

- **A. Technological progress:** This is not explicitly included in the basic Harrod-Domar model. It was later incorporated in the Solow-Swan model.
- **D. Labor force growth:** While labor is acknowledged, the model primarily focuses on capital requirements to employ growing labor, not labor growth itself as a direct driver.
- A major **limitation** of the model is its **knife-edge problem**—the instability of the equilibrium growth path, where any deviation leads to further divergence.

**Q16.**

Consider the following system of equations:

$$Y_1 = \alpha_0 + \alpha_1 Y_2 + \alpha_3 Y_3 + \alpha_4 X_1 + \alpha_5 X_2 + U_1$$

$$Y_2 = \beta_0 + \beta_1 Y_3 + \beta_2 Y_1 + \beta_3 X_2 + U_2$$

$$Y_3 = \lambda_0 + \lambda_1 X_1 + \lambda_2 X_2 + \lambda_3 X_3 + U_3$$

According to the order condition, the first equation is:

(A). Unidentified

(B). Just identified

(C). Over identified

(D). Not possible to say because the reduced form of the model is not given.

Answer: a

Solution:

**Correct Option: A.** Unidentified

**Explanation:**

- The **Order Condition** is a necessary condition for the identification of a structural equation.
- It compares the number of excluded exogenous variables to the number of included endogenous variables (minus one).
- If the number of excluded exogenous variables is less than the number of included endogenous variables minus one, the equation is unidentified.

**Information Booster:**

- **Formula:** $K - k \geq g - 1$
  - $K = 3$: Total exogenous variables in the system ($X_1, X_2, X_3$).
  - $k = 2$: Exogenous variables in the first equation ($X_1, X_2$).
  - $g = 3$: Total endogenous variables in the first equation ($Y_1, Y_2, Y_3$).
- **Calculation:**
  - Excluded Variables ($K - k$): $3 - 2 = 1$ (Only $X_3$ is excluded).
  - RHS Endogenous Variables ($g - 1$): $3 - 1 = 2$ ($Y_2$ *and* $Y_3$ appear on the RHS).
- **Conclusion:** Since $1 < 2$ (Excluded < Required), the equation is **Unidentified.**

**Additional Knowledge:**

- **Just Identified:** Condition holds with equality ($K - k = g - 1$).
- **Over Identified:** Excluded variables are greater than required ($K - k > g - 1$).
- **Rank Condition:** While the Order Condition is necessary, the Rank Condition is both necessary and sufficient for identification. It checks if the matrix of excluded coefficients has full rank.

**Q17.** Consider the following statements regarding the IS-LM Model:
Statement I: The IS curve shows the combinations of interest rates and output levels where the goods market is in equilibrium.
Statement II: A decrease in government spending shifts the IS curve to the right.
Statement III: In the "Liquidity Trap" region, the LM curve is perfectly elastic (horizontal).
Which of the statements given above are correct?
(A). I only
(B). I and II only
(C). I and III only
(D). II and III only
Answer: c
Solution:
**Correct Option: 3.** I and III only
**Explanation:**
The IS-LM model illustrates the interaction between the goods market (IS curve) and the money market (LM curve) to determine equilibrium interest rates and output.
**Information Booster:**
- **Statement I is correct:** The IS curve plots all combinations of interest rate (r) and output (Y) where Investment = Saving, i.e., where the goods market is in equilibrium.
- **Statement III is correct:** The "Liquidity Trap" occurs when interest rates are very low and money demand becomes perfectly elastic. Here, the LM curve is horizontal, meaning monetary policy cannot lower interest rates further to stimulate output.

**Additional Knowledge:**

- **Statement II is incorrect:** A decrease in government spending reduces aggregate demand, shifting the IS curve to the left, not the right.
- An increase in government spending **shifts IS right**.
- In a liquidity trap, fiscal policy is effective because the IS shift does not raise interest rates.

