GS SCORE

An Institute for Civil Services

PRELIMS 2025

INDIAN ECONOMY

PRACTICE TEST - 2

External Sector & International Organizations

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Prelims PYQ+	Question Booklet

GENERAL STUDIES

PRACTICE TEST - 2

(Indian Economy: Banking and External Sector)

Time Allowed: 40 Min. ***Maximum Marks: 50***

INSTRUCTIONS

1. IMMEDIATELY AFTER THE COMMENCEMENT OF THE EXAMINATION, YOU SHOULD CHECK THAT THIS TEST BOOKLET DOES *NOT* HAVE ANY UNPRINTED OR TORN OR MISSING PAGES OR ITEMS, ETC. IF SO, GET IT REPLACED BY A COMPLETE TEST BOOKLET.
2. **Please note that it is the candidate's responsibility to encode and fill in the Roll Number carefully without any omission or discrepancy at the appropriate places in the OMR Answer Sheet. Any omission/discrepancy will render the Answer Sheet liable for rejection.**
3. You have to enter your Roll Number on the test booklet in the Box provided alongside. ***DO NOT*** write anything else on the Test Booklet.
4. This Test Booklet contains ***25*** items (questions). Each item is printed in English. Each item comprises four responses (answers). You will select the response which you want to mark on the Answer Sheet. In case you feel that there is more than one correct response, mark the response which you consider the best. In any case, choose ***ONLY ONE*** response for each item.
5. You have to mark all your responses ***ONLY*** on the separate Answer Sheet provided. See directions in the Answer Sheet.
6. All items carry equal marks.
7. Before you proceed to mark in the Answer Sheet in response to various items in the Test Booklet, you have to fill in some particulars in the Answer Sheet as per instructions sent to you with your Admission Certificate.
8. After you have completed filling in all your responses on the Answer Sheet and the examination has concluded, you should hand over to the Invigilator ***only the Answer Sheet***. You are permitted to take away with you the Test Booklet.
9. Sheets for rough work are appended in the Test Booklet at the end.
10. **Penalty for wrong answers:**

    THERE WILL BE PENALTY FOR WRONG ANSWERS MARKED BY A CANDIDATE IN THE OBJECTIVE TYPE QUESTION PAPERS.

    (i) There are four alternatives for the answer to every question. For each question for which a wrong answer has been given by the candidate, **one-third** of the marks assigned to that question will be deducted as penalty.

    (ii) If a candidate gives more than one answer, it will be treated as a **wrong answer** even if one of the given answers happens to be correct and there will be same penalty as above to that question.

    (iii) If a question is left blank, i.e., no answer is given by the candidate, there will be **no** penalty for that question.

1. Consider the following statements regarding Non-Banking Financial Companies (NBFCs):

1. NBFCs can engage in lending activities but cannot issue cheques drawn on themselves.
2. NBFCs are allowed to accept demand deposits from the public.
3. NBFCs are under the direct supervision of the Ministry of Finance and not the Reserve Bank of India.

Which of the statements given above is/are correct?

(a) 1 only

(b) 1 and 2 only

(c) 2 and 3 only

(d) 1, 2 and 3

2. Which of the following instruments are part of the money market in India?

1. Treasury Bills
2. Commercial Paper
3. Equity Shares
4. Call Money

Select the correct answer using the code given below:

(a) 1, 2, and 3 only

(b) 1, 2, and 4 only

(c) 2, 3, and 4 only

(d) 1, 3, and 4 only

3. With reference to the Balance of Payments (BoP), which of the following statements is correct?

(a) A BoP surplus occurs when the value of imports exceeds the value of exports.

(b) The capital account records only foreign direct investment (FDI) inflows and outflows.

(c) The current account consists of trade balance, net invisibles, and unilateral transfers.

(d) A BoP deficit can never be managed by external borrowing.

4. Which of the following factors may cause a Balance of Payments (BoP) deficit in an economy?

1. Decline in exports due to global recession.
2. Increase in foreign portfolio investments (FPI).
3. Increase in the import of capital goods.
4. Reduction in remittances from abroad.

Select the correct answer using the code given below:

(a) 1 and 2 only

(b) 2 and 3 only

(c) 1, 3, and 4 only

(d) 1, 2, 3, and 4

5. Which of the following statements regarding India's foreign trade is correct?

(a) India has consistently maintained a trade surplus in goods and services over the last decade.

(b) Petroleum products and electronic goods form a major part of India's exports.

(c) India's trade policy is governed by the Securities and Exchange Board of India (SEBI).

(d) The World Trade Organization (WTO) imposes restrictions on India's ability to enter Free Trade Agreements (FTAs).

6. Consider the following statements regarding Regional Rural Banks (RRBs):

1. RRBs are jointly owned by the Central Government, State Government, and a sponsoring commercial bank.
2. They are mandated to provide 100% of their credit to rural and agricultural activities.
3. The Reserve Bank of India (RBI) directly supervises the operations of RRBs.

How many of the above statements are correct?

(a) Only one

(b) Only two

(c) All three

(d) None

7. Assertion (A) & Reason (R) Question on BoP:

Assertion (A): A persistent Current Account Deficit (CAD) can lead to a depreciation of the domestic currency.

Reason (R): CAD implies that a country is importing more than it is exporting, increasing the demand for foreign currency.

Choose the correct option:

(a) Both A and R are true, and R is the correct explanation of A.

(b) Both A and R are true, but R is not the correct explanation of A.

(c) A is true, but R is false.

(d) A is false, but R is true.

8. Consider the following statements regarding India's foreign trade:

1. India's largest trading partner in goods has been China in recent years.
2. Petroleum products are one of India's major export commodities.
3. India is the world's largest importer of gold.

How many of the above statements are correct?

(a) Only one

(b) Only two

(c) All three

(d) None

9. Assertion (A) & Reason (R) Question on Monetary Policy:

Assertion (A): An increase in the Cash Reserve Ratio (CRR) leads to a decrease in money supply.

Reason (R): A higher CRR reduces the amount of funds available for banks to lend, thereby controlling inflation.

Choose the correct option:

(a) Both A and R are true, and R is the correct explanation of A.

(b) Both A and R are true, but R is not the correct explanation of A.

(c) A is true, but R is false.

(d) A is false, but R is true.

