CBSE
Class 12 Economics

Time: 3 hrs **Max. Marks: 80**

General Instructions:

i. **All** questions in both sections are **compulsory**.
ii. Marks for questions are indicated against each question.
iii. Question Nos. **1–4** and **13–16** are very short answer questions carrying **1** mark each. They are required to be answered in one sentence.
iv. Question Nos. **5–6** and **17–18** are short answer questions carrying **3** marks each. Answers to them should normally not exceed **60** words each.
v. Question Nos. **7–9** and **19–21** are also short answer questions carrying **4** marks each. Answers to them should normally not exceed **70** words each.
vi. Question Nos. **10–12** and **22–24** are long answer questions carrying **6** marks each. Answers to them should normally not exceed **100** words each.
vii. Answers should be brief and to the point, and the above word limits should be adhered to as far as possible.

SECTION A

1. What is meant by marginal cost? [1]

2. Under perfect competition, AR is
a. Downward sloping
b. Upward sloping
c. Horizontal straight line
d. Rectangular hyperbola [1]

3. What is meant by increasing returns to a factor? [1]

4. How does an increase in output affect the behaviour of total variable costs? [1]

5. A consumer purchases 10 units of a commodity when the price is Rs 10 per unit. He can purchase 8 units of the commodity with an expenditure of Rs 80. Calculate the price elasticity of demand using the percentage method.

Price elasticity of demand =

$$e_d = (-)\frac{P}{Q} \times \frac{\Delta Q}{\Delta P}$$

Given : [3]

P = Rs 10

Q = 10 units

6. Explain why the chain reaction in the market price is higher than the equilibrium price. [3]

7. What is meant by production possibility curve? What will be the shape of the production possibility curve based on the following schedule? [4]

Good X (units)	***Good Y (units)***
0	10
1	8
2	5
3	1

8. Explain the difference between extension of demand and increase in demand. [4]

9. Using the MR–MC approach, find at which level of output will the producer strike equilibrium? Give reasons. [4]

Output (units)	***Marginal Revenue (Rs)***	***Marginal Cost (Rs)***
1	5	10
2	5	5
3	5	3
4	5	5
5	5	9

10. How is elasticity of demand affected by the following factors: [6]

i. Nature of commodity

ii. Availability of substitutes

iii. Variety of uses

11. Define supply. Explain the factors which affect supply. [6]

12. What can be said about products sold under perfect competition? How does it differ from products sold under monopolistic competition? [6]

SECTION B

13. What is bank rate? [1]

14. Loans offered by commercial banks are: (Choose the correct alternative)

a. Less than the deposits received by them

b. More than the deposits received by them

c. Equal to deposits received by them

d. None of the above

15. State one point of distinction between APS and MPS. [1]

16. The ratio of marginal propensity to consume and marginal propensity to save is 3:1, then the value of investment multiplier will be: (Choose the correct alternative) [1]

a. five
b. three
c. four
d. six

17. State the merits and demerits of fixed exchange rate system. [3]

18. What are the difference between balance of trade (BOT) and balance of payments (BOP)?

[3]

19. Calculate the value of intermediate consumption from the following information: [4]

Particulars	In Rs crore
i. Net value added at factor cost	100
ii. Sales tax	20
iii. Depreciation	10
iv. Value of output	300
v. Subsidy	10

20. How does money solve the problem of double coincidence of wants and lack of measure of value as faced under the barter system? [4]

21. In an economy, a unit increase in investment brings about an increase in income which is two times more than the increase in investment. What is the value of marginal propensity to consume? [4]

Suppose increase in investment = ΔI

Then, increase in income = $2\Delta I + \Delta I = 3\Delta I$

Now,

$$\text{Multiplier} = \frac{\Delta Y}{\Delta I} = \frac{3\Delta I}{\Delta I} = 3$$

22. What is revenue deficit? What does it indicate and how can it be reduced? [6]

23. Explain national income determination through the AD–AS approach. [6]

24. Calculate GDP at factor cost from the following information: [6]

Particulars	In Rs crore
i. Net domestic capital formation	100
ii. Change in stock	20
iii. Private final consumption expenditure	500

iv.	Government final consumption expenditure	500
v.	Net exports	30
vi.	Consumption of fixed capital	10
vii.	Net indirect taxes	150
viii.	Net factor income from abroad	30

CBSE
Class XII Economics
Solution

Answer 1

Marginal cost refers to the change in total cost per unit increase in output.