**Q18.** According to the Coase Theorem, which of the following are necessary conditions or likely outcomes for the efficient resolution of an externality through bargaining?
A. Transaction costs must be zero or very low.
B. The initial assignment of property rights affects the final distribution of wealth.
C. The government must intervene to define the legal liability for the externality.
D. The polluting activity will always be stopped completely if the victim holds the rights.
E. The efficient level of pollution control can be achieved regardless of who is assigned the property rights.
Choose the most appropriate answer from the options given below:
(A). A, B & E Only
(B). A, C & D Only
(C). B, C & E Only
(D). C, D & E Only
Answer: a
Solution: Correct Option: (A). A, B & E Only.
**Explanation:**
The Coase Theorem states that if property rights are well-defined and transaction costs are zero (or negligible), private parties can bargain to an efficient outcome regardless of the initial allocation of those property rights.
**Information Booster:**
- **Statement A. Transaction costs must be zero or very low:** This is a core necessary condition for the theorem to hold in its ideal form. Low transaction costs allow parties to negotiate effectively until an efficient agreement is reached.
- **Statement B. The initial assignment of property rights affects the final distribution of wealth:** This is a correct outcome or implication. While the final efficient allocation of resources is the same regardless of who has the rights, who initially holds the rights determines who receives compensation, thereby affecting the final wealth distribution.
- **Statement E. The efficient level of pollution control can be achieved regardless of who is assigned the property rights:** This is the central outcome or "invariance" proposition of the Coase Theorem. As long as conditions (like zero transaction costs) are met, the same efficient solution (e.g., optimal level of pollution abatement) is reached through bargaining, regardless of the initial owner of the property right.

**Additional Knowledge:**
- **Statement C. The government must intervene to define the legal liability for the externality:** This is incorrect. The Coase Theorem's key insight is that private bargaining can solve the externality problem without government intervention (beyond defining and enforcing property rights in the first place).

- **Statement D. The polluting activity will always be stopped completely if the victim holds the rights: This is incorrect.** The outcome depends on a cost-benefit analysis through bargaining. The polluting activity will only stop if the victim's value of clean air is greater than the polluter's value of polluting (or the cost of abatement is less than the damage caused). The efficient level of pollution (which might be a reduced level, not zero) will be reached, not necessarily a complete stop.

**Q19.** For a linear demand function Q = 100 - 2P, at what price is the point elasticity of demand equal to unity?
(A). 25
(B). 20
(C). 15
(D). 10

**Correct Option: (A) 25**
**Solution:**

- The point elasticity of demand **measures** the responsiveness of quantity demanded to a change in price at a **specific point** on the demand curve.
- It is given by the formula: $|E_d| = \left(\frac{dQ}{dP}\right) \times \left(\frac{P}{Q}\right)$
- Demand function: $Q = 100 - 2P$
- Derivative: $\frac{dQ}{dP} = -2$
- $|E_d| = \left|(-2) \times \frac{P}{Q}\right| = 1$
- Substitute $Q = 100 - 2P$: $2 \times \frac{P}{100 - 2P} = 1$
- Now, Solve for P: $\frac{2P}{100 - 2P} = 1 \Rightarrow 2P = 100 - 2P \Rightarrow 4P = 100 \Rightarrow P = 25$
- At $P = 25, Q = 100 - 2(25) = 50.$

**Q20.** Primary deficit is given by _____
(A). Fiscal deficit - Interest payment.
(B). Revenue deficit - Interest payment
(C). Budget deficit - Interest Payment
(D). Revenue Receipt - Revenue Expenditure
Answer: A
Solution:
**Correct Answer: A.** Fiscal deficit – Interest payments
**Explanation:**
Primary Deficit measures the government's borrowing requirement excluding interest payments on past debt.
**Information Booster:**
1. Formula: Primary Deficit = Fiscal Deficit – Interest Payments

2. It shows the fiscal gap arising from current-year spending other than debt servicing.
3. A zero primary deficit means borrowing is only for interest payments, not new expenditure.

**Additional Knowledge:**

1. Fiscal Deficit = Total expenditure − (Revenue receipts + Non-debt creating capital receipts).
2. Revenue Deficit = Revenue expenditure − Revenue receipts.
3. Budget Deficit (older term) = Total expenditure − Total receipts (now largely replaced by fiscal deficit).