10. Consider the following statements regarding Free Trade Agreements (FTAs):

1. FTAs eliminate all tariffs and trade barriers between member countries.
2. FTAs allow countries to engage in duty-free trade without any restrictions.
3. FTAs sometimes include clauses on labor standards and environmental protection.

Select the correct answer using the code below:

(a) 1 and 2 only

(b) 2 and 3 only

(c) 1 and 3 only

(d) 3 only

11. **Assertion (A):** A high Current Account Deficit (CAD) can put pressure on a country's foreign exchange reserves.

Reason (R): A current account deficit means that the country is importing more than it is exporting, leading to a higher demand for foreign currency.

(a) Both A and R are correct, and R is the correct explanation of A.

(b) Both A and R are correct, but R is not the correct explanation of A.

(c) A is correct, but R is incorrect.

(d) A is incorrect, but R is correct.

12. Consider the following statements about Capital Account and Current Account in the Balance of Payments (BoP):

1. Capital account transactions deal with investments, foreign loans, and remittances.
2. Current account transactions include trade in goods and services, primary income, and secondary income.
3. A surplus in the capital account offsets a deficit in the current account in the overall balance of payments.

Which of the statements given above is/are correct?

(a) 1 and 2 only

(b) 2 and 3 only

(c) 1, 2, and 3

(d) 1 and 3 only

13. Consider the following statements regarding Monetary Aggregates in India:

1. M1 includes currency with the public, demand deposits with banks, and other liquid deposits.
2. M3, also known as Broad Money, includes M1 as well as time deposits.
3. Reserve Money (M0) consists of RBI's total liabilities, including currency

in circulation, bankers' deposits, and reserves with the RBI.

How many of the above statements are correct?

(a) Only one

(b) Only two

(c) All three

(d) None

14. Consider the following statements regarding the Rupee Depreciation:

1. When the rupee depreciates, Indian exports become more competitive in international markets.
2. Rupee depreciation leads to a fall in the Current Account Deficit (CAD).
3. A depreciating rupee increases the cost of servicing external debt.

Which of the statements given above is/are correct?

(a) 1 and 2 only

(b) 1 and 3 only

(c) 2 and 3 only

(d) 1, 2, and 3

15. If the RBI increases the Cash Reserve Ratio (CRR), what will be the impact on the economy?

(a) Banks will have more money to lend, increasing liquidity.

(b) Banks will have less money to lend, reducing liquidity.

(c) Inflation will rise due to an increase in money supply.

(d) RBI will have to print more money to counteract the liquidity shortage.

16. Which of the following correctly describes the Liquidity Adjustment Facility (LAF)?

(a) It allows banks to borrow and lend among themselves.

(b) It is a system where banks borrow funds from RBI against government securities.

(c) It is used for financing long-term infrastructure projects.

(d) It refers to the regulation of the call money market by the RBI.

17. Consider the following statements about Rural Financial Institutions (RFIs):

1. RFIs primarily focus on providing financial services to rural areas, including agricultural financing.
2. NABARD oversees the health and performance of RFIs.
3. Regional Rural Banks (RRBs) are not regulated by the Reserve Bank of India (RBI).

Which of the statements given above is/are correct?

(a) 1 and 2 only

(b) 2 and 3 only

(c) 1, 2 and 3

(d) 1 only

18. Which of the following are the key functions of Development Financial Institutions (DFIs)?

1. Provide long-term financing for infrastructure development
2. Facilitate the growth of the industrial sector
3. Focus on short-term consumer loans
4. Promote financial inclusion in rural areas

Select the correct answer using the codes given below:

(a) 1, 2, and 4 only

(b) 1, 2, and 3 only

(c) 3 and 4 only

(d) 1 and 2 only

19. Which of the following best describes the term 'Friendshoring' as mentioned in Economic Survey 2024-25?

(a) Establishing production facilities in friendly countries to reduce dependence on geopolitical rivals.

(b) Increasing trade with neighboring countries to enhance regional economic integration.

(c) Shifting from industrial production to service-based economies to strengthen diplomatic ties.

(d) Developing global digital payment systems to facilitate international trade.

20. How many of the following statements about Non-Tariff Measures (NTMs) are correct?

1. NTMs are used as an alternative to tariffs to control trade policies.
2. CBAM and EUDR are examples of NTMs impacting India's exports.
3. The United Nations Conference on Trade and Development (UNCTAD) notes that NTMs affect about 70% of global trade.

Select the correct answer using the codes given below:

(a) Only one
(b) Only two
(c) All three
(d) None

21. Consider the following statements about India's textile exports:

1. India is the 6th largest textile and apparel exporter globally.
2. Europe and the United States account for 66% of India's apparel exports.
3. The Production-Linked Incentive (PLI) scheme has been extended for the textile sector until 2030.

How many of the above statements are correct?

(a) Only one
(b) Only two
(c) All three
(d) None

22. Which of the following statements is true regarding the global economic impact of Geo-Economic Fragmentation (GEF)?

1. GEF disrupts global trade by increasing trade barriers and limiting productivity gains.
2. The rise in geopolitical tensions has led to a significant reduction in foreign direct investment (FDI) worldwide.
3. GEF has a limited impact on global trade as most countries still rely on open markets.
4. Trade fragmentation is expected to result in an estimated global GDP loss of 0.2% to 7%.

Select the correct answer using the codes below:

(a) 1 and 4 only
(b) 2 and 3 only
(c) 1 and 2 only
(d) 3 and 4 only

23. As per the Economic Survey 2024-25, which of the following food items contributed the most to food inflation in India?

(a) Rice and wheat
(b) Vegetables and pulses
(c) Dairy and sugar
(d) Fruits and spices

24. Which of the following are unique features of preferential stocks?

1. They pay a fixed dividend before any dividend is distributed to common stockholders.
2. They receive preferential treatment in asset distribution during liquidation.
3. They typically have limited or no voting rights.
4. They often include a convertible feature, allowing conversion into common stock.

Options:

(a) 1, 2, 4 only
(b) 1, 2, 3 only
(c) 1, 3, and 4 only
(d) All of the above

25. Which of the following are unique features of primary markets?

1. They facilitate the issuance of new securities by companies and governments.
2. They enable companies to raise fresh capital through instruments such as IPOs, FPOs, and rights issues.
3. They determine the initial pricing of new securities through underwriting processes and regulatory guidelines.
4. They are subject to regulatory oversight by authorities like SEBI.

