CBSE Class 12 Economic
Abroad (Set-2)

Time: 3 hours (Marks: 90)

General Instructions:

(i) ***All*** *questions in* ***both*** *sections are* ***compulsory****. However, there is* ***internal choice*** *in some questions.*

(ii) ***Marks*** *for questions are indicated against* ***each*** *question.*

*(iii) Question No.****1-5*** *and* ***16-20*** *are* ***very short answer questions*** *carrying* ***1 mark*** *each. They are required to be answered in one sentence.*

*(iv) Question No.****6-8*** *and* ***21-23*** *are* ***short answer questions*** *carrying* ***3 marks*** *each. Answers to them should not normally* ***exceed 60 words*** *each.*

*(v) Question No.****9-11*** *and* ***24-26*** *are also* ***short answer questions*** *carrying* ***4 marks*** *each. Answers to them should not normally* ***exceed 70 words*** *each.*

*(vi) Question No.****12-15*** *and* ***27-30*** *are* ***long answer questions*** *carrying* ***6 marks*** *each. Answers to them should not normally* ***exceed 100 words*** *each.*

(vii) Answers ***should be brief*** *and* ***to the point*** *and the above* ***word limit be adhered*** *to as far as possible.*

Section A

Q1 Marginal revenue of a firm is constant throughout under: (choose the correct alternative)

(a) Perfect competition

(b) Monopolistic competition

(c) Oligopoly

(d) All the above

Ans: Marginal revenue of a firm is constant throughout under ***Perfect competition*** .

Hence, the correct answer is option (a).

Q2 'A few big sellers' is a characteristics of : (choose the correct alternative)

(a) Perfect competition

(b) Monopolistic competition

(c) Oligopoly

(d) None of the above

Ans: 'A few big sellers' is a characteristics of ***Oligopoly*** .

Hence, the correct answer is option (c).

Q3 A firm is able to sell more quantity of a good only by lowering the price. The firm's marginal revenue, as he goes on selling, would be :

(choose the correct alternative)

(a) Greater than average revenue

(b) Less than average revenue

(c) Equal to average revenue

(d) Zero

Ans: A firm is able to sell more quantity of a good only by lowering the price. The firm's marginal revenue, as he goes on selling, would be less than average revenue.

Hence, the correct alternative is option (b) .

Q4 What is 'price taker' firm?

Ans: A price taker firm implies the firm which has no control over the existing market price and cannot influence it. In such form of market, the price is determined by the ' *invisible hands of market* ' and the determined price is at which the firm can sell the goods. Thus, the firm has no control over price and is merely takes the price what is being given by the industry.

Q5 A farmer invests his own saving in doing farmings but hires labour to do work. Identify implicit cost.

Ans: Implicit cost is the cost of self supplied factors. Accordingly, the investment made by farmer from his savings is the implicit cost.

Q6 Explain the meaning of 'minimum' price ceiling and its implications.

Ans: Minimum price ceiling is the legislated or government imposed maximum level of price that can be charged by the seller. Usually, the government fixes this maximum price much

below the equilibrium price, in order to preserve the welfare of the poorer and vulnerable section of the society.

The following are the implications of price ceiling.

1. ***Excess demand***- Due to artificially lowering the price, the demand becomes comparatively higher than the supply. This leads to the emergence of the problem of excess demand.

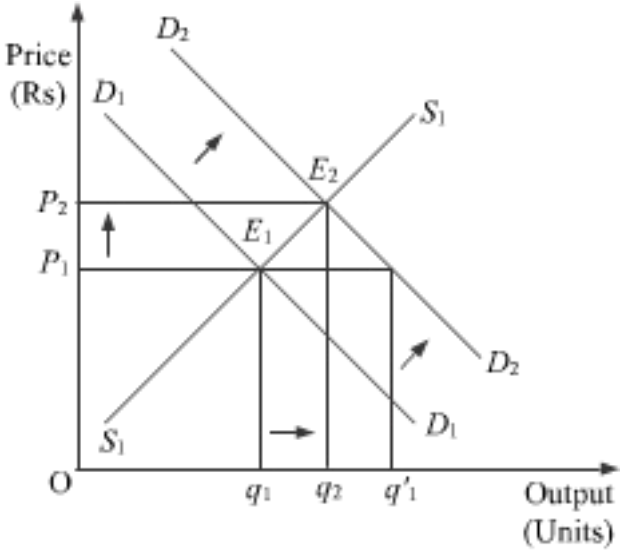
2. ***Enhances Welfare***- The imposition of the price ceiling ensures the access of the necessity goods within the reach of the poor people. This safeguards and enhances the welfare of the poor and vulnerable sections of the society.

3. ***Fixed Quota***- Each consumer gets a fixed quantity of good (as per the quota). The quantity often falls short of meeting the individual's requirements. This further leads to the problem of shortage and the consumer remains unsatisfied.

OR

Explain the chain of effects of 'increase' in demand of a good.

Ans: The effect of 'increase' in demand of a good is explained as follows.



Suppose D_1D_1 and S_1S_1 are the initial market demand curve and market supply curve, respectively. The initial equilibrium is established at point E_1, where the market demand curve and the market supply curve intersects each other. Accordingly, the equilibrium price is OP_1 and the equilibrium quantity demanded is Oq_1.

Now, assume that market demand increases (may be due to an increase in the consumer's income). This shifts the market demand curve parallely rightwards to D_2D_2 from D_1D_1, while

the market supply curve remains unchanged at S_1S_1. This implies that at the initial price OP_1, there exist excess demand equivalent to ($Oq'_1 - Oq_1$) units. This excess demand will increase competition among the buyers and they will now be ready to pay a higher price to acquire more units of good. This will further raise the market price. The rise in the price will continue till it the market price becomes OP_2. The new equilibrium is established at point E_2, where the new demand curve D_2D_2 intersects the supply curve S_1S_1. Observe that at the new equilibrium both market price and quantity demanded are more than the initial equilibrium. The new equilibrium quantity supplied Oq_2 and the new equilibrium price is OP_2. Hence, an increase in demand with supply remaining constant, results in rise in the equilibrium price as well as the equilibrium quantity.

The chain effect is ,

Increase in demand ⇒ Excess demand at the existing price ⇒ Competition among the buyers ⇒ Rise in the price level ⇒ New equilibrium ⇒ Rise in both quantity demanded as well as price.

Q7 A consumer consumes only two goods X and Y. The Marginal Rate of Substitution is 2. Prices per unit of X and Y are Rs 5 and Rs 4 respectively. Is consumer in equilibrium? What will be the further reaction of the consumer? Give reasons.