**Q21. A firm's production function is given as $Q=50L^{0.8}K^{0.4}$. What kind of returns to scale does this function exhibit?**

(A). Constant returns to scale
(B). Increasing returns to scale
(C). Decreasing returns to scale
(D). Cannot be determined
Answer: b
Solution:

**Correct Option:** (b) Increasing returns to scale

Returns to scale describe how output changes when all inputs are increased proportionally. For a production function $Q=AL^{\alpha}K^{\beta}$, the sum of the exponents ($\alpha+\beta$) determines the returns to scale.

**Information Booster:**

· The production function is $Q=50L^{0.8}K^{0.4}$.
· Here, the exponents of labor (L) and capital (K) are 0.8 and 0.4, respectively.
· Sum of exponents: $0.8+0.4=1.2$
· Since $\alpha+\beta=1.2>1$, the production function exhibits **increasing returns to scale**.
· This means that if all inputs are doubled (L and K multiplied by 2), output increases by more than double.
· Increasing returns to scale occur due to factors like specialization, efficient use of machinery, or economies of scale.
· This is common in industries with high fixed costs and low marginal costs (e.g., technology).

**Additional Knowledge:**

· Option 1 (constant) would require $\alpha+\beta=1$.
· Option 3 (decreasing) would require $\alpha+\beta<1$.
· Option 4 is incorrect as we can determine it.

**Q22.** Testing for cointegration between two non-stationary time series is primarily performed using which of the following?

(A). Chow Test for structural break
(B). Phillips-Perron unit root test
(C). Engel-Granger two-step method
(D). Error-correction mechanism estimation
Answer: c
Solution:

**Correct Option: (C):** Engel-Granger two-step method

**Explanation:**

- The Engel-Granger two-step method is primarily used to test for cointegration between two non-stationary time series. This method involves two main steps:
- First, testing for unit roots (non-stationarity) in each of the individual time series using the Augmented Dickey-Fuller (ADF) test or Phillips-Perron test.
- Second, performing a cointegration test on the residuals obtained from the regression of one series on the other.
- If the residuals are found to be stationary, then the two series are considered cointegrated.

**Additional Knowledge:**

- Option (a) : The Chow test is primarily used to test for structural breaks in a time series, such as changes in trend or variance, rather than for cointegration.
- Option (b) : The Phillips-Perron unit root test is one of the methods used to check for non-stationarity in individual time series. It is an important step but is not directly involved in cointegration testing.
- Option (d) : The Error-correction model (ECM) is used after confirming cointegration. It helps in modeling the relationship between the variables in the short term, adjusting the system to return to equilibrium.

**Q23.**

Let A and B be two events in a sample space S. Consider the following statements:

I. If A and B are mutually exclusive, then $P(A \cap B) = 0$.

II. If A and B are independent, then $P(A \cup B) = P(A) + P(B)$.

III. $P(A^c) = 1 - P(A)$, where $A^c$ is the complement of event A.

IV. $If A \subseteq B, then P(A) \geq P(B)$.

Which of the above statements are correct?

**Correct Option: B) I and III only**

**Explanation:**

The statements deal with relationships between events in a sample space, including mutually exclusive events, independent events, complements, and subsets of events.

**Information Booster:**

The correct statements are I and III, which are direct definitions and axioms of probability.

*** Statement I. If A and B are mutually exclusive, then $P(A \cap B) = 0$.**

1. **Correct.** Mutually exclusive (or disjoint) events are events that **cannot occur at the same time.**
2. The intersection, $A \cap B$, represents the event that both A and B occur. Since this is impossible for mutually exclusive events, the event $A \cap B$ is the empty set ($\emptyset$), and its probability is $P(\emptyset)=0$.

*** Statement** III. $P(A^c) = 1 - P(A)$, where $A^c$ is the complement of event A.

1. **Correct.** The complement of an event A, denoted $A^c$ (or $\overline{A}$), consists of all outcomes in the sample space that are not in A.
2. Since an event and its complement cover the entire sample space and are mutually exclusive ($A \cup A^c = S$ and $A \cap A^c = \emptyset$), the sum of their probabilities must equal 1: $P(A) + P(A^c) = 1$. Rearranging this gives $P(A^c) = 1 - P(A)$.

