CBSE Class 12 Economic 2016
All India (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.*

*(iv) Question No.****6-8*** *and* ***21-23*** *are* ***short answer questions*** *carrying* ***3 marks*** *each.*

*(v) Question No.****9-11*** *and* ***24-26*** *are also* ***short answer questions*** *carrying* ***4 marks*** *each.*

*(vi) Question No.****12-15*** *and* ***27-30*** *are* ***long answer questions*** *carrying* ***6 marks*** *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 Demand curve of a firm is perfectly elastic under:
(Choose the correct alternative)
(a) Perfect competition
(b) Monopoly
(c) Monopolistic competition
(d) Oligopoly

ANS: Demand curve of a firm is perfectly elastic under ***perfect competition*** .
Hence, the correct answer is option '***a***'.

Q2 Differentiated products is a characteristic of :
(Choose the correct alternative) :
(a) Monopolistic competition only
(b) Oligopoly only
(c) Both monopolistic competition and oligopoly
(d) Monopoly

Ans: Differentiated products is a characteristic of ***both monopolistic competition and oligopoly*** .
Hence, the correct answer is option ***'c'***.

Q3 A firm is able to sell any quantity of a good at a given price. The firm's marginal revenue will be :
(Choose the correct alternative) :
(a) Greater than Average Revenue
(b) Less than Average Revenue
(c) Equal to Average Revenue
(d) Zero
ANS: When a firm is able to sell any quantity of a good at a given price, then the firm's marginal revenue will be ***less than Average Revenue*** .
Hence, the correct answer is option (b).

Q4 When does "change in quantity demanded" take place?
Ans: Change in quantity demanded takes place when price of the good changes assuming other determinants remaining unchanged. Graphically, the change in quantity demanded is represented as movement along the demand curve.

Q5 What happens to the difference between Average Total Cost and Average Variable Cost as production is increased?
Ans: The difference between Average Total Cost (*ATC*) and Average Variable Cost (*AVC*) tends to diminish as production is increased. But the Average Total Cost and Average Variable Cost curves would never meet. This is because *AFC* is a rectangular hyperbola, which has a property that it would never touch the *x* -axis. Thus, at higher level of output, *AFC* becomes smaller and smaller, consequently, *ATC* curve and *AVC* curve tends to converge.

Q6 What is minimum price ceiling? Explain 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.

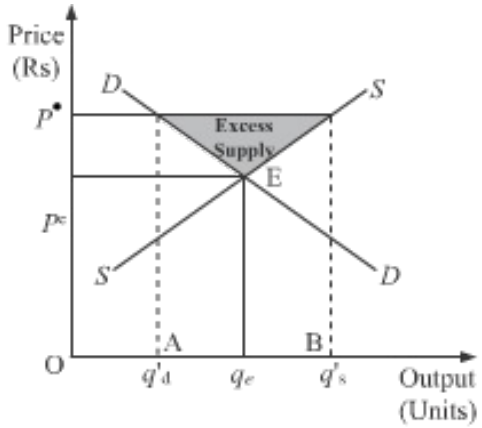
2. ***Enhances Welfare***- The imposition of the price ceiling ensures the access of the necessity goods within the reach of the poor people. This safeguards and enhances the welfare of the poor and vulnerable sections of the society.

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

If the prevailing market price is above the equilibrium price, explain its chain of effects.

Ans: If the prevailing market price is above the equilibrium price, then there occurs the situation of excess supply. Let us assume that the market price P^* is above the equilibrium price P^e . According to the demand curve, quantity demanded is q'_d . Whereas, according to the supply curve, the quantity supplied is q'_s . So, it can be seen that there emerges the situation of excess supply equivalent to ($q'_s - q'_d$). This excess supply will increase competition among the sellers; consequently, they will reduce the price in order to sell more of their output. The fall in price will continue until price becomes P^e , where market demand equals market supply.



Q7 A consumer consumes only two goods X and Y. Marginal utilities of X and Y are 4 and 3 respectively. Price of X and price of Y is Rs 3 per unit. Is consumer in equilibrium? What will be further reaction of the consumer? Give reasons.

Ans: According to the utility approach, a consumer reaches equilibrium where the following equality is met.

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

According to the given question:

$$\frac{MU_x}{P_x}=\frac{4}{3}=1.33$$

$$\frac{MU_y}{P_y}=\frac{3}{3}=1$$

Since, $\frac{MU_x}{P_x}$ *is greater than* $\frac{MU_y}{P_y}$

Thus, a consumer is not in equilibrium. In order to reach the equilibrium, a rational consumer would ***increase the consumption of good X*** and ***decrease that of good Y.***

Q8 What will be the effect of 10 percent rise in price of a good on its demand if price elasticity of demand is (a) Zero, (b) –1, (c) –2.