Ans: A consumer attains *equilibrium at the point where the budget line is tangent to the indifference curve* . This optimum point is characterised by the following equality.

Slope of the *IC* = Slope of the budget line

$$\left|-\frac{d_y}{d_x}\right| = \left|MRS\right| = \left|-\frac{P_x}{P_y}\right|$$

Absolute value of the slope of the *IC* = Absolute value of the slope of the budget line

According to the given question,

P_x = Rs 5

P_y = Rs 4

$|MRS|$ = 2

$$\left|-\frac{P_x}{P_y}\right| = \left|-\frac{5}{4}\right| = 1.25$$

Clearly,

$$|MRS| > |-\frac{P_x}{P_y}| \Rightarrow$$

Consumer is *not* at equilibrium

In order to reach the equilibrium, a rationale consumer would ***increase the consumption of good X*** and ***decrease that of good Y***.

Q8 Price elasticity of demand for the two goods X and Y are zero and (–) 1 respectively. Which of the two is more elastic and why?

Ans: ***Demand of good Y is more elastic*** as compared to good X. Also, price elasticity of zero implies perfeclty inelastic (or zero elastic), so good Y has more elastic demand.

Note- Due to negative relationship between price and demand, elasticity of demand is a negative number. But in case of elasticity negative sign does not matter.

That is, although, Mathematically, 0 > –1

But, in context of elasticity, –1 > 0

Q9 When price of a good falls from Rs 20 to Rs 10 per unit, producer reduces supply from 100 units to 50 units. Calculate price elasticity of supply.

Ans: ***Given*** **:**

$$Q_0 = 100 \ units$$

$$P_0 = Rs \ 20$$

$$P_1 = Rs \ 10$$

$$Q_1 = 50 \ units$$

$$E_s = ?$$

$$\Delta P = P_1 - P_0$$

$$\Delta P = 10 - 20 = -10$$

$$\Delta Q = Q_1 - Q_0$$

$$\Delta Q = 50 - 100 = -50 \ units$$

$$We \ know, Es = \frac{\Delta Q}{\Delta P} \times \frac{P_0}{Q_0}$$

$$E_s = \frac{-50}{-10} \times \frac{20}{100}$$

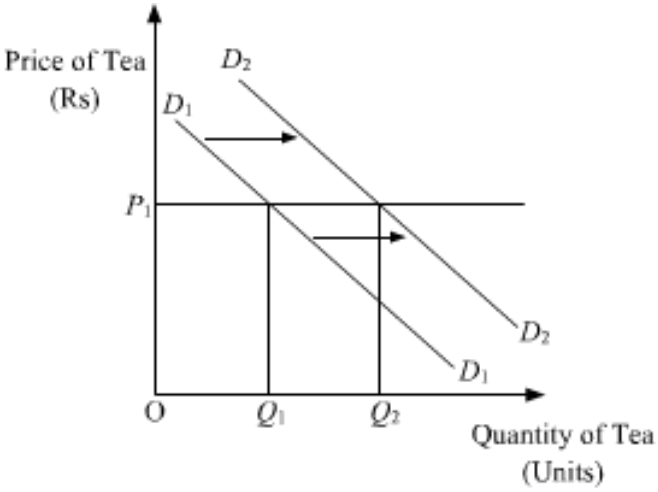
$$E_s = 5 \times \frac{1}{5}$$

$$E_s = 1$$

Q10 Explain the effect of change in prices of related goods on demand of a given good.

Ans: Change in Price of Related Goods: The related goods can be classified into following two categories.

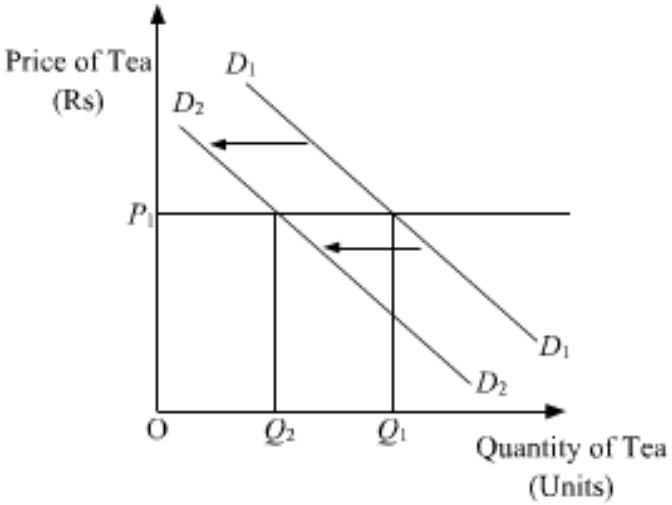
i. *Substitute Goods*- Substitute goods refer to those goods that can be consumed in place of each other. For example, tea and coffee. In case of substitute goods, if the price of one good increases, the consumer shifts his demand to the other (substitute) good i.e. rise in the price of one good results in a rise in the demand of the other good. In this case, the demand curve shifts parallely outwards to the right.



Increase in Price of Substitute Good

In th e above diagram, as a result of rise in price of coffee, the demand for tea increases and the demand curve for tea shifts from D_1D_1 to D_2 D_2.

In case, there is a fall in the price of the substitute goods, then the demand for the other good will also fall. And in this case, the demand curve for the other good (tea) will shift parallely towards left.

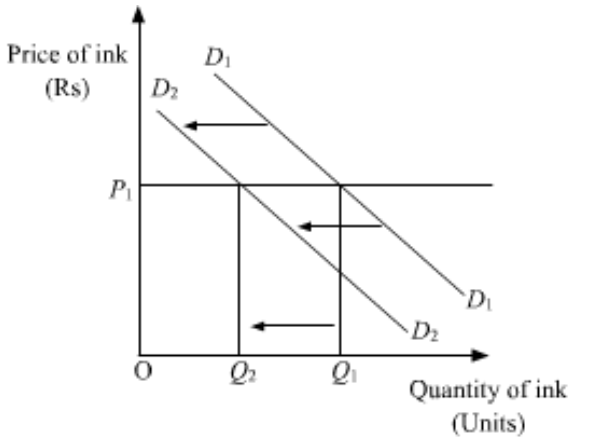


Fall in Price of Substitute Good

In the above diagram, as a result of fall in price of coffee, the demand for tea falls and the

demand curve for tea shifts from D_1D_1 to D_2 D_2.