**Q24.** Match the following components of money supply with their correct definitions as per the Reserve Bank of India's classification:

| Component | Definition |
|---|---|
| 1. M0 (Reserve Money) | A. Currency with the public + Demand deposits with banks + Other deposits with RBI |
| 2. M1 (Narrow Money) | B. M3 + All post office deposits (excluding NSC) |
| 3. M3 (Broad Money) | C. Currency in circulation + Bankers' deposits with RBI + Other deposits with RBI |
| 4. M4 | D. M1 + Time deposits with banks |

**Codes:**

(A). 1-A, 2-B, 3-C, 4-D

(B). 1-C, 2-A, 3-D, 4-B

(C). 1-B, 2-D, 3-A, 4-C

(D). 1-A, 2-C, 3-B, 4-D

Answer: b

Solution:

**Correct Option : 2.** 1-C, 2-A, 3-D, 4-B

**Explanation:**

The Reserve Bank of India classifies money supply into four main aggregates (M0, M1, M3, M4). Each has a specific composition reflecting varying degrees of liquidity and breadth.

**Information Booster:**

**1. M0 (Reserve Money) → C:**

- M0 = Currency in circulation + Bankers' deposits with RBI (CRR balances) + Other deposits with RBI. This is the monetary base or high-powered money.

**2. M1 (Narrow Money) → A:**

- M1 = Currency with the public + Demand deposits with banks + Other deposits with RBI. It is the most liquid measure of money.

**3. M3 (Broad Money) → D:**

- M3 = M1 + Time deposits (fixed/term deposits) with banks. This is the most commonly used measure of money supply for policy.

**4. M4 → B:**

- M4 = M3 + All post office savings deposits (excluding National Savings Certificates). This is the broadest measure.

**Additional Knowledge:**

- M2 = M1 + Post Office Savings Bank deposits (but not all post office deposits), but **M2 is less commonly cited than M3**.
- **M0** is controlled directly by RBI; changes in M0 affect broader money supply via the money multiplier.
- M3 growth is a key indicator for inflation targeting and monetary policy in India.

**Q25.** Three coins are tossed simultaneously. What is the probability that they will fall 2 heads and 1 tail ?

(A). 1/2
(B). 1/4
(C). 3/4
(D). 3/8
Answer: d
Solution:

**Correct Option: (D):** $\frac{3}{8}$

**Solution:**

**Step 1.** Find total number of outcomes:

When 3 coins are tossed, the total number of outcomes = $2^3 = 8$.

**Step 2.** Favorable outcomes for 2 heads and 1 tail:

HHT, HTH, THH → 3 favorable outcomes.

**Step 3.** Find Probability :

P(2H,1T) = $\frac{3}{8}$ Answer.

**Q26.** Which of the following is NOT a function of the Securities and Exchange Board of India (SEBI)?
(A). Regulating the securities market
(B). Protecting the interests of investors
(C). Formulating monetary policy
(D). Prohibiting fraudulent and unfair trade practices
Answer: c
Solution:
**Correct Option: (3) Formulating monetary policy**
**Explanation:**
The Securities and Exchange Board of India (SEBI) is the regulatory authority for the securities market in India. It was established to oversee and promote the development of the market, protect investors, and ensure fair practices. However, it does not handle monetary policy, which is the responsibility of the Reserve Bank of India (RBI).
**Information Booster:**
SEBI was given statutory powers in 1992 via the SEBI Act. It also regulates mutual funds, takeovers, and corporate disclosures. Confusing SEBI with RBI is common, but their roles are distinct: SEBI for capital markets, RBI for banking and monetary policy. SEBI's key functions:

- Regulating the securities market (1): Includes supervising stock exchanges, brokers, and other intermediaries.
- Protecting investors' interests (2): Ensures transparency, educates investors, and redresses grievances.

- Prohibiting fraudulent practices (4): Prevents insider trading, market manipulation, and other unfair activities.