Options:

(a) 1 and 3 only
(b) 1, 2, and 3 only
(c) 2 and 4 only
(d) All of the above

Space for Rough Work

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Prelims PYQ+	Answer Booklet

GENERAL STUDIES

PRACTICE TEST - 2

(Indian Economy: Banking and External Sector)

Answer Key

Q. 1 (a)	Q. 6 (b)	Q. 11 (a)	Q. 16 (b)	Q. 21 (a)
Q. 2 (b)	Q. 7 (a)	Q. 12 (b)	Q. 17 (a)	Q. 22 (a)
Q. 3 (c)	Q. 8 (b)	Q. 13 (c)	Q. 18 (a)	Q. 23 (b)
Q. 4 (c)	Q. 9 (a)	Q. 14 (b)	Q. 19 (a)	Q. 24 (d)
Q. 5 (b)	Q. 10 (d)	Q. 15 (b)	Q. 20 (c)	Q. 25 (d)

1. **Correct Option: (a)**

Explanation:

Thought Process to Find the Answer:

- **Statement 1: “NBFCs can engage in lending activities but cannot issue cheques drawn on themselves.”**
  - **Correct.** NBFCs are financial institutions that provide banking-like services, including lending, asset financing, and investment activities.
  - However, unlike banks, **NBFCs cannot issue cheques drawn on themselves** since they do not have a Demand Deposit facility.
  - The inability to issue cheques differentiates NBFCs from traditional banks.
- **Statement 2: “NBFCs are allowed to accept demand deposits from the public.”**
  - **Incorrect.** NBFCs **cannot** accept demand deposits, as this function is **reserved for banks**.
  - Allowing NBFCs to accept demand deposits would make them functionally similar to banks, which would require stricter regulations like CRR (Cash Reserve Ratio) and SLR (Statutory Liquidity Ratio).
  - Some NBFCs are allowed to accept **time deposits**, but not demand deposits.
- **Statement 3: “NBFCs are under the direct supervision of the Ministry of Finance and not the Reserve Bank of India.”**
  - **Incorrect.** NBFCs are **regulated and supervised by the Reserve Bank of India (RBI)** under the **RBI Act, 1934**.
  - The Ministry of Finance may set broader economic policies, but **RBI is the primary regulatory body for NBFCs**, ensuring financial stability and compliance.

Conclusion:

- **Statement 1 is correct.**
- **Statements 2 and 3 are incorrect.**
- **The correct answer is (a) 1 only.**

2. **Correct Option: (b) 1, 2, and 4 only**

Explanation:

Thought Process to Find the Answer:

- **Understanding Money Market:**
  - The money market deals with **short-term borrowing and lending** (typically less than one year).
  - It includes highly liquid and low-risk instruments that facilitate liquidity management in the financial system.
- **Evaluating the Given Options:**
  - **Treasury Bills (T-Bills) (Statement 1) → Correct**
    - Treasury Bills are short-term government securities issued by the **Reserve Bank of India (RBI)**.
    - They have maturities of **91 days, 182 days, and 364 days**, making them an integral part of the money market.
  - **Commercial Paper (Statement 2) → Correct**
    - Commercial Paper (CP) is an unsecured short-term debt instrument issued by corporations to raise funds.
    - It is used for **meeting working capital needs** and typically has a maturity period ranging from **7 days to 1 year**.
  - **Equity Shares (Statement 3) → Incorrect**
    - **Equity Shares are part of the capital market, not the money market**.
    - The capital market deals with **long-term financial instruments** like stocks, bonds, and debentures.
  - **Call Money (Statement 4) → Correct**
    - Call Money refers to **short-term interbank loans** with a maturity of **one day**.
    - It is widely used by banks to manage their daily liquidity requirements.

Conclusion:

- **Statements 1, 2, and 4 are correct.**
- **Statement 3 (Equity Shares) is incorrect since it belongs to the capital market.**
- **The correct answer is (b) 1, 2, and 4 only.**

3. Correct Option: (c) The current account consists of trade balance, net invisibles, and unilateral transfers.

Explanation:

Thought Process to Find the Answer:

- **Understanding Balance of Payments (BoP):**
  - BoP is a comprehensive record of **all economic transactions** between residents of a country and the rest of the world in a given period.
  - It is divided into two main accounts:
    - **Current Account**: Trade in goods and services, net invisibles (remittances, tourism, software exports), and unilateral transfers.
    - **Capital Account**: Records financial transactions like foreign direct investment (FDI), foreign portfolio investment (FPI), external commercial borrowings, and banking capital.
- **Evaluating the Options:**
  - **Option a is incorrect:**
    - A **BoP surplus** occurs when the inflows of foreign exchange (exports, remittances, capital inflows) exceed outflows.
    - If **imports exceed exports**, it leads to a **trade deficit**, not a BoP surplus.
  - **Option b is incorrect:**
    - The **Capital Account** does not just record **FDI** but also includes FPI, external borrowings, external assistance, banking capital, and reserve asset changes.
  - **Option c is correct:**
    - The **Current Account** consists of:
      - ◊ Trade Balance (exports and imports of goods).
      - ◊ Net Invisibles (trade in services, remittances, and investment income).
      - ◊ Unilateral Transfers (foreign aid, worker remittances, gifts).
  - **Option d is incorrect:**
    - A **BoP deficit** can be managed by **external borrowing**, forex reserves, IMF assistance, or monetary policy adjustments.

4. Correct Option: (c) 1, 3, and 4 only

Explanation:

Thought Process to Find the Answer:

- **Understanding a BoP Deficit:**
  - A BoP deficit occurs when the **outflows** of foreign exchange **exceed** the inflows.
  - This can be caused by factors such as:
    - Decline in exports.
    - High imports.
    - Reduction in foreign remittances.
    - Large capital outflows.
- **Evaluating the Given Factors:**
  - **Statement 1: Decline in exports due to global recession → Correct**
    - If the global economy slows down, demand for Indian exports (textiles, IT services, manufactured goods) declines.
    - Lower exports reduce foreign exchange earnings, worsening the **current account deficit (CAD)** and BoP position.
  - **Statement 2: Increase in foreign portfolio investments (FPI) → Incorrect**
    - FPI inflows improve the **capital account** by bringing in foreign exchange.
    - If FPI **outflows** happen (capital flight due to interest rate hikes abroad), it may contribute to a BoP deficit.
  - **Statement 3: Increase in the import of capital goods → Correct**
    - Importing machinery, technology, and infrastructure materials increases forex outflows.
    - A surge in capital goods imports without a proportionate increase in exports can **widen the trade deficit**, leading to a BoP deficit.
  - **Statement 4: Reduction in remittances from abroad → Correct**
    - Remittances from Indian workers abroad (Middle East, US, UK) are a major source of forex inflows under **invisibles**.
    - A decline in remittances weakens the current account and contributes to a **BoP deficit**.