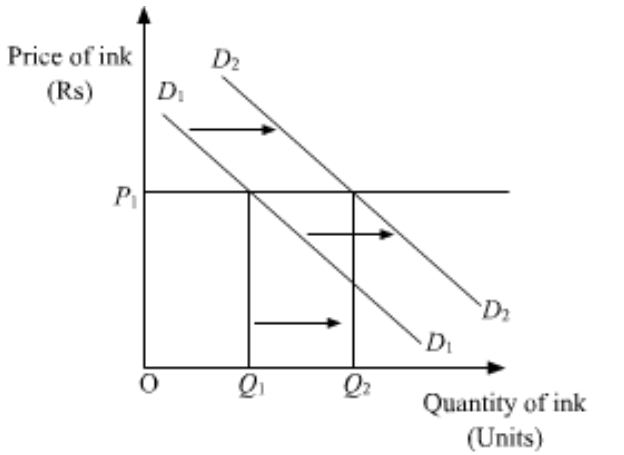
ii. *Complementary Goods*- Complementary goods refer to those goods that are consumed together. The joint consumption of these goods satisfies wants of the consumer. For example: ink and ink pens. In case of complementary goods, if the price of one good increases then a consumer reduces his demand for the complementary good as well, i.e. a rise in the price of one good results in a fall in demand of the other good. In this case, the demand curve shifts parallely inwards to the left.



Increase in the Price of Complementary Good

In the above diagram, as a result of rise in price of ink pens, the demand for ink falls and the demand curve for ink shifts from D_1D_1 to D_2 D_2.

In case, there is a fall in the price of the complementary good, then the demand for the other good will rise. And in this case, the demand curve for the other good (ink) will shift parallely towards right.



Decrease in the Price of Complementary Good

In the above diagram, as a result of a decrease in price of ink pens, the demand for ink rises and the demand curve for ink shifts from D_1D_1 to D_2 D_2.

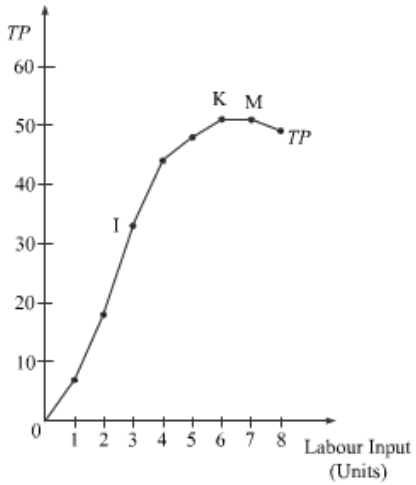
Q11 What type of production function is this in which only one input is increased and others kept constant? State the behaviour of total product in this production function.

Ans: In short run production function only one input is increased and others kept constant. A short run production function is expressed as:

$$Q_x = f(L, \overline{K})$$

The behaviour of Total Product in this function is explained below.

Units of Labour	Total Product	Change in the TP curve
0	0	TP rises at an increasing rate till point I
1	7	
2	18	
3	33	
4	44	TP Rises at a decreasing rate from point I to K
5	48	
6	51	TP attains maximum and becomes constant
7	51	
8	49	TP Falls after M



From the figure and the schedule, we can analyse that initially as more and more labour units are employed, the TP curve increases at an increasing rate till point I (corresponding to 2 units of labour units). After point I, the TP curve rises at a decreasing rate till the point K. The point I is also known as point of inflexion. This is because passing through the point I, the curvature of the TP curve changes from convex to concave. With successive rise in the labour units, the TP curve continues to rise and attains its maximum point K (corresponding

to 6 units of labour) and remains stable till point M. Beyond this point, the TP curve starts falling when more than 8 units of labour are employed.

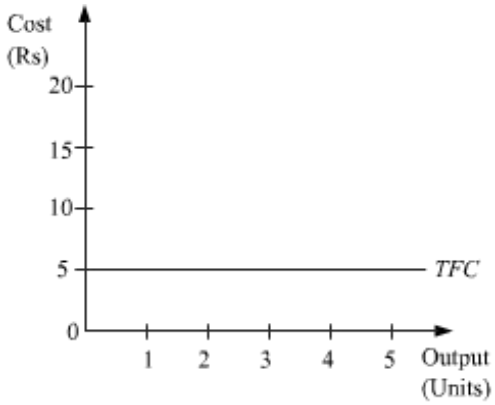
OR

Define cost. State the behaviour of
(a) Total Fixed Cost and
(b) Total Variable Cost as output is increased.

Ans: Cost is the total expenditure incurred in producing a commodity. In economics, it is sum total of actual expenditure incurred on inputs (i.e. explicit cost) and the imputed valued of inputs supplied by the owners (i.e. implicit cost).

(a) Total Fixed Cost (*TFC*) is the cost which is incurred by a firm in order to acquire the services of the fixed factors for production. In the short run, the firm cannot vary the fixed factors of production. Hence, *TFC* remains constant in the short run whether the output produced is 1 unit or 100 units.

Output (Units)	TFC (in Rupees)
0	5
1	5
2	5
3	5
4	5
5	5



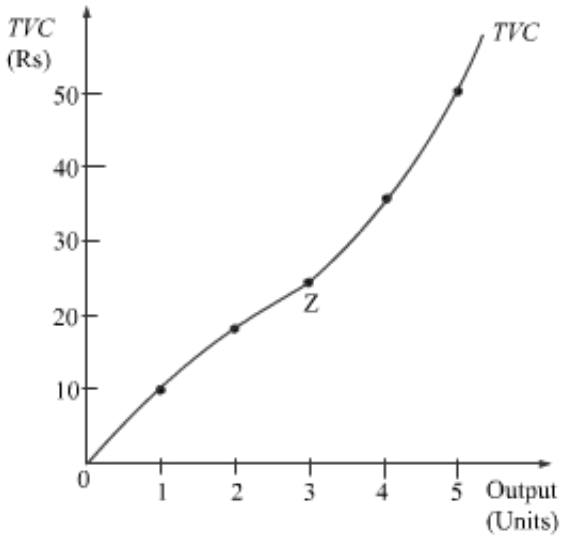
Analysing the TFC schedule and the figure, we can say that TFC remains constant irrespective of the output levels. Therefore in short run TFC is a horizontal curve parallel to *x*-axis.

(b) Total Variable Cost (*TVC*) refers to the costs which is incurred by a firm on the variable

inputs for production. The variable costs are positive function of output i.e. as output increases, variable costs also increases and vice-versa. That is, as more and more units of labour are employed to produce higher units of output, accordingly the variable costs rises. These costs are also known as *Prime Costs* or *Direct Costs* and include expenses such as:

1. Wages of labour
2. Fuel expenses
3. Costs of raw materials

Output (Units)	TVC (in Rupees)
0	0
1	10
2	18
3	24
4	36
5	50



Q12 Explain the implications of the following :

(a) Product differentiation in monopolistic competition.

(b) Perfect knowledge in perfect competition.