**Additional Knowledge:**

**Option 3 : Monetary policy**

- Formulated by the Reserve Bank of India (RBI).
- Involves controlling money supply, interest rates, and inflation to maintain economic stability.
- SEBI focuses on capital markets, not macroeconomic monetary controls.
- It includes repo rate, CRR, SLR, and open market operations.

**Q27.** As per the Union Budget 2025-26, the government has set the Fiscal Deficit target for FY 2025-26 at what percentage of GDP?

(A). 4.9%

(B). 4.5%

(C). 4.4%

(D). 5.1%

Answer: c

Solution:

**Correct Option: C.** 4.4%

**Explanation:**

The Fiscal Deficit is the difference between the government's total expenditure and its total revenue (excluding borrowings). It indicates the total borrowing needed by the government in a financial year and is expressed as a percentage of the country's Gross Domestic Product (GDP). The Union Budget for 2025–26, presented in February 2025, announced a fiscal deficit target aligned with the government's medium-term fiscal consolidation plan.

**Information Booster:**

1. The government set the fiscal deficit target for FY 2025–26 at 4.4% of GDP.
2. This is part of a gradual reduction plan from earlier years, aiming to reach a lower deficit in the coming years.
3. Lowering the fiscal deficit helps in maintaining macroeconomic stability and controlling inflation.

**Q28.** In the context of the "Rational Expectations Hypothesis," the 'Policy Ineffectiveness Proposition' suggests that:

(A). Fiscal policy is always more effective than monetary policy.

(B). Monetary policy is effective only in the long run.

(C). Anticipated government policy cannot affect real output or employment.

(D). Unanticipated policy has no effect on price levels.

Answer: c

Solution:

**Correct Option: C.** Anticipated government policy cannot affect real output or employment.

**Explanation:**

- The **Policy Ineffectiveness Proposition** is a major finding of the **New Classical Macroeconomics** based on the **Rational Expectations Hypothesis**.

- It argues that if economic agents have rational expectations and markets clear quickly, any policy changes that are **systematic** and **anticipated** will be factored into wages and prices upfront, leaving **real variables** like output and employment unchanged. Only nominal variables (like the price level) adjust.

**Information Booster:**

- The proposition was developed by **Thomas Sargent** and **Neil Wallace** in the 1970s.
- It **assumes** rational expectations, flexible prices, and no money illusion.
- Only **unexpected or random policy shocks** can have short-run real effects because agents cannot anticipate and adjust to them.

**Additional Knowledge:**

- The statement that "fiscal policy is more effective than monetary policy" is a Keynesian view, not related to this proposition.
- "Monetary policy is effective only in the long run" is incorrect here—PIP says anticipated policy is ineffective in both short and long run for real variables.
- "Unanticipated policy has no effect on price levels" is false—unanticipated policy can affect both prices and output temporarily.

**Q29.** Consider the following statements regarding the Determinants of Output and Employment in Classical vs. Keynesian frameworks:

1. In the Classical model, output is determined solely by supply-side factors (technology, capital, labor), while in Keynesian economics, aggregate demand determines output in the short run.
2. The Classical theory assumes perfect wage-price flexibility, ensuring full employment, whereas Keynes argued for wage rigidity leading to involuntary unemployment.
3. Say's Law ("supply creates its own demand") is a cornerstone of Keynesian economics, justifying government intervention.
4. Both theories agree that monetary policy affects only prices, not real output, in the long run.

Which of the statements are correct?

(A). 1, 2, and 4 only
(B). 2 and 4 only
(C). 1 and 2 only
(D). 1, 2, 3, and 4
Answer: a
Solution:

**Correct Option: A.** 1, 2 and 4 only.

**Explanation:**

- **Statement 1 is Correct:**
  - The **Classical model** assumes the economy operates at full employment, constrained only by real factors like capital and labor (Supply-side).
  - In contrast, **Keynes** argued that in the short run, the economy is constrained by insufficient Effective Demand.
- **Statement 2 is Correct:**

- **Classical economists** believed that **flexible wages and prices** would automatically clear markets, eliminating involuntary unemployment.
- **Keynes** introduced the concept of **wage rigidity** (sticky wages), explaining why markets might fail to clear, resulting in unemployment.