5. Correct Option: (b) Petroleum products and electronic goods form a major part of India's exports.

Explanation:

Thought Process to Find the Answer:

- **Understanding India's Trade Trends:**
  - India has a **trade deficit** in goods but a **trade surplus in services**.
  - India's **major exports** include petroleum products, gems & jewelry, pharmaceuticals, textiles, and software services.
  - **Major imports** include crude oil, gold, electronic goods, and machinery.
- **Evaluating the Given Statements:**
  - **Option a is incorrect:**
    - India has **not consistently maintained a trade surplus** over the last decade.
    - It has a **persistent trade deficit in goods** due to heavy reliance on crude oil and electronic imports.
    - However, India **earns a surplus in services trade** (IT, BPO, financial services).
  - **Option b is correct:**
    - **Petroleum products** (refined oil) are among India's **top export items**.
    - **Electronic goods** are both exported and imported, with increasing domestic manufacturing under the **Production-Linked Incentive (PLI) scheme**.
  - **Option c is incorrect:**
    - India's trade policy is governed by the **Ministry of Commerce and Industry** and framed under the **Foreign Trade Policy (FTP)**, not by SEBI.
    - SEBI regulates the **securities market**, not trade policy.
  - **Option d is incorrect:**
    - The **WTO does not restrict India from entering into FTAs**.
    - WTO **sets global trade rules**, while FTAs are **bilateral or regional agreements** negotiated independently by member countries.

6. Correct Option: (b) Only two

Explanation:

Thought Process to Find the Answer:

- **Understanding Regional Rural Banks (RRBs):**
  - RRBs were **established under the Regional Rural Banks Act, 1976** to provide credit and banking facilities to rural areas.
  - They are **jointly owned** by the **Central Government (50%)**, the **State Government (15%)**, and a **sponsoring commercial bank (35%)**.
  - Their primary function is to **support agriculture and rural development**, but they can provide loans for **non-agricultural activities** as well.
- **Evaluating the Given Statements:**
  - **Statement 1 is correct:**
    - RRBs have a **tripartite ownership structure** with the **Central Government, State Government, and a sponsoring bank** sharing equity.
  - **Statement 2 is incorrect:**
    - RRBs are **not mandated** to provide **100% of their credit to rural/agricultural activities**.
    - While their **primary focus is agriculture**, they can lend to **MSMEs, rural artisans, housing, education, and small businesses**.
  - **Statement 3 is correct:**
    - RRBs are **regulated and supervised by the RBI** under the **Banking Regulation Act, 1949**.
    - However, the **NABARD (National Bank for Agriculture and Rural Development)** also plays a significant role in refinancing and monitoring their activities.

7. Correct Option: (a) Both A and R are true, and R is the correct explanation of A.

Explanation:

Thought Process to Arrive at the Answer:

- **Understanding Current Account Deficit (CAD) and Currency Depreciation:**
  - The Current Account Deficit (CAD) occurs when a country imports more than

it exports, leading to a higher outflow of foreign currency.

- If CAD persists for a long time, it means the country is continuously relying on external financing, which can reduce investor confidence and lead to currency depreciation.

- **Evaluating Assertion (A):**
  - **A persistent CAD means that foreign exchange reserves are depleting as the** country spends more foreign currency than it earns.
  - If investors perceive a risk in financing this deficit, capital outflows increase, further increasing pressure on the domestic currency.
  - As a result, the domestic currency depreciates due to increased demand for foreign currency.
  - Thus, Assertion (A) is correct.
- **Evaluating Reason (R):**
  - Since CAD means a country is importing more than exporting, there is greater demand for foreign currency to pay for these imports.
  - A higher demand for foreign currency weakens the domestic currency's value, leading to depreciation.
  - Thus, Reason (R) is also correct and explains the assertion.

8. Correct Option: (b) Only two

Explanation:

Thought Process to Arrive at the Answer:

- **Statement 1: "India's largest trading partner in goods has been China in recent years."**
  - **Correct.** China has consistently been India's largest trading partner in terms of goods trade, with bilateral trade exceeding **$100 billion in recent years**.
  - The **United States has overtaken China as India's top overall trade partner**, but when considering **only goods trade**, China remains the largest.
  - **Thus, this statement is correct.**
- **Statement 2: "Petroleum products are one of India's major export commodities."**
  - **Correct.** Petroleum products, including **refined petroleum and diesel**, are among India's top export commodities.
  - India has several large **refineries** and exports petroleum products to multiple countries.
  - **Thus, this statement is correct.**
- **Statement 3: "India is the world's largest importer of gold."**
  - **Incorrect.** While **India is one of the largest importers of gold**, it competes with **China** for the top position.
  - China often **imports more gold than India**, especially due to **higher domestic demand and government policies**.
  - **Thus, this statement is incorrect.**

9. Correct Option: (a) Both A and R are true, and R is the correct explanation of A.

Explanation:

Thought Process to Arrive at the Answer:

- **Understanding Cash Reserve Ratio (CRR):**
  - CRR is the percentage of a bank's **net demand and time liabilities (NDTL)** that must be kept as **reserves with the RBI**.
  - It is a **monetary policy tool** used by the **RBI to regulate liquidity** in the banking system.
- **Analyzing Assertion (A): "An increase in the Cash Reserve Ratio (CRR) leads to a decrease in money supply."**
  - **True.**
  - When the **RBI increases CRR**, banks must **keep more money as reserves** with the central bank.
  - This **reduces the funds available** for lending, leading to **less money circulating in the economy**.
  - Thus, **money supply decreases** in the economy.
- **Analyzing Reason (R): "A higher CRR reduces the amount of funds available for banks to lend, thereby controlling inflation."**
  - **True.**
  - If banks have **less money to lend**, there is **less borrowing and spending** in the economy.