Ans: (a) The product of a monopolistic firm is differentiated from the product of the other firm but both are close substitute for each other. The implication for this is that a firm can

design its own price policies.The firms are distinguished on the basis of their brand names, therefore each monopolistic firm enjoys a monopolist (or monopoly) control over their product and try to charge different prices (slight variations). Consequent of this product differentiation, we can't have a more elastic demand curve in monopolistic form. It tends to outweigh the elastic demand nature (due to presence of close subsititutes of products) and makes it more inelastic.This is because no other firm can produce and sell its products under the same brand name.

(b) Both buyers and sellers are fully aware of the market conditions, such as price of a product at different places. The sellers are also aware of the prices at which the buyers are willing to buy the product. The implication of this feature is that if any individual firm is charging higher (or lower) price for a homogeneous product, the buyers will shift their purchase to other firms (or shift their purchase from the firm to other firms selling at lower price). Consequent of this, the sellers in a perfect competition market form do not change their price and take the price as given which is determined by the industry. This is the reason why we regard a perfect competitive firm to be a price taker and not a price maker.

OR

Explain the implications of the following :

(a) Interdependence between firms in oligopoly.

(b) Large number of sellers in perfect competition.

Ans: (a) Due to the high degree of interdependence between the oligopolistic firms, each firm has to consider rival firm's reactions while framing polcies and making decisions. Each firm has to evaluate the reactions of the other firms to a particular move taken by it before actually materialising the decision. If in case, a firm fails or simply ignores to consider rival firm's reaction, then it will end-up at a worse scenario compared to pre-decision phase. Consequent to this, the price in oligopoly market is sticky or rigid and hardly any of the oligopolistic firm dares to change the price of their individual products.

(b) There exist a large number of sellers in a perfectly competitive market. The number of sellers is so large that no individual firm owns the control over the market price of the commodity. Thus, firms have no role to play other than supplying the required output at the existing market price and therefore, a firm is a price taker and not a price maker. The implication for this is that no individual firm can influence the market price and all firms sell their individual output at a uniform market price.

Q13 Explain the difference between "Shift of Supply Curve" and "Movement along Supply Curve". State one factor responsible for each. Use diagrams.

Ans:

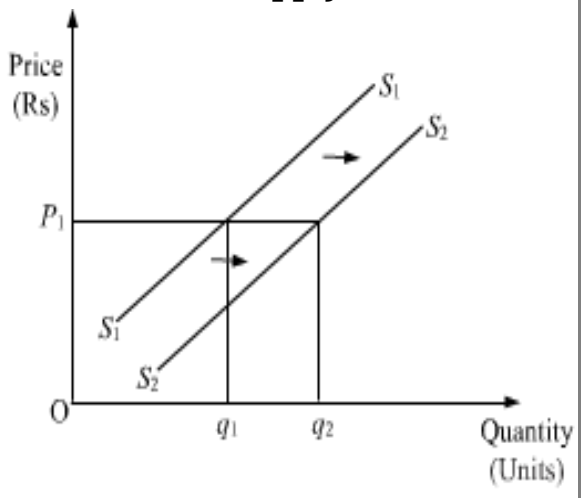
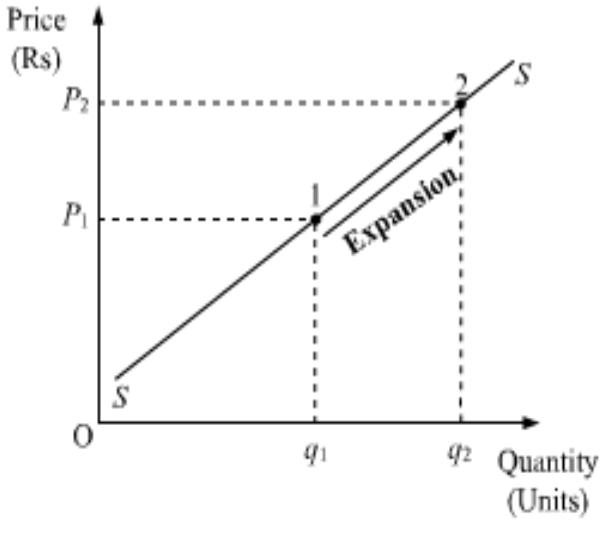
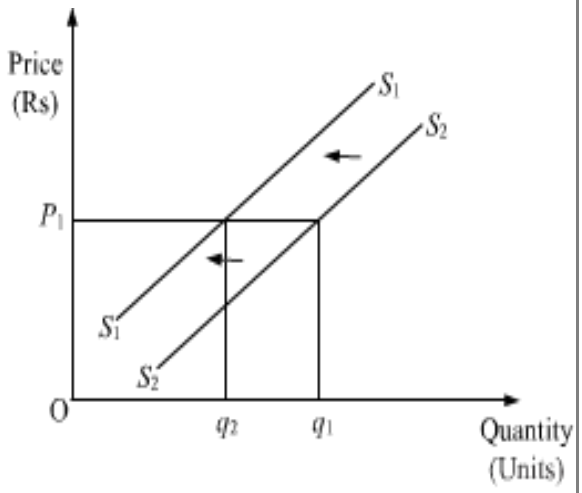
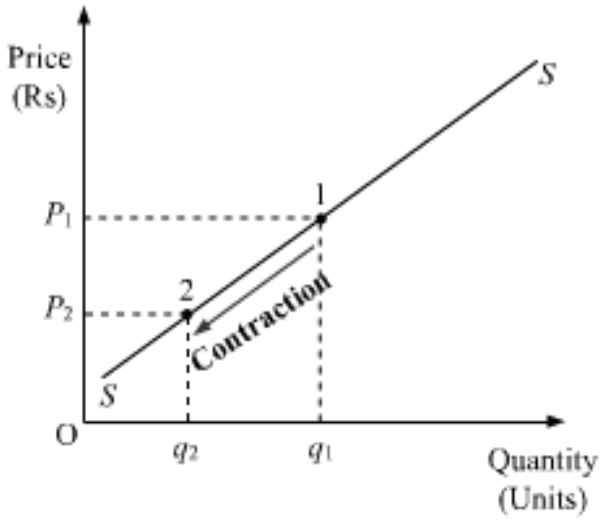
Basis	Shift in Supply Curve	Movement Along Supply Curve
Meaning	When supply changes due to the change in all other variables other than the price of a good (i.e. price of the good remains same), then it is referred as change in supply or sfift in supply curve	When supply changes due to change in the price of good only, assuming other determinants remaining unchanged, then it is referred as change in quantity supplied or movement along supply curve
Function	**It is represented as** $Q_x = f(\overline{P}_x, P_y, P_i, T, G, G_F, N_F)$	**It is represented as** $Q_x = f(P_x, \overline{P}_y, \overline{T}, \overline{P}_i, \overline{G}, \overline{G}_F, \overline{N}_F)$
Shift & Movement	It results in a shift in the supply curve of the firm which can be rightwards or leftwards.	It results in a movement of the supply curve of the firm which can be upwards or downwards.
Types	The following are its types: 1) Increase in Supply 2) Decrease in Supply	The following are its types: 1) Expansion of Supply 2) Contraction of Supply
Factors Responsible	Price of related goods, Change in Consumer Tastes and Preferences, etc.	Change in Price
	1) Increase in Supply 	**1) Expansion of Supply** 

Diagram	2) Decrease in Supply	2) Contraction of Supply
		

Q14 A consumer consumes only two goods X and Y. Explain the conditions of consumer's equilibrium using Marginal Utility Analysis.