Answer 2

The correct answer is (c). Under perfect competition, a firm is a price taker. Accordingly, the price is fixed in the market. So, the AR curve is a horizontal straight line parallel to the x-axis.

Answer 3

Increasing returns to a factor refers to a situation where a proportionate increase in factor of production brings about a more than proportionate increase in output. Here, the total product increases at an increasing rate.

Answer 4

An increase in output affects the behaviour of total variable costs (TVC) because TVC vary directly with the level of output i.e. TVC rise with increase in the output and fall with decrease in the output.

Answer 5

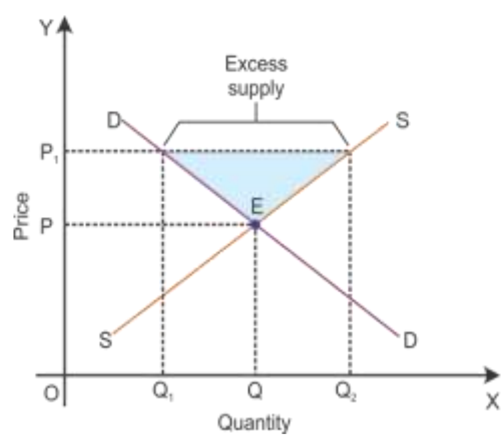
$P_1 = \frac{80}{8} = 10$

$Q_1 = 8$ units

Substituting the given values

$e_d = (-)\frac{10}{10} \times \frac{2}{0} = \mu$

Answer 6



In the diagram, DD is the initial demand curve and SS is the initial supply curve. Point E is the initial equilibrium point where DD intersects SS. Correspondingly, OQ is the equilibrium quantity and OP is the equilibrium price. Suppose the market price is P_1 which is more than the equilibrium price. At this price, the quantity demanded is OQ_1 and the quantity supplied is OQ_2. Thus, there is excess supply in the market. This implies that there is excess stock with the producers. To clear the stock, the producers reduce the market price. This reduction in the market price increases the demand (represented by a downward movement along the demand curve). This fall in price, increase in demand and fall in supply will continue till equilibrium Point E is reached and the market is cleared.

Answer 7

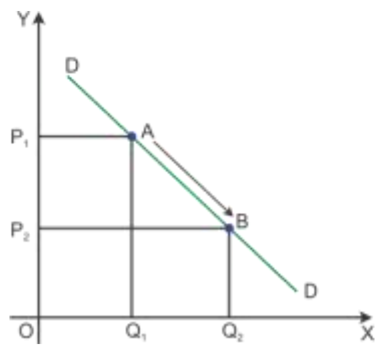
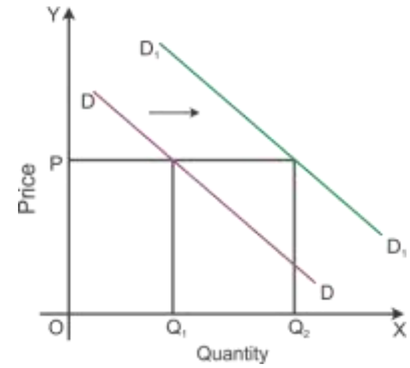
The production possibility curve refers to the curve which presents the alternative combinations of production possibilities of two goods which can be produced with the given resources and the given technology.

The slope of the production possibility curve is indicated by the marginal opportunity or the marginal rate of transformation. Opportunity cost refers to the units of one good which must be sacrificed for each additional unit of the other good.

Good X (units)	***Good Y (units)***	***Opportunity Cost*** $\frac{\Delta Y}{\Delta X}$
0	10	-
1	8	2
2	5	3
3	1	4

Answer 8

Extension of Demand	***Increase in Demand***
It refers to a rise in demand for a commodity because of a rise in its own price.	It refers to a rise in demand for a commodity because of factors other than the price.
Fall in price is the only factor which leads to extension of demand.	Factors which cause increase in demand: • Increase in income of the consumer • Rise in price of substitute good • Fall in price of complementary good • Change in taste and preferences in favour of the good

Diagrammatically, it is depicted by a downward movement along the same demand curve. 	Diagrammatically, it is depicted by a parallel rightward shift of the demand curve. 