Ans:

$$(a)\, E_d = 0, Percentage\, Change\, in\, Price = 10$$

$$\Rightarrow E_d = \frac{Percentage\, Change\, in\, Quantity\, Demanded}{Percentage\, Change\, in\, Price}$$

$$0 = \frac{Percentage\, Change\, in\, Quantity\, Demanded}{10}$$

$$Therefore, Percentage\, Change\, in\, Quantity\, Demanded = 0$$

$$(b)\ E_d = -1, Percentage\, Change\, in\, Price = 10$$

$$\Rightarrow E_d = \frac{Percentage\, Change\, in\, Quantity\, Demanded}{Percentage\, Change\, in\, Price} - 1$$

$$= \frac{Percentage\, Change\, in\, Quantity\, Demanded}{10}$$

Therefore, Percentage Change in Quantity Demanded=−10

(c) $E_d = -2, Percentage\ Change\ in\ Price = 10$

$$\Rightarrow E_d = \frac{Percentage\ Change\ in\ Quantity\ Demanded}{Percentage\ Change\ in\ Price}$$

$$-2 = \frac{Percentage\ Change\ in\ Quantity\ Demanded}{10}$$

Therefore, Percentage Change in Quantity Demanded=−20

Q9 When price of a good rises from Rs 10 to Rs 12 per unit, the producer supplies 10 percent more. Calculate price elasticity of supply.

Ans: Given: Percentage Change in Quantity Supplied = 10

$P_0 = Rs10$

$P_1 = Rs12$

$E_s = ?$

$\Delta P = P_1 - P_0$

$\Delta P = 12 - 10$

$\Delta P = Rs2$

Percentage Change in Price

$$= \frac{\Delta P}{P_O} \times 100$$

$$= \frac{2}{10} \times 100 = 20$$

$$Price\ Elasticity\ of\ Supply\ (E_S)$$

$$= \frac{Percentage\ Change\ in\ Qunatity\ Supplied}{Percentage\ Change\ in\ Price}$$

$$\therefore Price\ Elasticity\ of\ Supply\ (E_S) = 1020 = 0.5$$

Q10 Define utility. Explain the Law of Diminishing Marginal Utility.

Ans: Utility refers to the satisfaction that a consumer expects to derive from the consumption of a particular good. It is a subjective concept and varies from person to person and from time to time. For example, a commodity, say, apples provide different level of satisfaction to different persons. Also, the same person can derive different level of satisfaction from

consumption of apples at different points of time (for example, at the time of illness the apples may provide a consumer with a higher level of satisfaction).

Law of Diminishing Marginal Utility states that as a consumer consumes more and more units of a commodity at succession, then Marginal Utility derived from the consumption of each additional unit of the commodity falls.

Assumptions

The Law of Diminishing Marginal Utility is based on the following assumptions.

1. ***Standard Units and Reasonable Size of Units***- A consumer consumes only standard units of the commodity. For example, a whole of an apple and not half of it. Similarly, glass of water and spoon of water.
2. ***Successive Consumption***- Consumption of the successive units of the commodity takes place continuously (i.e. without any time lag). This is because if the consumption takes place with a time lag say of an hour or a week (i.e. consumption of one unit of the commodity takes place today and the consumption of the second unit takes place after one week) then, in the next week the consumer will start a fresh valuation of the utility without taking into consideration the utility derived from the consumption of the previous unit of the commodity in the previous week.
3. ***Homogeneous Units***- The law also assumes that the quality of the commodity remains the same throughout the process of consumption. In other words, all the units of a commodity should be homogeneous and identical in terms of shape, size, colour, quality, etc. That is, if a consumer is consuming water, then a glass of normal water should not be followed by a glass of cold water or a glass of sweet water.
4. ***Rational Consumer***- The law is applicable only if the consumer is a rational human being. That is, he should make rational consumption decisions.
5. ***No Change in Consumer's Tastes and Preferences***- There is no change in the tastes and preferences of consumers.
6. ***Utility can be measured***- The law only holds if the consumer is able to express his utility in terms of utils. That is, utility can be measured cardinally (or numerically).