Ans: In case of two commodities, the Consumer's Equilibrium is given in accordance with the Law of Equi-Marginal Utility.

Law of Equi-Marginal Utility states that a consumer allocates his expenditure on various commodities in such a manner that the utility derived from each additional unit of the rupee spent on each of the commodities is equal. Algebraically, this is represented the following equality.

$$\frac{MU_x}{P_x} = \frac{MU_y}{P_y} = \ldots \frac{MU_m}{P_n} = MU_m$$

Let us understand the concept of Consumer's Equilibrium in case of two commodities with the help of the following numerical example. Let us suppose that for a consumer the Marginal Utility of Money (MU_m) is 5 utils and the price of commodity x (P_x) is Rs 5, while, the price of another commodity y, (P_y) is also Rs 5

Consider the following Marginal Utility Schedule for commodity x (MU_x) and commodity y (MU_y)

Units of x (units)	MUx (utils)	MUy (utils)

1	30	35
2	28	32
3	25	28
4	20	25
5	10	12
6	2	3
7	– 5	– 1

As per the schedule, the consumer strikes equilibrium when he is consuming 3 units of commodity x and 4 units of commodity y. At such a consumption combination, the Marginal Utility of a Rupee spent on the commodity x $\left(\frac{MU_x}{P_x}\right)$ is equal to the Marginal Utility of a Rupee spent on the commodity y $\left(\frac{MU_y}{P_y}\right)$, which in turn is equal to the Marginal Utility of Money (MU_m).

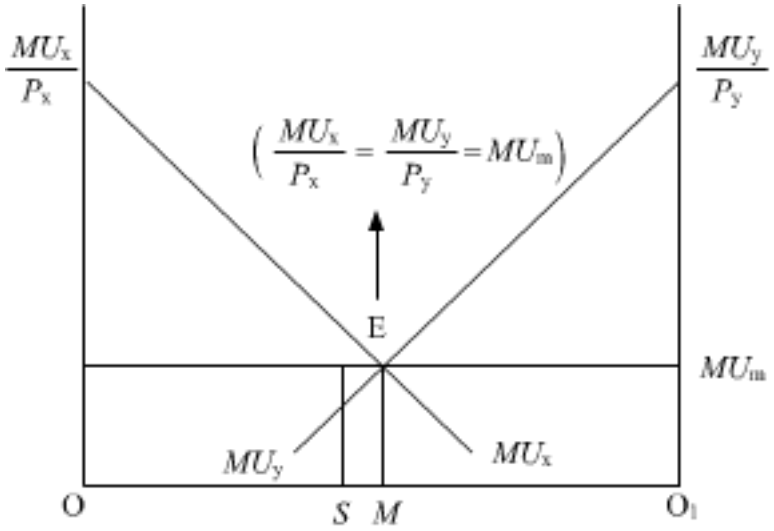
That is,

Marginal Utility of a Rupee spent on commodity x = Marginal Utility of a Rupee spent on commodity y = Marginal Utility of Money

$$\frac{MU_x}{P_x} = \frac{MU_y}{P_y} = MU_m$$

$$\Rightarrow \frac{MU_x}{P_x} = \frac{MU_Y}{P_Y} = \frac{25}{5} = 5 = MU_m$$

Diagrammatically, the consumer's equilibrium in case of two commodities is represented as:



In the above figure, OO_1 represents the total income of a consumer. MU_x and MU_y represent the Marginal Utility curves of commodity x and commodity y, respectively. The point E

represents the point of consumer's equilibrium, where:

$$\frac{MU_x}{P_x} = \frac{MU_y}{P_y} = MU_m$$

At this point, OM amount of income is spent on commodity *x* and the remaining amount of income MO_1 is spent on commodity *y*.

Suppose, instead of point M, the consumer is at point S, where he spends OS amount of income on commodity *x* and SO_1 amount of income on commodity *y*. At point S, however;

$$\frac{MU_x}{P_x} > \frac{MU_y}{P_y}$$

Thus, the consumer would increase his consumption of commodity *x* till the equality is achieved. That is, in other words, when he reaches point E, where the equilibrium is restored by the equality between the marginal Utilities of each commodities.

$$\frac{MU_x}{P_x} = \frac{MU_y}{P_y}$$

Q15 Explain the concepts of Opportunity Cost and Marginal Rate of Transformation using a production possibility schedule based on the assumption that no resource is equally efficient in production of all goods.

Ans: The cost of enjoying more of one good in term of sacrificing the benefit of another good is called opportunity cost of the additional unit of the good.

The slope of PPC shows for the production of every additional unit of one good, more and more units of other good has to be sacrificed. This is known as Marginal Rate of Transformation (MRT) or Opportunity Cost.

$$MRT = \frac{\Delta Y}{\Delta X} = \frac{\text{Amount of consumer good sacrificed}}{\text{Amount of capital good gained}}$$

It should be noted that as we move down along the PPC, the slope of PPC (or MRT) increases. This suggests that as the production increases, to produce each additional unit of one good, more and more units of other good needs to be sacrificed. In other words, the opportunity cost increases. This is called as the law of increasing opportunity cost.

Let us once again consider the example of the economy producing two goods- consumer goods and capital goods assuming the level of resources and technology remain same. The following schedule depicts the different possible combination of the consumer goods and the capital goods that the economy can produce with its resource endowment and the available technology. This schedule is called production possibility schedule.