- **Statement 4 is Correct:**
- This is the concept of **monetary neutrality** in the long run.
- While **Keynes** also focused on the short-run non-neutrality of money (where it affects output and interest rates).
- Modern synthesis and long-run interpretations of both schools generally agree that an increase in the money supply eventually leads only to higher price levels without changing long-run real output.

**Information Booster:**

- **Say's Law Refutation:** Keynes explicitly rejected Say's Law, arguing that supply does not necessarily create its own demand because of the "leakage" of savings into idle cash balances (Liquidity Trap).

**Additional Information:**

- **Statement (3)** Say's Law ("supply creates its own demand") is a cornerstone of Keynesian economics, justifying government intervention: **This is Incorrect.**
- Say's Law ("Supply creates its own demand") is the foundational pillar of **Classical Economics**. Keynesian economics was born out of the rejection of Say's Law, demonstrating that demand deficiency can occur.
- **Government Intervention:** Because Keynes rejected the self-correcting nature of Say's Law, he advocated for active Fiscal Policy (government intervention) to manage aggregate demand, unlike the Classical Laissez-faire approach.

**Q30.** The "Principle of Maximum Social Advantage" in public finance, primarily associated with economist Hugh Dalton, refers to which of the following?

(A). The point where marginal social benefit from public expenditure equals marginal social sacrifice from taxation.

(B). The optimal level of public debt that maximizes economic growth without causing inflation.

(C). The tax rate that maximizes government revenue without affecting incentives to work and save.

(D). The allocation of public funds to sectors that have the highest potential for employment generation.

Answer: a

Solution:

**Correct Option: A.** The point where marginal social benefit from public expenditure equals marginal social sacrifice from taxation.

**Explanation:**

The Principle of Maximum Social Advantage, also known as the "Dalton's Principle," is a fundamental concept in public finance that aims to optimize the balance between government spending and taxation to maximize societal welfare.

**Information Booster:**

1. **Key concept:** Optimal public finance occurs when: Marginal Social Benefit (MSB) of Public Expenditure = Marginal Social Sacrifice (MSS) of Taxation

2. **MSB:** Additional welfare gained from each unit of public spending.
3. **MSS:** Welfare lost from the burden of additional taxation.
4. Beyond this point, the cost of taxation exceeds benefits of spending.

**Additional Knowledge:**

1. Hugh Dalton introduced this in his 1922 book "Principles of Public Finance."
2. The principle guides both tax policy (equity, efficiency) and expenditure policy (allocative efficiency).
3. Other options describe different economic concepts:

**Option B.** Optimal public debt → Debt sustainability frameworks
**Option C.** Revenue-maximizing tax rate → Laffer Curve
**Option D.** Employment-focused allocation → Employment policy, not Dalton's principle

**Q31.** What does the original Phillips Curve illustrate?
(A). An inverse relationship between the rate of unemployment and the rate of inflation.
(B). A direct relationship between the rate of unemployment and the rate of inflation.
(C). The trade-off between economic growth and inflation.
(D). The relationship between interest rates and investment.
Answer: a
Solution:

**Correct Option: (a) An inverse relationship between the rate of unemployment and the rate of inflation.**

**Explanation:**

- The Phillips Curve, as originally proposed, demonstrates an inverse trade-off between unemployment and inflation.
- According to this concept, policymakers could choose a combination of unemployment and inflation; to reduce unemployment, they would have to accept higher inflation, and to reduce inflation, they would have to tolerate higher unemployment.

**Information Booster:**

- A. W. Phillips, a New Zealand economist, initially studied the inverse relationship between the rate of unemployment and the rate of change of money wage rates in the UK.
- The concept was later extended to include the relationship between unemployment and inflation.
- This relationship was observed to hold in many economies during the 1950s and 1960s, suggesting a stable trade-off.