Answer 9

According to the MR–MC approach, a consumer strikes equilibrium at the point where the following two conditions are met:

a. MR is equal to MC
b. MC is rising

The two conditions are met when 4 units of output are produced. At this point, MR and MC are equal to 5.

MR is equal to MC at 2 units of output as well. However, at this point, MC is falling. So, this is not the equilibrium point.

Answer 10

a. ***Nature of commodity***: Elasticity of demand of a commodity depends on the nature of the commodity. Necessities have low price elasticity, i.e. the quantity demanded of necessities does not change much with the change in the price of the commodity. On the other hand, luxuries have high price elasticity, i.e. the quantity demanded is highly responsive to change in price.
b. ***Availability of substitutes***: If a commodity has a large number of close substitutes, then the demand for it would be relatively more elastic. This is because in case of a rise in price, a consumer can easily shift the demand towards the substitutes, thereby highly reducing the quantity demanded.
c. ***Variety of uses***: If a commodity can be put to a large variety of uses, then it will have relatively elastic demand. This is because in case of a rise in price, the use for unnecessary purposes can be reduced, and thereby the total quantity can be reduced.

Answer 11

Supply of a commodity refers to the various quantities of the commodity which the producers are willing to offer for sale at different prices.

Factors which affect supply:

i. ***Price of the commodity***: Quantity supplied of a commodity is directly related to its price. Higher the price, higher is the quantity supplied and *vice versa*.

ii. ***Price of related goods***: Supply of a commodity also depends on the price of the related goods. For instance, if the price of the substitute good rises, the supply of the concerned good would fall and *vice versa*. This is because the producer would be willing to supply more of the substitute good.

iii. ***Number of firms***: A rise in the number of firms in the industry would lead to arise in the total supply and *vice versa*.

iv. ***Price of raw material and other factors of production***: If the price of raw material or other factors of production increases, then this implies an increase in the cost of production. Accordingly, the firms would be willing to supply more quantity of the commodity at the existing price.

v. ***Government policies***: Government policies related to taxes and subsidies also affect the quantity supplied of a commodity. For instance, an increase in taxes may lead to a reduction in the supply of the commodity.

Answer 12

Under perfect competition, products sold by firms are completely homogeneous. In other words, they are exactly identical to each other in terms of size, shape and colour. Accordingly, the products of various firms are perfect substitutes of each other. Also, there is no need for any kind of selling costs or advertising costs.

The presence of homogeneous products has the following implications:

i. No single firm can control the market prices. There prevails uniform market price.

ii. There is absolutely zero product differentiation.

iii. Because of homogeneity of products, the market price which prevails is the minimum possible.

As against this, under monopolistic competition, there is product differentiation. Product differentiation means that the products sold by different firms are only close substitutes of each other. The products serve the same purpose but differ in terms of certain features such as size, colour, packaging and certain ingredients.

Product differentiation under monopolistic competition has the following implications:

i. Firms are able to exercise some control over the market price.

ii. Because a large number of close substitutes are available in the market, the price elasticity of demand is very high.

iii. A large variety or choice of products is available to consumers.

SECTION B

Answer 13

Bank rate refers to the rate at which the Central Bank lends to the commercial bank. Bank rate is used by the Central Bank as an instrument of credit control in the economy.

Answer 14

The correct option is (b). Loans offered by commercial banks are many times more than the deposits received by them. This function of the bank is known as *money creation*.

Answer 15

APS	MPS
Average propensity to save (APS) refers to the ratio of saving and the corresponding level of income.	Marginal propensity to save (MPS) refers to the ratio of change in savings to change in income.

Answer 16

The correct option is (C).

Ratio of 3:1 between marginal propensity to consume (MPC) and marginal propensity to save (MPS) shows that

$$\mathrm{MPC} = \frac{3}{4} = 0.75$$

$$\mathrm{MPS} = \frac{1}{4} = 0.25$$

$$\text{Therefore, investment multiplier}(\mathrm{k}) = \frac{1}{\mathrm{MPS}} = \frac{1}{0.25} = 4$$

Answer 17

Merits of fixed exchange rate system:

- **Promotes international trade**: This builds the confidence among the people because the existing exchange rate will remain the same in future. Thus, promotes foreign trade and smooth flow of capital movements.
- **Removes speculation**: As the exchange rates are fixed by the government, it removes the chances of speculative activities in foreign exchange.