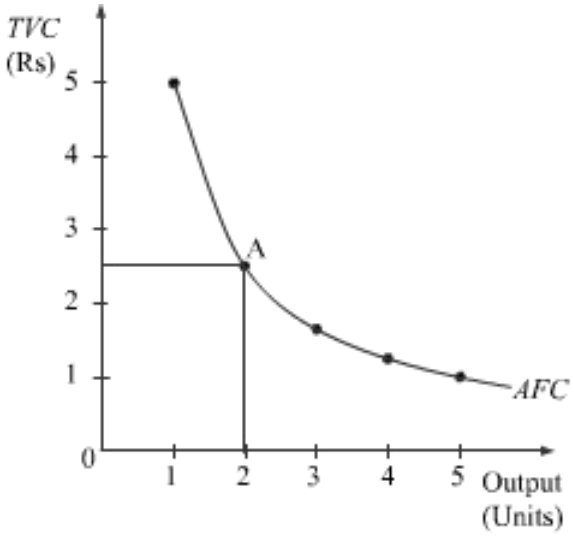
Q11 Define fixed cost. Give an example. Explain with reason the behaviour of Average Fixed Cost as output is increased.

Ans: Those costs which are incurred on the fixed factors are called Fixed Costs or Total Fixed Costs (*TFC*). Cost of machinery, buildings, depreciation on fixed assets, etc. are some of the

examples of the fixed costs.

The behaviour of Average Fixed Cost can be understood with the help of the following schedule and graph.

Output (units)	*TFC*	*AFC* (Rs) $AFC = \frac{TFC}{Q}$
0	5	∞
1	5	5
2	5	2.5
3	5	1.66
4	5	1.25
5	5	1



As you can see in the above graph, *AFC* falls as ouput increases. This is because *AFC* is defined as the fixed cost per unit of output produced. It is derived by dividing the Total Fixed Cost by quantity of output produced. That is,

$$AFC = \frac{TFC}{Q}$$

where,

TFC represents Total Fixed Cost

Q represents units of output produced

TFC remains fixed at all the levels of output, so *AFC* will fall with an increase in output.

OR

Define marginal product. State the behaviour of marginal product when only one input is increased and other inputs are hold constant.

Ans: Marginal Product is defined as the additional output due to the employment of an additional unit of labour. In other words, it is the change in the total output brought by employing one additional unit of labour. In other words, *MP* can be regarded as the contribution by one unit of labour to the total product.

Algebraically, it is defined as the ratio of the change in the total product to the change in the units of labour employed. That is,

$$\text{MP} = \frac{\text{Change in the Total Product}}{\text{Change in the Labour Units}} = \frac{\Delta TP}{\Delta L}$$

or, $MP_n = TP_n - TP_{n-1}$

where,

MP_n represents marginal product of nth unit of labour

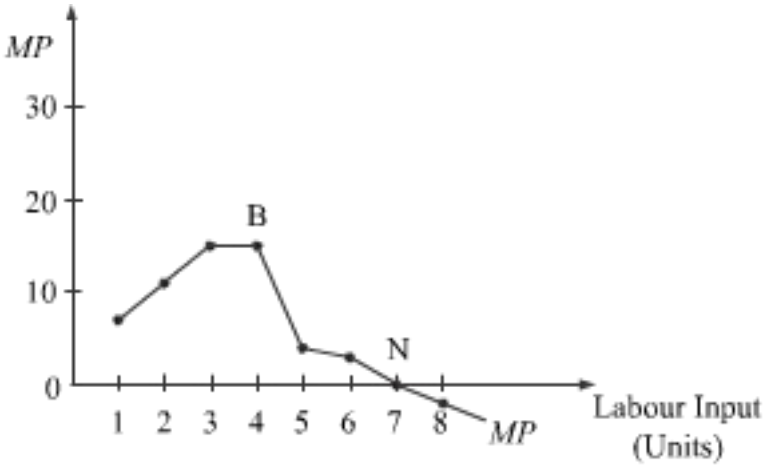
TP_n = Total product produced by employing n units of labour.

TP_{n-1} = Total product produced by employing (n – 1) unit of labour.

The behavior of *MP* when only one input is increased and other inputs are hold constant is explained below with the help of the folluwing scheduled and figure.

Units of Labour	**Total Product (*TP*)**	**Marginal Product** $MP = \frac{\Delta TP}{\Delta L}$	**Change in the *MP* curve**
0	0	–	*MP* increases an increasing rate and attains its maximum point at B.
1	7	7	
2	18	11	
3	33	15	
4	44	11	After point B, *MP* curve continues to fall
5	48	4	

6	51	3	and becomes zero at N.
7	51	0	
8	49	–2	After point N, *MP* curve continues to fall and becomes negative.