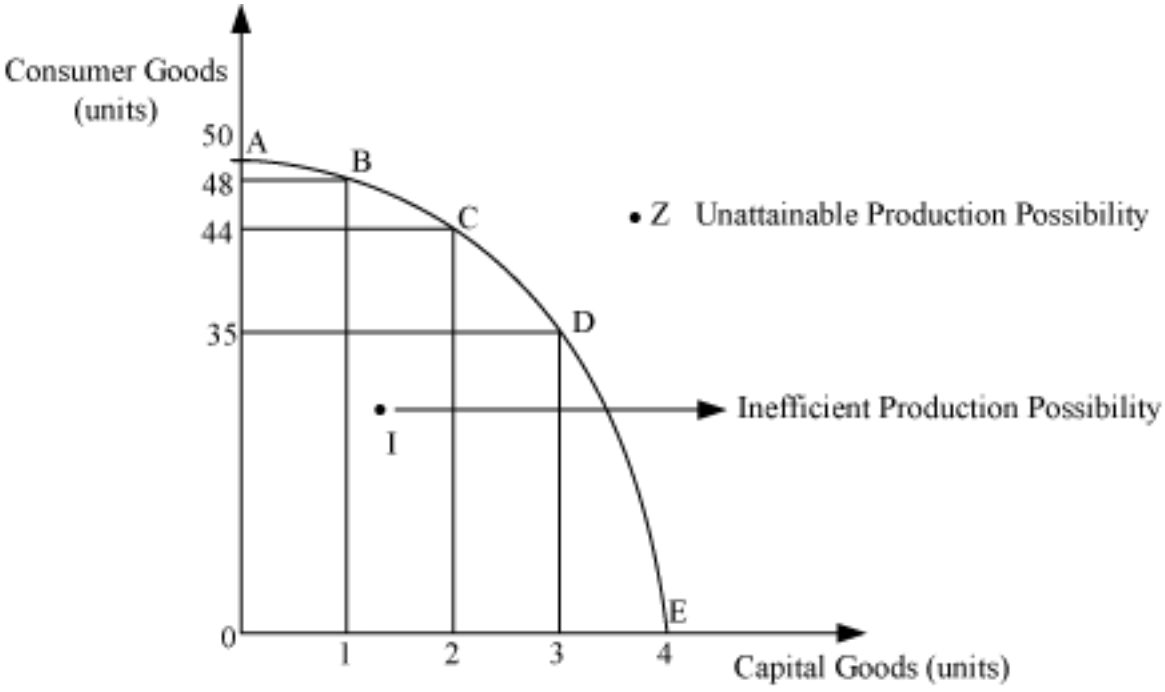
Production Possibilities	Consumer Goods (units)	Capital Goods (units)
A	50	0
B	48	1
C	44	2
D	35	3
E	0	4

Consider the initial production point B, where 1 unit of capital good and 48 units of consumer goods are produced. To produce an additional unit of capital good, 4 units of consumer good must be sacrificed.

Here, the Marginal Rate of Transformation or Opportunity Cost is:

$$MRT = \frac{\Delta Y}{\Delta X} = \frac{Amount\ of\ consumer\ good\ sacrificed}{Amount\ of\ capital\ good\ gained} = \frac{44-48}{2-1} = -4$$

Thus, the MRT or the opportunity cost of getting an additional unit of capital good is 4 units of consumer goods.



Production Possibility Curve

Section B

Q16 Balance of Payments 'deficit' is the excess of : (choose the correct alternative)

(a) Current account payments over current account receipts.

(b) Capital account payments over capital account receipts.

(c) Autonomous payments over autonomous receipts.

(d) Accommodating payments over a accommodating receipts.

Ans: Balance of Payments 'deficit' is the excess of autonomous payments over autonomous receipts.

Hence, the correct answer is option *'c'* .

Q17 Disinvestment by government means: (choose the correct alternative)

(a) Selling of its fixed capital assets

(b) Selling of shares of public enterprises held by it.

(c) Selling of its buildings

(d) All the above

Ans: Disinvestment is a process in which the public undertaking reduces its portion in equity by disposing its shareholding. Thus, disinvestment by government means selling of shares of public enterprises held by it.

Hence, the correct answer is option *'b '* .

Q18 Unforeseen obsolescence of fixed capital assets during production is:
(choose the correct alternative)

(a) Consumption of fixed capital

(b) Capital loss

(c) Income loss

(d) None of the above

Ans: Capital Loss is a loss of capital nature that is of abnormal and non-recurring nature. Such losses are unpredictable or unforeseen. Accordingly, loss in value of fixed assets due to unforeseen obsolescense, natural calamities, thefts and accidents is regarded as capital loss.

Hence, the correct answer is option (b).

Q19 What is revenue expenditure?

Ans: Revenue expenditure refers to the government expenditure which *does not cause any reduction in government liabilities and also does not create assets for the government* . For

example: Expenditure on salaries, pensions, subsidies, interest payments, etc.

Q20 Define Gross Investment.

Ans: Gross Investment implies the part of the final output produced in an economy during an accounting year that consists of capital goods (machinery, tools, etc.). In other words, gross investment comprises of total expenditure incurred on capital goods.

Q21 An economy is in equilibrium. Find marginal propensity to consume :

Autonomous consumption expenditure	=	**100**
Investment expenditure	=	**100**
National Income	=	**2,000**

Ans: Given,

Y= Rs 2,000

$\bar{C} = Rs.100$

$I = Rs.100$

$We\ know,\ At\ Equilibrium$

$Y = C + I$

$\Rightarrow 2,000 = \bar{C} + cY + I$

$\Rightarrow 2000 = 100 + c \times 2,200 + 100$

$\Rightarrow 2000 = 200 + c \times 2000$

$\therefore c = 0.9$

Hence, marginal propensity to consume is 0.9

Q22 Given nominal income to be Rs 375 and price index 125, calculate real income.

Ans:

$$Real\ Income = \frac{Nominal\ Income}{Price\ Index\ of\ Current\ Year} \times Price\ Index\ of\ Base\ Year$$

$Assuming\ Price\ Index\ of\ base\ year\ to\ be\ 100$

$$\Rightarrow Real\ Income = \frac{375}{125} \times 100$$

∴Real Income=Rs 300

Q23 Distinguish between Average Propensity to Consume and Marginal Propensity to Consume using a numerical example.

Ans: *Average Propensity to Consume (APC)* expresses the propensity to consume in aggregate terms. It *shows the ratio of consumption expenditure to the level of income.* Algebraically,

$APC = CY$

Marginal Propensity to Consume (*MPC*) expresses the propensity to consume in proportionate terms. *It refers to the ratio of change in the consumption expenditure and change in the disposable income.* Algebraically,

$MPC = \Delta C \Delta Y$

Consider the following *numerical example*.

Income (*Y*)	Consumption Expenditure (*C*)	*APC=CY*
1000	800	8001000 = 0.8
1500	1200	12001500 = 0.8

$$MPC = \frac{\Delta C}{\Delta Y} = \frac{1200 - 800}{1500 - 1000} = \frac{400}{500}$$

MPC = 0.8

Or

Explain how can government spending be helpful in removing deficient demand.