Demerits of fixed exchange rate system:

- **Requires huge foreign exchange reserves**: The government requires huge foreign exchange reserves to keep the exchange rate at the fixed level. This limits the flow of capital movements and obstructs the international growth.
- **No fixed exchange rates: Generally, the exchange rates are kept fixed but sometimes it is difficult to keep the** rates fixed. This is because of the fluctuations in the international market and other other unfavourable balance of payments. commodity prices.

Answer 18

Balance of Trade (BOT)	Balance of Payments (BOP)
It refers to difference between exports and imports of goods.	It refers to accounting statement which provides information of all economic transactions take place between residents of the country and rest of the world at a particular period of time.
It includes only visible items.	It includes visible items, invisible items, capital transfers and unilateral transfers.
It is a narrow concept as compared to BOP. It is in fact a part of BOP.	It is a wide concept as compared to BOT. It includes BOT.

Answer 19

Intermediate consumption = Value of output − Net value added at factor cost − Depreciation − (Sales tax − Subsidy)
= 300 − 100 − 10 − (20 − 10)
= Rs 180 crore

Answer 20

With money as a medium of exchange, the need for the existence of double coincidence of wants is eliminated. With money, goods and services can be sold and purchased independently. In other words, money enables the separation of the acts of selling and buying. That is, purchasing and selling can be done at different points of time.
In the barter system, there was no common unit in which the value of different commodities and services could be measured. The value of one commodity was measured in terms of another commodity for which it would be exchanged. As against this, money forms the common unit in which the value of all the commodities can be measured.

Answer 21

Also,

$$\text{Multiplier} = \frac{1}{1 - \text{MPC}}$$

$$3 = \frac{1}{1 - \text{MPC}}$$

$$1 - \text{MPC} = \frac{1}{3}$$

$$\text{MPC} = 0.7$$

Answer 22

Revenue deficit in a budget refers to a situation where the revenue receipts of the government are less than the revenue expenditure during a fiscal year.

Revenue Deficit = Revenue Expenditure − Revenue Receipts

Indications

Implications of revenue deficit:

i. The government is not able to meet its routine expenditure.
ii. The government is using savings to meet its consumption expenditure.
iii. The government is using the capital receipts to cover the deficit, i.e. it is either creating liabilities or reducing its assets.
iv. Borrowings to meet the deficit lead to inflationary pressures in the economy.

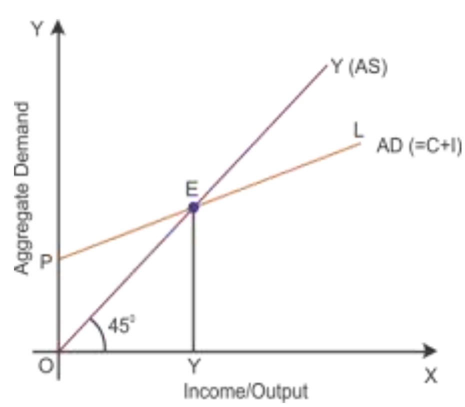
Reduction

Revenue deficit can be reduced through the following measures:

i. Reducing expenditure: Unnecessary and unproductive expenditure of the government should be reduced.
ii. Increasing revenue: Receipts from various taxes and non-tax sources should be increased.

Answer 23

According to the AD–AS approach, the equilibrium level of income is determined at the point where aggregate demand is equal to aggregate supply.



According to the diagram, aggregate demand (the summation of consumption and investment) is represented by the curve PL. On the other hand, aggregate supply is represented by the 45 degree line.
The equilibrium is determined at Point E where the AD curve and the AS curve intersect each other. Corresponding to this, the equilibrium level of income is *OY*.
In case there is any deviation from the equilibrium, a readjustment would start which would again push the economy to equilibrium.
In a situation when AD is more than AS, there would be a fall in the level of planned inventory. To restore the level of inventory, firms would increase output and employment until the equilibrium level of output is again reached.
On the other hand, when AD is less than AS, there is a rise in the level of planned inventory. To correct the situation, firms reduce the level of output and employment until the equilibrium level is again reached.

Answer 24

GDP at factor cost = Private final consumption expenditure + Government final consumption expenditure + Net domestic capital formation + Net exports + Consumption of fixed capital − Net indirect taxes

= 500 + 500 + 150 + 30 + 10 − 150

= Rs 1,040 crore