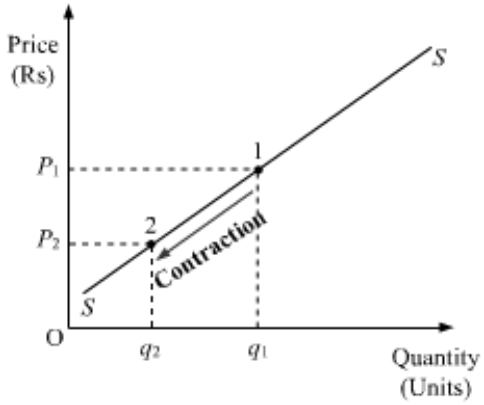
Q12 Explain the implications of the following in a perfectly competitive market :
(a) Large number of sellers
(b) Homogeneous products.
Ans: (a) There exist a large number of buyers and sellers in a perfect competitive market. The number of sellers is so large that no individual firm owns the control over the market price of the commodity. Due to the existence of large number of sellers in the market, there exists perfect and free competition in the market. Hence, no individual firm can influence the market price and all firms sell their individual output at a uniform market price.
(b) All the firms in perfect competitive market produces homogeneous product. This implies that the product of each and every firm in the market is perfect substitute to others' product in terms of quantity, quality, colour, size, features, etc. This indicates that the buyers are indifferent between the products of different firms. Due to homogeneity of the products, existence of uniform price is guaranteed.

OR

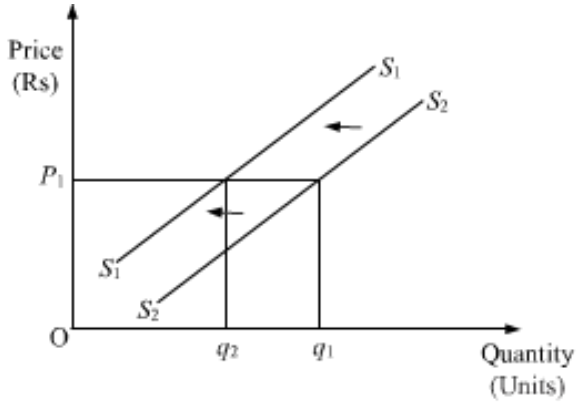
Explain the implications of the following in an oligopoly market :
(a) Barriers to entry of new firms
(b) A few or a few big sellers

Ans: (a) As there exists a cut-throat competition among the firms, so it is very difficult for any new firm to enter into the industry. Moreover, as the existing firms are the only giants in the market, so it narrows the scope for a new entrant to enter the industry due to high cost associated with the entry.
(b) There exists few but large and dominating firms. These firms account for majority of market supply, thereby control the market price and quantity of the output.

Q13 Examine the effect of (a) fall in the own price of good X and (b) rise in tax rate on good X, on the supply curve. Use diagrams.
Ans: (a) Fall in the own price of good X will lead to contraction of supply. It is shown by downward movement along the same supply curve. As price falls from P_1 to P_2 , the quantity supplied will decrease from q_1 to q_2 . The following figure depicts the contraction of supply.



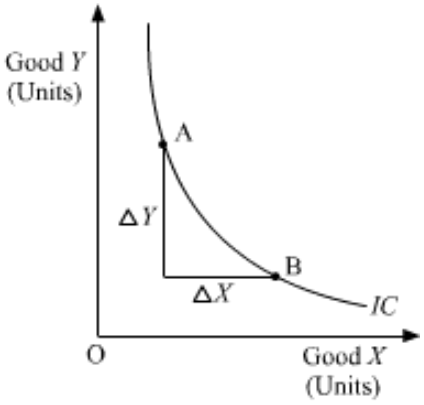
(b) Rise in tax rate on good X will lead to decrease in supply. The decrease in supply is graphically shown in the following graph. The leftwards upward shift of the supply curve from S_1S_1 to the new supply curve S_2S_2 depicts decrease in supply. It can be analysed from the figure that due to the decrease in the supply, lower quantity of good is supplied at the given price level of OP_1.



Q14 Explain three properties of indifference curves.

Ans: 1. ***Indifference curves are downward sloping to the right*** : Downward slope of the indifference curve to the right implies that a consumer cannot simultaneously have more of both the goods. An increase in the quantity of one good is associated with the decrease in the quantity of the other good. This is in accordance with the assumption of monotonic preferences.

2. ***Slope of IC***: The Slope of an *IC* is given by the ***Marginal Rate of Substitution (MRS)***. Marginal rate of substitution refers to the rate at which a consumer is willing to substitute one good for each additional unit of the other good.