- This **reduces inflationary pressure** by controlling excessive liquidity in the system.
- Thus, a higher CRR is a **contractionary monetary policy tool** used to curb inflation.

- **Evaluating the Relationship between A and R:**
  - Since **higher CRR leads to a reduction in the money supply**, and **this reduction is a mechanism to control inflation**,
  - **R correctly explains A.**

10. Correct Option: (d) 3 only

Explanation:

- **Understanding Free Trade Agreements (FTAs):**
  - FTAs are **agreements between two or more countries** that aim to **reduce trade barriers** like tariffs and quotas to facilitate smoother trade.
  - However, **FTAs do not necessarily eliminate all tariffs and restrictions**; they are negotiated agreements with specific conditions.
- **Analysing Each Statement:**
  - **Statement 1: "FTAs eliminate all tariffs and trade barriers between member countries."**
    - **Incorrect.**
    - FTAs **reduce** or **eliminate tariffs on certain goods** but do not remove all trade barriers.
    - Some **sensitive sectors** (e.g., agriculture, defense-related goods) **still have tariffs and trade restrictions** under FTAs.
    - Example: India's FTAs with ASEAN and Japan include **phased tariff reductions** but do not eliminate all trade barriers.
  - **Statement 2: "FTAs allow countries to engage in duty-free trade without any restrictions."**
    - **Incorrect.**
    - FTAs **do not mean unlimited duty-free trade**. They have **rules of origin** (ensuring goods originate from FTA members), **quotas**, and **specific trade regulations**.
    - Example: The **India-UAE CEPA** allows duty-free access for some goods but maintains rules for **local value addition** to prevent trade diversion.
  - **Statement 3: "FTAs sometimes include clauses on labor standards and environmental protection."**
    - **Correct.**
    - Many modern FTAs include **provisions on labor rights, environmental standards, and intellectual property rights** to ensure **fair trade practices**.
    - Example: The **EU's FTAs with developing countries** include clauses on **sustainable development, labor laws, and environmental protection**.

11. Correct Option: (a) Both A and R are correct, and R is the correct explanation of A.

Explanation:

Thought Process to Arrive at the Answer:

- **Understanding Current Account Deficit (CAD):**
  - **CAD occurs when a country imports more goods, services, and transfers than it exports.**
  - This creates an **outflow of foreign exchange** as payments for imports must be made in foreign currency.
- **Evaluating the Assertion (A):**
  - *"A high Current Account Deficit (CAD) can put pressure on a country's foreign exchange reserves."*
  - **Correct.**
  - When a country has a **large CAD**, it **needs more foreign currency** (like USD, Euro) to pay for its imports.
  - If export earnings and capital inflows (FDI, remittances) **are not enough**, the country **dips into its foreign exchange reserves** to meet its trade deficit.
  - This depletes reserves and **increases financial vulnerability**.
  - Example: **India's CAD in 2013** was high, leading to **a sharp decline in forex reserves** and currency depreciation.
- **Evaluating the Reason (R):**
  - *"A current account deficit means that the country is importing more than it is*

exporting, leading to a higher demand for foreign currency."

- **Correct.**
- **Imports require payment in foreign currency**, which increases demand for USD, Euro, or other reserve currencies.
- If export earnings are not sufficient to offset imports, the **demand for forex rises**, weakening the domestic currency.

- **Checking the Explanation Link Between A and R:**
  - A **high CAD leads to a rise in forex demand**, causing forex reserves to deplete.
  - Since **the CAD directly leads to higher demand for foreign currency**, it puts pressure on forex reserves.
  - Thus, **R correctly explains A**.

12. Correct Option: (b) 2 and 3 only

Explanation:

- **Understanding the Balance of Payments (BoP):**
  - The **BoP** is an accounting statement that records all **economic transactions** between residents of a country and the rest of the world.
  - It consists of two major accounts:
    - **Current Account:** Deals with trade in goods, services, income, and transfers.
    - **Capital Account:** Deals with financial transactions like investments and foreign borrowings.
- **Evaluating Statement 1:**
  - *"Capital account transactions deal with investments, foreign loans, and remittances."*
  - **Incorrect.**
  - **Capital account** includes **foreign direct investment (FDI), portfolio investment, external commercial borrowings (ECB), and changes in forex reserves**.
  - **Remittances (money sent by NRIs to India) belong to the current account**, under the secondary income component.
  - **Since remittances are included incorrectly under the capital account, the statement is incorrect.**
- **Evaluating Statement 2:**
  - *"Current account transactions include trade in goods and services, primary income, and secondary income."*
  - **Correct.**
  - The **current account** consists of:
    - **Trade balance:** Exports and imports of goods.
    - **Services trade:** IT services, consulting, tourism.
    - **Primary income:** Investment income like interest, dividends, and wages from foreign employment.
    - **Secondary income (Transfers):** Remittances and foreign aid.
  - **Since all components are correctly listed, this statement is correct.**
- **Evaluating Statement 3:**
  - *"A surplus in the capital account offsets a deficit in the current account in the overall balance of payments."*
  - **Correct.**
  - If **a country has a current account deficit (CAD)**, it means more forex is going out than coming in.
  - To balance this, a country **relies on capital inflows** (FDI, FPI, loans).
  - Example: **India often runs a CAD but finances it through capital inflows (FDI, FPI, and foreign loans).**

13. Correct Option: (c) All three

Explanation:

- **Understanding Monetary Aggregates in India:**
  - The Reserve Bank of India (RBI) defines different monetary aggregates (M0, M1, M2, M3, M4) to measure liquidity in the economy.
  - These aggregates classify money supply based on liquidity, from most liquid (M1) to least liquid (M4).
- **Evaluating Statement 1:**
  - *"M1 includes currency with the public, demand deposits with banks, and other liquid deposits."*
  - **Correct.**

- **M1 (Narrow Money)** consists of:
  - **Currency with the public** (excluding cash with RBI and banks).
  - **Demand deposits with banks** (e.g., savings accounts, current accounts).
  - **Other liquid deposits with RBI** (such as certain specialized deposits).
- **Since these components define M1, the statement is correct.**