Ans: The government of a country incurs various types of expenditure to enhance the welfare of the people and also to facilitate economic growth and development. The following are some of the important types of government expenditure.

1. Development expenditure such as roads, dams, bridges, etc.
2. Welfare expenditure such as education, health, etc.
3. Defence expenditure and civil expenditure such as maintenance of law and order, etc.
4. Expenditure on subsidies and transfer payments such as, old age pensions, scholarships, etc.

The role of government expenditure in removing deficient demand is explained below.
In case of deficient demand, the government *raises its expenditure* in form of fresh investments either say establishinn newer schools, hospitals, putting-up new infrastructure, etc. This *raises the level of economic activity* via providing new employment opportunities or transferring of income in the hands of poor people. Consequent of this, there is an increased flow of income in the economy, which then encourages people to demand more. This then leads to rise in the ***aggregate demand***. The government continues to increase its spending till the point the aggregate demand has sufficiently raised and the *deficient demand gets wiped out* .

Q24 Explain 'government's bank' function of central bank.

Ans: Central bank acts as a banker and financial advisor to the government. As a banker to the government, it performs the following functions.

1. It manages the account of the government.
2. It accepts receipts from the government and makes payment on behalf of it.
3. It grants short-term loans and credit to the government.
4. It performs the task of managing the public debt.
5. The central bank advises the government on all the banking and financial related matters.

Q25 Government spends on child immunization programme. Analyse its impact on Gross Domestic Product and welfare of the people.

Ans: As government spends on child immunization programme it leads to increase in society's welfare. It is in the sense that if complete immunisation is provided to children of a nation, then it prevent them from the deadly diseases and there will be a drastic reduction in the number of child falling ill. This then checks absenteeism and drop-out ratios from school. With a complete vaccination, there is also reduction in the number of prematured deaths. All these factors contribute to superior human capital, which then ensures the better and efficient utilisation of physical resources. With higher probability of getting employed (as there are more number of literate people and also they are healthy), there would be greater participation in the production process and greater volume of output will be produced. This raises the country's GDP and welfare in long run.

Q26 Explain the 'Unit of Account' function of money. How has it solved the related

problem created by barter?

Ans: *Unit of Account*: Money serves as a common medium or unit of value. The goods and services are of different types and are measurable in different units such as, meter, litre, gram, etc. Money has provided a common yardstick to measure all these different units in a common denomination known as price. This has made different goods and services comparable to each other in terms of their respective prices.

Under the Barter system of exchange, there was no common unit for measuring the value of one good in terms of other good for the purpose of exchange. For example, a horse cannot be measured in terms of rice in the case of exchange between rice and horse. However, money solved this problem by measuring the values of different goods in terms of a common denomination, i.e. Rupees, Dollars, etc.

Or

Explain the 'Standard of differed payment' function of money. How has it solved the related problem created by barter?

Ans: *Standard of Deferred Payments*- Deferred Payments refer to the future payments and contractual payments such as loans and interest payments, salaries, etc. As money is widely accepted as medium of exchange and can be used as to store value without much loss of value, so it can be used for future payments.

Under barter system it was very difficult to make future payments and contractual payments such as salaries, loans, interest payments, etc. For example, it was difficult to decide whether wages to a labour are to be paid in terms of food grains or any other commodity. This is because it was difficult to value the services of labour in terms of a commodity. Similarly, if a loan is taken in the form of a commodity, then the problem will arise in its repayment. However, as superior to the Barter system, money made the system of deferred or contractual payments such as, salaries, interest payments, etc. possible. For example, a worker working on contract basis can be easily paid in terms of money.

Q27 Find Gross Domestic Product at Factor Cost and Personal Disposable Income:

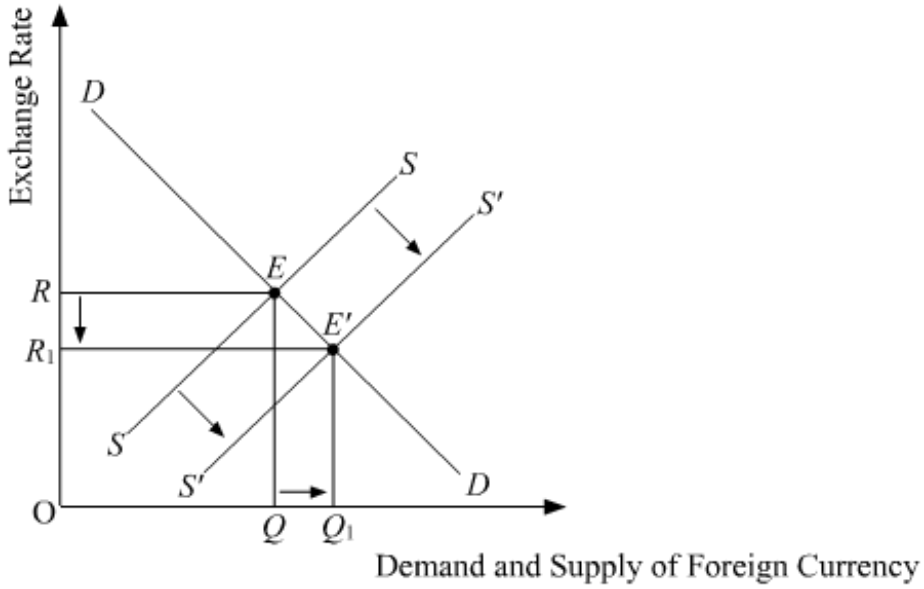
		(*Rs crore*)
(i)	**Personal tax**	**100**

(ii)	**Net National Disposable Income**	**800**
(iii)	**Corporation tax**	**50**
(iv)	**Net factor income to abroad**	**(–)10**
(v)	**Retained Income**	**200**
(vi)	**Indirect tax**	**170**
(vii)	**Private income**	**600**
(viii)	**Subsidy**	**30**
(ix)	**Consumption of fixed capital**	**60**
(x)	**Net current transfer from abroad**	**10**

Ans: GDP_{FC} = Net National Disposable Income – Net Current Transfers from Abroad -Net Indirect Taxes - Net
Current Transfers from Abroad – Net Factor Income to Abroad + Consumption of fixed capital
= 800 – (170 - 30) - 10 + (–10) + 60 = Rs 700Crores
Personal Disposable Income = Private Income – Corporation Tax – Personal Tax - Retained Income
= 600 – 50 –100 - 200
= Rs 250 Crores

Q28 Indian investors borrow from abroad. Answer the following:
(a) In which sub-account and on which side of the Balance of Payments Account will this borrowing be recorded? Give reason.
(b) Explain what is the impact of this borrowing on exchange rate.
Ans: (a) In *Capital account* and on the *credit side of BOP* , the borrowings of Indian investors from abroad will be recorded. Indian investors borrowings from abroad cause an inflow of foreign exchange into the country. Thus, it is recorded as *positive* item in the Capital Account of BOP.
(b) Borrowings from abroad by Indian investors will increase the supply of foreign currency.