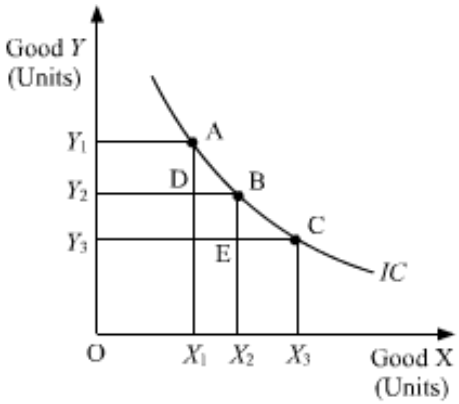


At point A:

$$\text{Slope of indifference curve } (MRS) = \frac{\Delta Y}{\Delta X}$$

i.e. MRS shows the rate at which the consumer is willing to sacrifice good *Y* for an additional unit of good *X*.

3. ***Shape of Indifference Curve***: As we move down along the Indifference curve to the right, the slope of *IC* (MRS) decreases. This is because as the consumer consumes more and more of one good, the marginal utility of the good falls. On the other hand, the marginal utility of the good which is sacrificed rises. In other words, the consumer is willing to sacrifice less and less for each additional unit of the other good consumed. Thus, as we move down the *IC*, MRS diminishes. This suggests the ***convex*** shape of indifference curve.



In the above figure, *IC* is the Indifference Curve.

At point A,

$$MRS_{xy} = \frac{AD}{DB}$$

At point B,

$$MRS_{xy} = \frac{BE}{EC}$$

$$\frac{BE}{EC} < \frac{AD}{DB}$$

MRS at *B* < *MRS* at *A*, so *MRS* has fallen.

Q15 Why do central problems of an economy arise? Explain the central problem of "for whom to produce"?

Ans: There are three main causes that give rise to the central problems in an economy. These are:

1. **Unlimited Human Wants**- Human wants are never-ending and new wants keep arising.
2. **Limited Economic Resources**- In relation to the unlimited wants, the resources required to satisfy them are relatively scare and limited in supply.
3. **Alternative Use of Resources**- Resources are not only scarce but also have alternative uses. This implies that a choice has to be made among the various alternative uses of resources.

One of the three central problems is ***For Whom to Produce? Or the Problem of Distribution of National Product***.

This economic problem basically focuses on the distribution mix of the final goods and services produced. The distribution of the final goods and services is equivalent to the distribution of National Income (or National Product) among the factors of production such as land, labour, capital and entrepreneur.

The economy needs to decide a mechanism of distributing the final goods and services among the different segments of population, so as to reduce the inequality of income. This problem is concerned about who gets more or who gets less? Which goods should be made available free or at low (nominal) price and to which segment?

Section B

Q16 Foreign exchange transactions which are independent of other transactions in the Balance of Payments Account are called :

(Choose the correct alternative)

(a) Current transactions

(b) Capital transactions

(c) Autonomous transactions

(d) Accommodating transactions

Ans: ***Autonomous transactions*** are the foreign exchange transactions which are independent of other transactions in the Balance of Payments Account.

Hence, the correct answer is option (c).

Q17 Primary deficit equals :

(Choose the correct alternative)

(a) Borrowings

(b) Interest payments

(c) Borrowings less interest payments

(d) Borrowings and interest payments both

Ans: Primary deficit equals *borrowings less interest payments.*

Hence, the correct answer is option (c).

Q18 National income is the sum of factor incomes accruing to :

(Choose the correct alternative)

(a) Nationals

(b) Economic territory

(c) Residents

(d) Both residents and non-residents

Ans: National income is the sum of factor incomes accruing to *Residents*

Hence, the correct answer is option (c).

Q19 Define fiscal deficit.

Ans: Fiscal deficit refers to the difference between the total budget expenditure and total budget receipts of the government, other than the borrowings and liabilities.

Q20 Define flows.

Ans: A variable is said to be a flow variable, if it is measured over (during) a period of time. They have an element of time attached to them. For example, income earned during the month of March is a flow variable.

Q21 An economy is in equilibrium. Find investment expenditure :

National income	=	**1200**
Autonomous consumption expenditure	=	**150**
Marginal Propensity to consume	=	**0.8**

Ans: Given,

Y= Rs 1,200

$\bar{C} = Rs\,150$

$c = 0.8$

$We\ know,\ At\ Equilibrium$

$Y = C + I$

$\Rightarrow 1,200 = \bar{C} + cY + I$

$\Rightarrow 1,200 = 150 + 0.8 \times 1,200 + I$

$\Rightarrow 1,200 = 1,110 + I$

$\therefore I = Rs\,90$

Q22 If nominal income is Rs 500 and price index is 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$= \frac{500}{125} \times 100$

$\therefore$Real Income=Rs 400

Q23 What is aggregate demand? State its components.