**Additional Knowledge:**

- **(b) A direct relationship:** This is not what the Phillips Curve depicts. A direct relationship would imply that both unemployment and inflation rise or fall together, which is characteristic of stagflation, a phenomenon that challenged the original Phillips Curve.
- **(c) The trade-off between economic growth and inflation:** While inflation can impact economic growth, this specific trade-off is not the primary subject of the Phillips Curve.
- **(d) The relationship between interest rates and investment:** This is a core concept in monetary policy and investment theory, but it is not the focus of the Phillips Curve.

**Q32.** Arrange the following economists chronologically based on their contribution to Development/Growth theories:
1. Adam Smith
2. Karl Marx
3. David Ricardo
4. Joseph Schumpeter
Correct Code:
(A). 3, 1, 2, 4
(B). 1, 2, 3, 4
(C). 1, 3, 2, 4
(D). 1, 3, 4, 2
Answer: c
Solution:
**Correct Option: (c)** 1, 3, 2, 4.
**Explanation:**

- **(1) Adam Smith (1776):** The Wealth of Nations (Classical School).
- **(3) David Ricardo (1817):** Principles of Political Economy and Taxation (Classical School).
- **(2) Karl Marx (1867):** Das Kapital (Marxian political economy).
- **(4) Joseph Schumpeter (1911):** The Theory of Economic Development (Innovation/Entrepreneurship).

**Information Booster:**

- **Smith:** Absolute Advantage, Laissez-faire.
- **Ricardo:** Stationary State, Law of Diminishing Returns, Comparative Advantage.
- **Marx:** Organic composition of capital, Class struggle.
- **Schumpeter:** Innovation clusters, Business cycles.

**Q33.** The conceptual foundation of the Human Development Index (HDI), first presented in 1990, is most directly credited to the work of which economist?
(A). Amartya Sen
(B). Morris D. Morris
(C). Paul Rosenstein-Rodan
(D). Mahbub ul Haq
Answer: d
Solution:
**Correct Option: 4.** Mahbub ul Haq
**Explanation:**
The Human Development Index (HDI) was introduced in the first Human Development Report in 1990, under the United Nations Development Programme (UNDP). While it draws on broader ideas of development, its direct creator was economist Mahbub ul Haq, with intellectual contributions from Amartya Sen.
**Information Booster:**

1. Mahbub ul Haq led the creation of the HDI as a practical measure to shift focus from GDP to people-centered development.
2. The HDI combines three dimensions: Life expectancy at birth (health), Education (mean years of schooling and expected years of schooling) and GNI per capita (standard of living)
3. Amartya Sen's capability approach influenced the conceptual foundation, but Sen himself did not design the index.

**Additional Knowledge:**

1. Amartya Sen – Provided philosophical grounding (development as expansion of capabilities), but did not create the HDI.
2. Morris D. Morris – Created the Physical Quality of Life Index (PQLI) earlier, which influenced thinking but is not the HDI.
3. Paul Rosenstein-Rodan – Known for the "Big Push" theory in development economics, not HDI.

**Q34.** In the extreme case of a liquidity trap in the Keynesian theory:
(A). Monetary policy becomes highly effective in stimulating the economy
(B). The LM curve becomes perfectly horizontal
(C). The demand for money becomes perfectly interest-inelastic
(D). Bond prices are expected to fall significantly
Answer: b
Solution:
**Correct Option (B) :** The LM curve becomes perfectly horizontal
**Explanation:**
In a liquidity trap, interest rates are so low that people prefer holding cash over bonds, expecting rates to rise (bond prices to fall). Money demand becomes perfectly interest-elastic, making the LM curve horizontal.

**Information Booster:**

1. At near-zero interest rates, monetary policy is ineffective — increasing money supply doesn't lower rates further.
2. Fiscal policy becomes more effective in this situation (IS shifts raise output without raising rates).
3. Keynes described this during deep depressions.

**Additional Knowledge:**

1. **Option A: Monetary policy highly effective → False;** it's ineffective in a liquidity trap.
2. **Option B: Demand for money perfectly interest-inelastic → False;** it's perfectly elastic.
3. **Option C: Bond prices expected to fall →** True but not the defining feature; horizontal LM is the key graphical representation.