This would shift the supply curve from *SS* to *S'S'*. With the shift in supply curve, the new equilibrium is established at point *E'*, where the *exchange rate falls* from *OR* to OR_1 and the demand and supply of *foreign currency rises* to OQ_1.



Q29 Derive the two alternative conditions of expressing national income equilibrium. Show these equilibrium conditions on a single diagram.

Ans: The two alternative conditions of expressing national income equilibrium are as follows.

1. Aggregate Demand and Aggregate Supply approach (AD and AS approach)
2. Saving and Investment approach (S and I approach).

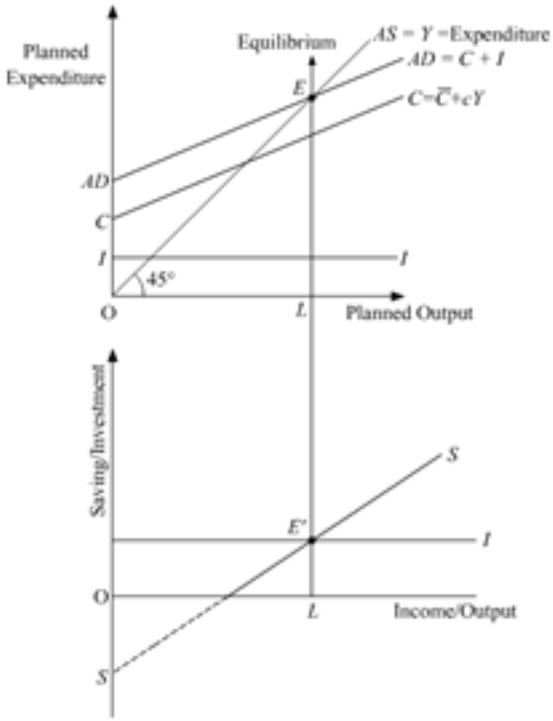
Aggregate Demand and Aggregate Supply approach (AD and AS approach)

According to this approach, the equilibrium level of income is determined at that point, where Aggregate Demand (AD) is equal to Aggregate Supply (AS). It should be noted that here AD refers to the planned/desired level of expenditure in the economy during an accounting year. Similarly, AS refers to the planned/desired level of output in an economy during an accounting year.

Saving and Investment Approach

According to this approach, the equilibrium is determined at that point, where the saving and investment are equal to each other. In other words, the equilibrium is established, where leakages are equal to the injections.

The equilibrium conditions with the help of a diagram is given as follows.



In the upper panel of the diagram, the equilibrium is represented using the AD and AS approach. The lower panel represents equilibrium using the S and I approach. The equilibrium using the AD and AS approach is established at point E. Correspondingly, in the lower panel, the equilibrium is established at point E'.

This can be also proved mathematically.

As per the AD and AS approach, equilibrium happens at a point, where:

AS = AD

or, C + S = C + I

i.e. S = I

Q30 What are revenue receipts? Explain the role of government budget in bringing stability in the economy.

Ans: Revenue Receipts are those receipts of the government which neither creates any liability nor it creates any reduction in the assets of the government. These comprises of tax and non-tax receipts, duties and fines, interest and dividends receipts on government investments and assets. These are further classified into:

1. Tax Receipts
2. Non-tax Receipts

a) Tax Receipts- A tax is a legally compulsory monetary contribution to the government by different economic units such as household, firms and other economic units. Taxes are

imposed by the government on different activities, income, property, production, occupation, etc. The main motive of imposing taxes is to raise revenue and to incur various expenditures for enhancing welfare of the country. The following are the various types of taxes.

1. Direct and indirect taxes
2. Progressive and regressive taxes
3. Ad valorem and specific taxes

b) Non-Tax Receipts- These budget receipts of the government from sources other than taxes such as interest receipts, dividends, fines, duty fees, etc. Various non-tax receipts of the government can be classified as:

1. Fees
2. License Fees
3. Escheat
4. Fines and Penalties

The government through it budget aims at insulating the economy from major fluctuations (such as inflation, unemployment, etc) and business cycles such as boom, recession, depression and recovery. If in case of inflation, for instance, government tries to raise The major concern of government is to achieve higher economic growth rates while maintaining price and employment stability. This state of economic growth with stability ensures a smooth and efficient functioning of an economy. Now, let's see how government aims to reduce inflationary and deflationary tendencies (for instance) in the economy.

In case of *deflationary tendencies* the following steps can be taken.

1. Deficit budget policy can be followed. Under this, the government would increase expenditure on development works, such as construction of infrastructure, schools, hospitals, etc. Expenditure on such projects have long-run effect on the economic growth of a country. Besides this, the presence of such infrastructure will facilitate future growth and development.
2. Taxes can be reduced so that there is an increase in purchasing power of people. This results in increase in consumption expenditure.
3. Steps can also be taken increase public expenditure and provide social security.

As against this in case of *inflationary tendencies* , following steps can be taken.

1. Reducing the public expenditure so that it leads to a decline in the demand for goods and services in the economy, causing a fall in the price level.
2. Reduction in public borrowings reduces the purchasing power of the people, reducing

their demand for goods and services. This reduction in demand, in turn, leads to a fall in the price level.
3. Increase in taxes reduces the disposable income in the hands of the people, which in turn lowers the demand for goods and services and leads to a fall in the prices.
4. Creating a surplus budget by lowering public expenditure and/or increasing government revenue by increasing taxes reduces the demand for goods and services in an economy and helps in reducing inflation.

Or

What is government budget? Explain the role of government budget in influencing allocation of resources in the economy.

Ans: Meaning of Government Budget
A Government Budget is a financial statement showing item-wise expected government receipts and government payments during a particular financial year. It also presents the government's report on the financial performance during the previous fiscal year.
The role of government budget in 'allocation of resources' can be explained as follows.
1) Government aims to allocate resources to maintain a balance between maxisation of welfare as well as profits.
2) Private sector of economy usually ignores social welfare. Government budget allows the government to intervene in the economy so as to increase social welfare.
3) For example, government levies taxes on socially harmful goods such as tobacco, cigarettes etc and provides subsidies on essential commodities such as LPG, food grains etc.