Ans: Aggregate demand implies the total demand of final goods and services by all the people in an economy. It expresses the total demand in terms of money. In this manner, it

can be defined as the actual aggregate expenditure incurred by all the people in an economy on different goods and services.

The componets of aggregate demand are enlisted below.

1) ***Private Consumption Expenditure (C)***: Private consumption expenditure refers to the total expenditure incurred by all the households in an economy on different types of final goods and services in order to satisfy their wants. Consumption depends on the level of the disposable income. There are two types of consumption expenditure- Autonomous Consumption Expenditure and Induced Consumption Expenditure.

2) ***Private Investment Expenditure (I)***: Private investment expenditure refers to the planned (ex-ante) total expenditure incurred by all the private investors on creation of capital goods such as, expenditure incurred on new machinery, tools, buildings, raw materials, etc. Broadly, investment can be categorised in two types- Autonomous Investment Expenditure and Induced Investment Expenditure.

3) ***Government Expenditure (G)***: Government expenditure refers to the total planned expenditure incurred by the government on consumption and investment purposes to enhance the welfare of the society and to achieve higher economic growth rates.

4) ***Net Exports (X – M)***: Net exports refers to the difference between the demand for domestically produced goods and services by the rest of the world (exports) and the demand for goods and services produced abroad by the residents of a country. In other words, it is the difference between the exports and imports. That is,

Net exports = ***Total Exports – Total Imports***

OR

Explain how controlling money supply is helpful in reducing excess demand.

Ans: There are different policy instruments through which the monetary authority regulates the money supply, thereby, helpful in reducing excess demand in the economy. The following are the various monetary policy instruments that the central bank uses to combat the excess demand.

1. ***Bank Rate***- Bank rate refers to the rate at which the central bank provides loans to the commercial banks. This instrument is a key at the hands of RBI to control the money supply. Changes in the bank rate change the cost of borrowings, thereby affect the money supply and aggregate demand. In case of excess demand, central bank raises the bank rate, thereby increases the cost of borrowings for the commercial banks. This discourages the demand for

loans and credits in the market. Therefore, the consumption expenditure falls and hence, aggregate demand falls.

2. ***Open Market Operations (OMOs)***- Open Market Operations refer to the buying and selling of securities either to the public or to the commercial banks in an open market. These operations are carried out by the central bank to affect the money supply in the economy. In case of excess demand, the central bank sells the securities, in order to restrict the supply of the money in the market. This reduces the spending capacity of the people, resulting in a lower level of aggregate demand, thereby, reduces the excess demand.

3. ***Cash Reserve Ratio (CRR)***- It refers to the minimum proportion of the total deposits that the commercial banks have to maintain with the central bank in form of reserves. Through *CRR*, the central bank influences the level of aggregate demand by controlling the availability of credit in the market. In case of excess demand, the central bank raises *CRR*. This implies that the commercial banks have to maintain a greater portion of their deposits in form of reserves with the central bank. This reduces the lending capacity of the commercial banks, consequently, lesser volume of credit and loans will be granted to the public. This further reduces the flow of money in the economy thereby reduces the level of aggregate demand.

4. ***Statutory Liquidity Ratio (SLR)***- Statutory Liquidity Ration (*SLR*) is defined as the minimum percentage of assets to be maintained by the commercial banks with themselves in the form of either fixed or liquid assets. Similar to the *CRR*, the central bank uses *SLR* to influence the aggregate demand by affecting the flow of credit. In case of excess demand, the central bank raises *SLR*. This restricts the commercial banks to pump additional money into the economy. As a result, money supply is reduced, resulting in lowering of the aggregate demand.

Q24 Explain the role of Cash Reserve Ratio in controlling credit creation.

Ans: Cash reserve ratio (*CRR*)- It refers to the minimum proportion of the total deposits that the commercial banks has to maintain with the central bank in form of reserves.

An increase in the *CRR*, would mean that banks would be required to keep a greater portion in form of deposits with the central bank. This implies that the commercial banks are left with lesser amount of funds to lend out. Hence, the lending capacity of the banks reduces, leading to fall in the money supply. On the contrary, a fall in *CRR* will lead to an increase in the money supply.

To summarise,

CRR ↑⇒ Deposits with the banks ↓
⇒ cash reserves of the bank ↓
⇒ Lending capacity of banks ↓
⇒ Money supply ↓
CRR ↓⇒ Deposits with the banks ↑
⇒ cash reserves of the bank ↑
⇒ Lending capacity of banks
↑⇒ Money supply ↑

Q25 Sale of petrol and diesel cars is rising particularly in big cities. Analyse its impact on gross domestic product and welfare.