- **Evaluating Statement 2:**
  - *"M3, also known as Broad Money, includes M1 as well as time deposits."*
  - **Correct.**
  - **M3 (Broad Money)** is the most widely used measure of the money supply and consists of:
    - **M1 (Narrow Money)**
    - **Time deposits with banks** (e.g., fixed deposits).
  - **Since M3 includes M1 and time deposits, this statement is correct.**
- **Evaluating Statement 3:**
  - *"Reserve Money (M0) consists of RBI's total liabilities, including currency in circulation, bankers' deposits, and reserves with the RBI."*
  - **Correct.**
  - **M0 (Reserve Money or High Powered Money)** consists of:
    - Currency in circulation (notes and coins with the public).
    - Bankers' deposits with RBI (Cash Reserves of Banks).
    - Other deposits with RBI (such as government accounts).
  - **Since this correctly defines M0, the statement is correct.**

14. Correct Option: (b) 1 and 3 only

Explanation:

- **Understanding Rupee Depreciation:**
  - Rupee depreciation means a **decline in the value of the rupee** relative to foreign currencies (e.g., USD).
  - This affects trade, foreign investments, and external debt servicing.
- **Evaluating Statement 1:**
  - *"When the rupee depreciates, Indian exports become more competitive in international markets."*
  - **Correct.**
  - When the rupee depreciates, Indian goods and services become cheaper for foreign buyers, boosting exports.
  - **Example:** If Rs. 1 was earlier equal to \$0.013, and after depreciation, Rs. 1 is now equal to \$0.012, Indian goods priced in rupees will be cheaper for foreign buyers, increasing demand for Indian exports.
- **Evaluating Statement 2:**
  - *"Rupee depreciation leads to a fall in the Current Account Deficit (CAD)."*
  - **Incorrect.**
  - **Impact on CAD:**
    - A depreciating rupee **makes imports costlier**, especially essential imports like crude oil, electronic goods, and machinery.
    - Since India is a net importer, **higher import costs often widen the CAD instead of reducing it**.
    - While exports become more competitive, India's heavy reliance on imports offsets this gain.
- **Example:** India imports over **80% of its crude oil needs**. If the rupee depreciates, the cost of oil imports rises, increasing the CAD rather than decreasing it.**Evaluating Statement 3:**
  - *"A depreciating rupee increases the cost of servicing external debt."*
  - **Correct.**
  - India's external debt is largely **denominated in US dollars**.
  - When the rupee depreciates, **more rupees are required to repay the same amount of external debt**, increasing the burden.
  - **Example:**
    - If India owes \$100 billion in external debt and Rs. 1 = \$0.013, the debt in rupees is Rs. 7.69 lakh crore.
    - If the rupee depreciates to Rs. 1 = \$0.012, the same \$100 billion debt now costs **Rs. 8.33 lakh crore**, increasing repayment costs.

15. Correct Option: (b) Banks will have less money to lend, reducing liquidity.

Explanation:

- **Understanding the Cash Reserve Ratio (CRR):**
  - CRR is the percentage of a bank's total deposits that it must maintain as reserves with the Reserve Bank of India (RBI).
  - It is a monetary policy tool used by the RBI to regulate liquidity in the banking system.
  - If CRR is increased, banks have to hold more reserves with the RBI, leaving them with less money to lend.
  - If CRR is decreased, banks have more money available for lending, increasing liquidity.
- **Evaluating Each Option:**
  - **Option (a):** *Banks will have more money to lend, increasing liquidity.*
    - Incorrect, as increasing CRR reduces the amount banks can lend.
  - **Option (b):** *Banks will have less money to lend, reducing liquidity.*
    - Correct, since higher CRR means banks must keep more funds with the RBI, reducing their lending capacity.
  - **Option (c):** *Inflation will rise due to an increase in money supply.*
    - Incorrect, because an increase in CRR reduces money supply, which helps control inflation rather than increasing it.
  - **Option (d):** *RBI will have to print more money to counteract the liquidity shortage.*
    - Incorrect, as the RBI does not print money to counteract liquidity shortages caused by CRR changes.

16. Correct Option: (b) It is a system where banks borrow funds from RBI against government securities.

Explanation:

- **Understanding the Liquidity Adjustment Facility (LAF):**
  - LAF is a monetary policy tool used by the **Reserve Bank of India (RBI)** to manage liquidity in the banking system.
  - It allows **banks to borrow money from RBI** or **lend excess funds to RBI** on a short-term basis.
  - The transactions under LAF are conducted through **Repo and Reverse Repo operations.**
  - **Repo Rate:** Banks borrow money from RBI by offering government securities as collateral.
  - **Reverse Repo Rate:** Banks deposit their excess funds with RBI and earn interest on them.
- **Evaluating Each Option:**
  - **Option (a):** *It allows banks to borrow and lend among themselves.*
    - Incorrect, as interbank borrowing and lending occur in the call money market, not under LAF.
  - **Option (b):** *It is a system where banks borrow funds from RBI against government securities.*
    - Correct, since LAF allows banks to borrow from RBI using **repo transactions** where government securities are used as collateral.
  - **Option (c):** *It is used for financing long-term infrastructure projects.*
    - Incorrect, as LAF deals with short-term liquidity adjustments, not long-term financing.
  - **Option (d):** *It refers to the regulation of the call money market by the RBI.*
    - Incorrect, as the call money market is separately regulated and involves short-term interbank lending.

17. Correct Option: (a) 1 and 2 only

Explanation:

- **Understanding Rural Financial Institutions (RFIs):**
  - RFIs are institutions that cater to the financial needs of **rural areas**, particularly in **agriculture, small businesses, and self-employment activities**.
  - They include **Regional Rural Banks (RRBs), Cooperative Banks, and Microfinance Institutions (MFIs)**.

- Their main objective is to **increase financial inclusion** in rural India.