Ans: Due to rising sale of petrol and diesel cars in big cities, the pollution level will increase. Due to increase in pollution level, people will suffer from respiratory diseases, lung cancer, etc. This will reduce the welfare of people.

As the sale of petrol and diesel cars is rising in big cities, it means people are demanding more cars. To meet the increasing demand of the people, producers will increase their level of production of cars leading to rise in *GDP*.

Q26 Explain the 'medium of exchange' function of money. How has it solved the related problem created by barter?

Ans: ***Medium of Exchange-*** Money acts as medium of exchange as it facilitates exchange through a common medium i.e. currency. With money as a medium, the two components of a transaction namely, sale and purchase can be easily separated. In other words, money eliminates the need for double coincidence of wants for an exchange to take place and can be performed independently of each other. Moreover, money has widened the domain and scope of market. Today, market is no more limited to a specific geographical location. This can be verified by the increasing popularity of online transactions. Hence, it can be concluded that money has infused commercialisation, which has raised the overall level of economic activities and has made production market oriented.

With money as a medium of exchange, the value of goods and services is measured under a common unit. For example, it is difficult to calculate the value of a horse in terms of rice. 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 deferred 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 Calculate Net National Product at Market Price and Private income.

		(Rs crores)
(i)	Net current transfers to abroad	10
(ii)	Private final consumption expenditure	500
(iii)	Current transfers from government	30
(iv)	Net factor income to abroad	20
(v)	Net exports	(–) 20
(vi)	Net indirect tax	120
(vii)	National debt interest	70
(viii)	Net domestic capital formation	80
(ix)	Income accruing to government	60
(x)	Government final consumption expenditure	100

Ans: GDP_{MP} = Private final consumption expenditure + Government final consumption expenditure + (Net domestic capital formation + Depreciation) + Net exports

⇒ GDP_{MP} = 500 + 100 + (80 + 0) + (–20)

⇒ GDP_{MP} = Rs 660 crores

NNP_{MP} = GDPMP – Depreciation – Net factor income to abroad

⇒ NNP_{MP} = 660 – 0 – 20

∴ NNP_{MP} = Rs 640 crores

Private income = NNP_{MP} – Net indirect tax – Income accruing to government + Current transfers from government – Net current transfers to abroad + National debt interest

⇒ Private income = 640 – 120 – 60 + 30 – 10 + 70

∴ Private income = Rs 550 crores

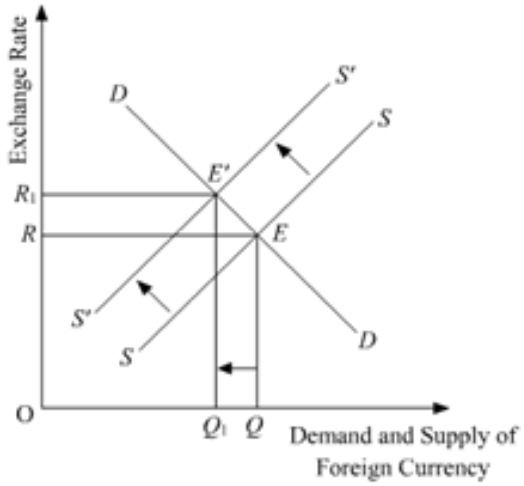
Q28 Indian investors lend abroad. Answer the following questions :

(a) In which sub-account and on which side of the Balance of Payments Account such lending is recorded? Give reasons.

(b) Explain the impact of the leading on market exchange rate.

Ans: (a) In ***Capital account*** , and on ***debit side of BOP*** , the lending of Indian investors to abroad will be recorded. Indian investors lending abroad cause an outflow of foreign exchange from the country. Thus, it is recorded as negative item in the Capital Account of BOP.

(b) Lending to abroad by Indian investors will decrease 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 rises*** from *OR* to OR_1.



Q29 Given saving curve, derive consumption curve and state the steps in doing so. Use diagram.

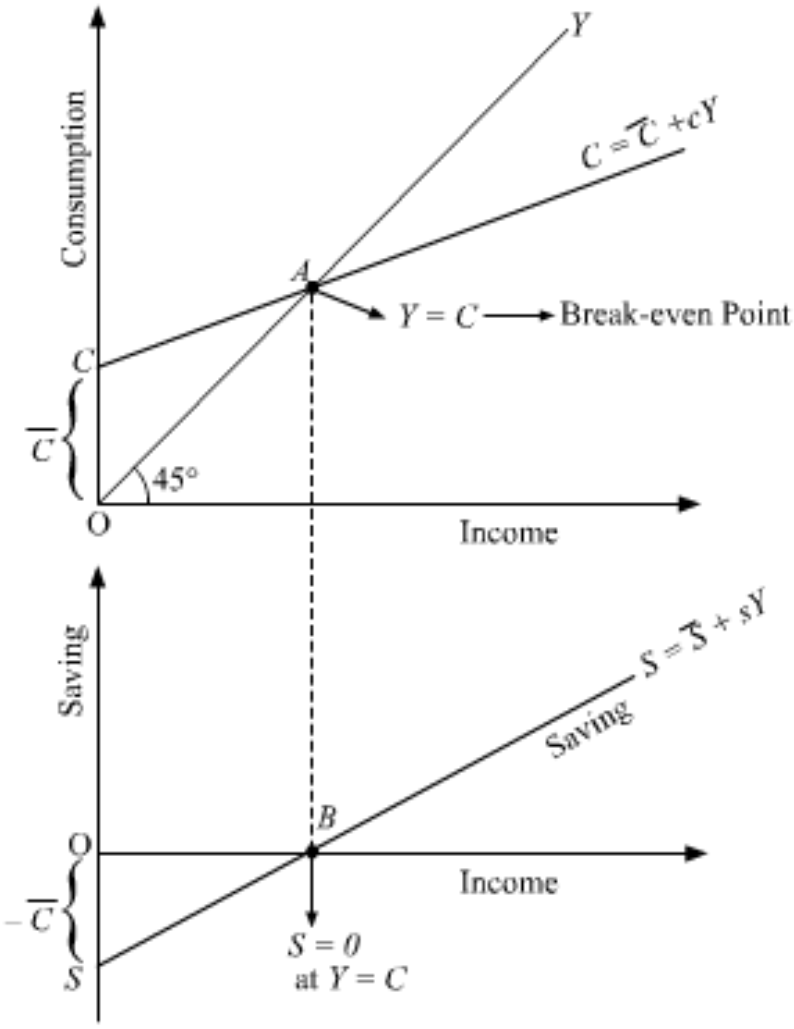
Ans: In the following figure, given is the supply curve respensted by *SS* curve. $-\overline{C}$ represents negative savings. Point *B* is break even point where $Y = C$ & $S = 0$. The following are the steps of deriving consumption curve from savings curve.

***Step* 1**: On the given Saving curve *SS*, take *OS* = *OC*.

***Step* 2**: From point *B*, draw a perpendicular meeting 45^{o} line at point *A*.

***Step* 3**: By joining the points *C* and *A* and extending the line to *C*, we derive the straight upward sloping consumption curve.

***Step* 4**: *CC* is the required consumption curve.



Q30 What is the difference between revenue expenditure and capital expenditure? Explain how taxes and government expenditure can be used to influence.

Ans:

Basis of Difference	Capital Expenditure	Revenue Expenditure
Meaning	This refers to that government expenditure, which ***causes reduction in the government liabilities as well as creates assets for the government.***	This refers to the government expenditure which ***does not cause any reduction in government liabilities and also does not create assets for the government.***
Examples	Expenditure on purchasing shares, bonds, etc.	Expenditure on salaries, pensions, subsidies, interest payments, etc.

The government through its budgetary policy attempts to promote fair and right distribution of income in a society. This is done through taxation and expenditure policy. On one hand, through its taxation policy, the government taxes the higher income group and on the other hand, through the expenditure policy (subsidies, transfer payments, etc.), it transfers the purchasing power in the hands of the poor sections of society. With the help of these policies, the government aims at fair distribution of income in the society.

Note: *The question is incomplete in the english version, however, on the basis of hindi version we have provided the solution. According to Hindi version the second part of the question is 'Explain how taxes and government expenditure can be used to influence income distribution in a society'.*

Or

What is the difference between direct tax and indirect tax? Explain the role of government budget in influencing allocation of resources.

Ans:

Direct Tax	Indirect Tax
Direct tax is ***imposed directly on the taxpayer*** and is paid by the taxpayer directly to the government. The incidence and impact of the tax is on the same person.	Indirect tax is tax ***collected*** by intermediaries (for e.g. retailers) ***from the ultimate taxpayer i.e. consumers***. The incidence and impact of the tax is on different persons.

Its ***burden cannot be transferred*** to other person.	Its ***burden can be shifted*** from one person to other. For e.g. manufacturer shifts the burden of tax to retailers who shifts it to consumers.
It ***doesn't affect the prices.***	Indirect tax may ***affect prices***, as generally consumers pay high prices which are inclusive of taxes.
Examples: Income Tax, Property Tax	Examples: VAT, Custom Duty

The *role of government budget* can in *influencing allocation of resources* is explained below.
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.