- **Evaluating Each Statement:**
  - **Statement 1:** *RFIs primarily focus on providing financial services to rural areas, including agricultural financing.*
    - **Correct**, as RFIs play a crucial role in **providing credit to farmers, rural entrepreneurs, and small businesses.**
  - **Statement 2:** *NABARD oversees the health and performance of RFIs.*
    - **Correct**, as the **National Bank for Agriculture and Rural Development (NABARD)** is responsible for the regulation, refinancing, and supervision of **Regional Rural Banks (RRBs) and Cooperative Banks**.
  - **Statement 3:** *Regional Rural Banks (RRBs) are not regulated by the Reserve Bank of India (RBI).*
    - **Incorrect**, as **RRBs are regulated by the RBI**, while NABARD plays a supporting and supervisory role.
    - RBI governs **RRBs' prudential norms, capital adequacy requirements, and monetary policies** similar to commercial banks.
- **Final Evaluation:**
  - **Statement 1 is correct.**
  - **Statement 2 is correct.**
  - **Statement 3 is incorrect.**

18. Correct Option: (a) 1, 2, and 4 only

Explanation:

- **Understanding Development Financial Institutions (DFIs):**
  - DFIs are **specialized financial institutions** that **provide long-term funding** for projects in sectors that require **large investments** but may not be served adequately by regular banks.
  - They primarily support **infrastructure, industrial development, and financial inclusion initiatives.**
  - In India, examples of DFIs include **NABARD, SIDBI, NHB, EXIM Bank, and IDBI Bank (earlier).**
- **Evaluating Each Statement:**
  - **Statement 1:** *Provide long-term financing for infrastructure development.*
    - **Correct**, as DFIs specialize in **long-term project financing**, especially in **infrastructure, power, and transport sectors.**
  - **Statement 2:** *Facilitate the growth of the industrial sector.*
    - **Correct**, as DFIs **support industrial expansion, entrepreneurship, and technological advancements** by financing industries that require long-term capital investments.
  - **Statement 3:** *Focus on short-term consumer loans.*
    - **Incorrect**, as DFIs do not focus on **short-term retail lending** like commercial banks. Their role is in **project financing and industrial development** rather than consumer loans.
  - **Statement 4:** *Promote financial inclusion in rural areas.*
    - **Correct**, as institutions like **NABARD** and **SIDBI** work towards **rural credit availability and small-business growth**.
- **Final Evaluation:**
  - **Statement 1 is correct.**
  - **Statement 2 is correct.**
  - **Statement 3 is incorrect.**
  - **Statement 4 is correct.**

19. Correct Option: (a) Establishing production facilities in friendly countries to reduce dependence on geopolitical rivals.

Explanation:

- **Understanding 'Friendshoring':**
  - 'Friendshoring' refers to the strategy of relocating supply chains to countries that are political and economic allies. This approach aims to mitigate risks associated with geopolitical tensions by ensuring that critical manufacturing and sourcing are conducted in nations with shared values and stable relations.
- **Context in the Economic Survey 2024-25:**
  - The Economic Survey 2024-25 discusses 'friendshoring' in the context of global

economic strategies to enhance supply chain resilience amid rising geopolitical fragmentation. By partnering with allied nations, countries aim to secure their supply chains against potential disruptions from geopolitical adversaries.

- **Evaluating the Options:**
  - **Option (a):** *Establishing production facilities in friendly countries to reduce dependence on geopolitical rivals.*
    - **Correct.** This option aligns with the definition of 'friendshoring,' where countries move production to allied nations to mitigate risks associated with adversarial countries.
  - **Option (b):** *Increasing trade with neighboring countries to enhance regional economic integration.*
    - **Incorrect.** This describes 'regional integration' or 'neighborhood trade agreements,' not specifically 'friendshoring.'
  - **Option (c):** *Shifting from industrial production to service-based economies to strengthen diplomatic ties.*
    - **Incorrect.** This describes an economic transition strategy, not related to 'friendshoring.'
  - **Option (d):** *Developing global digital payment systems to facilitate international trade.*
    - **Incorrect.** This pertains to financial infrastructure development, not 'friendshoring.'

20. Correct Option: (c) All three

Explanation:

- **Understanding Non-Tariff Measures (NTMs):**
  - NTMs refer to regulatory and policy measures other than tariffs that countries use to control the flow of goods across borders. These include **sanitary and phytosanitary measures (SPS), technical barriers to trade (TBT), licensing requirements, import quotas, and environmental regulations.**
  - Unlike tariffs, NTMs are not direct taxes but **impact trade through compliance costs and restrictions.**
- **Evaluating Each Statement:**
  - **Statement 1: NTMs are used as an alternative to tariffs to control trade policies.**
    - **Correct.** Many countries use NTMs **instead of or in addition to tariffs** to regulate trade for economic, health, environmental, and security reasons. NTMs can serve as **protectionist tools** or as **legitimate measures to ensure product safety, environmental protection, and fair competition.**
  - **Statement 2: CBAM and EUDR are examples of NTMs impacting India's exports.**
    - **Correct.**
      - ◊ **CBAM (Carbon Border Adjustment Mechanism):** The European Union's CBAM imposes carbon taxes on imports based on their carbon footprint, affecting India's **steel, aluminum, cement, and fertilizer exports.**
      - ◊ **EUDR (European Union Deforestation Regulation):** The EUDR **restricts imports of products linked to deforestation, such as coffee, soy, and palm oil**, directly impacting India's agricultural exports.
      - ◊ Both CBAM and EUDR **are NTMs because they impose additional compliance requirements rather than direct tariffs.**
  - **Statement 3: The United Nations Conference on Trade and Development (UNCTAD) notes that NTMs affect about 70% of global trade.**
    - **Correct.**
      - ◊ According to **UNCTAD reports, NTMs impact nearly 70% of global trade** as they **affect international supply chains, trade costs, and market access.**
      - ◊ UNCTAD has emphasized the **rising importance of NTMs as global trade becomes more regulated, especially in sectors like agriculture, manufacturing, and energy.**

21. Correct Option: (a) Only one

Explanation:

- **Evaluating Statement 1:** *India is the 6th largest textile and apparel exporter globally.*
  - According to data from the World Population Review, India is the 4th largest exporter of textiles, with exports valued at $44 billion.
  - Therefore, this statement is **incorrect**.
- **Evaluating Statement 2:** *Europe and the United States account for 66% of India's apparel exports.*
  - In fiscal year 2024, the United States was the largest export destination for Indian textile and apparel products, accounting for 28% of total exports.
  - While specific data combining both Europe and the United States is not provided in the available sources, it is plausible that together they could account for a significant portion of India's apparel exports. However, without precise figures, the exact percentage cannot be confirmed.
  - Given the lack of exact data, this statement is **uncertain**.
- **Evaluating Statement 3:** *The Production-Linked Incentive (PLI) scheme has been extended for the textile sector until 2030.*
  - The PLI scheme for textiles is operational from September 29, 2021, to March 31, 2030, with incentives payable for a period of 5 years within this timeframe.
  - This indicates that the scheme was initially planned to run until 2030, rather than being extended to that date.
  - Therefore, this statement is **incorrect**.
- **Conclusion:**
  - **Statement 1 is incorrect.**
  - **Statement 2 is uncertain due to lack of precise data.**
  - **Statement 3 is incorrect.**

Based on the available information, only one statement can be considered correct, leading to the answer: (a) Only one.

22. Correct Option: (a) 1 and 4 only

Explanation:

Thought Process:

- **Evaluating Statement 1:** *"GEF disrupts global trade by increasing trade barriers and limiting productivity gains."*
  - **Correct.** Geo-Economic Fragmentation (GEF) leads to the rise of trade barriers, which disrupt global trade and limit productivity gains.
- **Evaluating Statement 2:** *"The rise in geopolitical tensions has led to a significant reduction in foreign direct investment (FDI) worldwide."*
  - **Correct.** Rising geopolitical tensions have resulted in a notable increase in trade and FDI restrictions, with their prevalence tripling since 2018.
- **Evaluating Statement 3:** *"GEF has a limited impact on global trade as most countries still rely on open markets."*
  - **Incorrect.** GEF has a significant impact on global trade, as evidenced by the proliferation of trade and investment restrictions, leading to slowed global trade growth.
- **Evaluating Statement 4:** *"Trade fragmentation is expected to result in an estimated global GDP loss of 0.2% to 7%."*
  - **Correct.** The International Monetary Fund (IMF) estimates that trade fragmentation could reduce global GDP by between 0.2% and 7%.

23. Correct Option: (b) Vegetables and pulses

Explanation:

- **Understanding the Contributors to Food Inflation:**
  - The Economic Survey 2024-25 highlights that **food inflation**, measured by the Consumer Food Price Index (CFPI), increased from 7.5% in FY24 to 8.4% in FY25 (April–December).
  - This rise in food inflation was **primarily driven by specific food items**.
- **Identifying the Specific Contributors:**
  - The survey explicitly mentions that the **increase in food inflation** was **"primarily driven by a few food items such as vegetables and pulses."**
- **Evaluating the Options:**
  - **Rice and wheat:**
    - While staple cereals like rice and wheat are essential components of

the Indian diet, the survey does not indicate them as the primary drivers of the recent food inflation.

- **Vegetables and pulses:**
  - This option aligns directly with the survey's findings, which attribute the rise in food inflation to these items.
- **Dairy and sugar:**
  - The survey does not highlight dairy and sugar as significant contributors to the recent food inflation.
- **Fruits and spices:**
  - Similarly, fruits and spices are not identified as the main drivers of the current food inflation in the survey.

24. Correct Option: (d) All of the above

Explanation:

- **Understanding Preferential Stocks (Preferred Shares):**
  - Preferential stocks, also called **preferred shares**, are a type of equity that has characteristics of both stocks and bonds.
  - They offer **higher priority over common shares** in dividend payments and asset distribution during liquidation.
  - However, they generally **do not provide voting rights** like common stocks.
- **Analyzing Each Statement:**
  - **Statement 1: They pay a fixed dividend before any dividend is distributed to common stockholders. Correct**
    - One of the primary features of preferred stock is the **fixed dividend** they receive, which must be paid **before** dividends can be given to common stockholders.
    - This makes them similar to bonds in terms of predictable income.
  - **Statement 2: They receive preferential treatment in asset distribution during liquidation. Correct**
    - In case of **company liquidation**, preferred stockholders are ranked **higher than common stockholders** but **lower than debt holders** in terms of receiving company assets.
  - **Statement 3: They typically have limited or no voting rights. Correct**
    - Unlike common shareholders, **preferred stockholders usually do not have voting rights** in corporate decisions, although some preferred stocks grant limited rights under special circumstances.
  - **Statement 4: They often include a convertible feature, allowing conversion into common stock. Correct**
    - Some preferred shares are **convertible**, meaning they can be exchanged for a **predetermined number of common shares** at the holder's discretion.
- **Evaluating the Options:**
  - **(a) 1, 2, and 4 only** Incorrect (excludes voting rights characteristic).
  - **(b) 1, 2, and 3 only** Incorrect (excludes convertible feature).
  - **(c) 1, 3, and 4 only** Incorrect (excludes preferential asset distribution).
  - **(d) All of the above Correct (covers all key features of preferred stocks).**

25. Correct Option: (d) All of the above

Explanation:

- **Understanding Primary Markets:**
  - The **primary market** (also called the **new issue market**) is where **securities are issued for the first time** by companies, governments, or other entities to raise fresh capital.
  - Unlike the **secondary market**, where existing securities are traded among investors, the **primary market** deals only with **new securities**.
- **Analyzing Each Statement:**
  - **Statement 1: They facilitate the issuance of new securities by companies and governments. Correct**
    - The primary market serves as a **platform for companies and governments** to **issue securities for the first time** (such as stocks, bonds, or debentures).
  - **Statement 2: They enable companies to raise fresh capital through instruments such as IPOs, FPOs, and rights issues. Correct**

- Companies use the primary market to **raise funds** through:
  - ◊ **Initial Public Offering (IPO)**: First-time issuance of shares to the public.
  - ◊ **Follow-on Public Offering (FPO)**: Additional shares issued after an IPO.
  - ◊ **Rights Issues**: New shares offered to existing shareholders at a discount.

- **Statement 3: They determine the initial pricing of new securities through underwriting processes and regulatory guidelines. Correct**
  - The **pricing of new securities** in the primary market is influenced by **underwriters** (investment banks or financial institutions) and is regulated by bodies like **SEBI (Securities and Exchange Board of India)** to ensure fair valuation.

- **Statement 4: They are subject to regulatory oversight by authorities like SEBI. Correct**
  - The **SEBI in India**, the **SEC in the U.S.**, and other financial regulators **monitor** and **regulate primary market activities** to protect investor interests and maintain transparency.

- **Evaluating the Options:**
  - **(a) 1 and 3 only** Incorrect (Excludes capital raising and regulatory oversight).
  - **(b) 1, 2, and 3 only** Incorrect (Excludes regulatory oversight).
  - **(c) 2 and 4 only** Incorrect (Excludes issuance of securities and pricing mechanisms).
  - **(d) All of the above Correct (Covers all key features of the primary market).**

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