CBSE
Class XII 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. Ram opens a new factory for which he takes a building on rent. He manages the factory himself.
Identify the explicit cost and implicit cost in the given situation. [1]

2. A firm under which of the following forms of market follows price discrimination? [1]
a. Perfect competition
b. Monopoly
c. Oligopoly
d. Monopolistic competition

3. What is AFC? [1]

4. When the supply of a good changes due to change in any factor other than the own price of the good, it is known as: (Choose the correct alternative) [1]
a. Change in supply
b. Expansion in supply
c. Contraction in supply
d. Change in quantity supplied

5. A consumer consumes two Goods X and Y which are priced at Rs 5 each. The combination of the two goods chosen by the consumer is such that the marginal rate of substitution is 5. Is the consumer in equilibrium? How would a rational consumer react in the given situation? [3]

6. Market for a good is in equilibrium. With the help of a diagram, explain the chain reaction which would take place if there is increase in demand. [3]

7. a. What is economic problem? Why does it arise?
b. State the differences between microeconomics and macroeconomics. [4]

8. Explain the impact of the following on the demand for a commodity: [4]
a. Income of the consumer
b. Future expectations

9. A producer supplies 8 units of a commodity at Rs 10 per unit. If the price elasticity of supply is 1.25, how many units of the commodity will the producer supply at Rs 12 per unit? [4]

10. A consumer consumes two goods. Explain his equilibrium using utility analysis. [6]

11. Explain producer's equilibrium with the help of TR–TC approach. [6]

12. Differentiate between monopoly and monopolistic competition. [6]

SECTION B

13. State the two sources of revenue receipts. [1]

14. Which of the following deficits in government budget indicate the total borrowing requirements of the government: [1]
a. Revenue deficit
b. Fiscal deficit
c. Primary deficit
d. None of the above

15. Why can value of APC never be zero? [1]

16. Which of the following is the impact of excess demand? (Choose the correct alternative)[1]
a. Increase in the level of employment
b. Increase in the general price level
c. Decrease in the level of employment
d. Decrease in the level of employment

17. Explain the following functions of money: [3]

a. Medium of exchange
b. Standard of deferred payments

18. Why is the Central Bank called the banker to the government? [3]

19. Calculate the value of national income from the following information: [4]
Autonomous consumption = Rs 150 crore
Marginal propensity to consume = 0.80
Investment = Rs 60 crore

20. Calculate private income from the following information: [4]

Particulars	In Rs crore
i. Net factor income from abroad	50
ii. Corporation tax	30
iii. Income from domestic product accruing to the private sector	3000
iv. Current transfers from government	100
v. Current transfers from ROW	30

21. What is meant by government budget? Explain how the government budget helps in bringing economic stability and economic growth. [4]

22. Explain the determination of national income through the saving-investment approach. How will the equilibrium be reached if saving is more than investment? [6]

23. Calculate national income from the following information: [6]

Particulars	In Rs crore
i. Gross domestic fixed capital formation	100
ii. Net domestic fixed capital formation	50
iii. Net indirect taxes	10
iv. Net imports	−10
v. Change in stock	20
vi. Private final consumption expenditure	500
vii. Net factor income from abroad	15
viii. Government final consumption expenditure	300
ix. Net current transfers from abroad	10

24. Explain the determination of the exchange rate under the flexible exchange rate regime.

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Solution

SECTION A

Answer 1
Explicit cost: Cost of rent of the building
Implicit cost: Cost of managerial services provided by Ram

Answer 2
The correct answer is (b). Price discrimination refers to charging a different price for the same product from different buyers. It is a feature of a monopoly firm.

Answer 3
Average fixed cost (AFC) refers to the fixed cost per unit of output. Algebraically,

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

Answer 4
The correct answer is option (a). When the supply of a good changes due to change in any factor other than the own price of the good, it is known as change in supply. This leads to shift in the supply curve either rightward or leftward.

Answer 5
According to the indifference curve analysis, a consumer is at equilibrium when

$$MRS_{xy} = \frac{P_x}{P_y}$$

According to the given information,

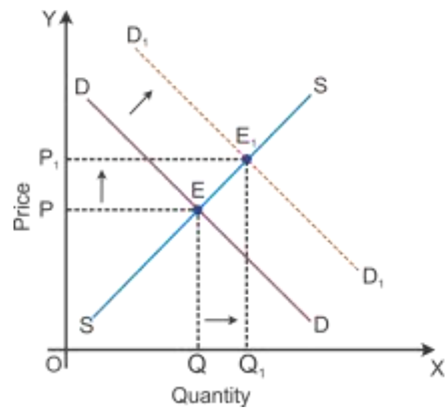
$$MRS_{xy} = 5$$

$$\frac{P_x}{P_y} = \frac{5}{5} = 1$$

$$\text{So}, MRS_{xy} > \frac{P_x}{P_y}$$

To restore equilibrium, the consumer would increase consumption of Good X and reduce consumption of Good Y.

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. With the increase in demand, the demand curve shifts parallelly outwards to D′D′. However, the supply remains the same. At the existing price, there is excess demand in the market. As a result, the price tends to rise. With the rise in price, the quantity demanded tends to fall, while the quantity supplied tends to rise. This process continues till excess demand is eliminated.

The new equilibrium is established at Point E′ where D′D′ intersects SS. Here, both equilibrium price and equilibrium quantity have risen to OP_1 and OQ_1, respectively. However, the rise in price is more than the rise in quantity.

Answer 7

a. Economic problem or the problem of choice refers to the problem of allocating resources to different alternative uses in the face of limited means and unlimited wants.
Reasons for economic problem:

i. ***Scarcity of resources***: In every economy, resources are always scarce in relation to the needs and wants. No matter how much resources economy may have, it will not be able to satisfy all the needs. The problem of scarcity of resources cannot be avoided at all.

ii. ***Alternative uses of resources***: Resources are not just scarce in relation to the needs, but they can be put to different alternative uses as well. For example, a piece of land can be used for farming or for the construction of a building. Accordingly, the resources must be managed and put to the best possible use.

b. Differences between microeconomics and macroeconomics:

Microeconomics	***Macroeconomics***
Microeconomics refers to the study of economic problem at the individual or household level.	Macroeconomics refers to the study of economic problem or the problem of choice for the economy as a whole.
It deals with the determination of price and output for an individual firm or industry.	It deals with the determination of general price and aggregate output for the economy as a whole.

It studies partial equilibrium, i.e. it assumes that macro variables remain constant.	It studies general equilibrium, i.e. various variables change simultaneously.

Answer 8

a. ***Income of the consumer***: How the income of the consumer affects the demand depends on the type of good.
   i. Normal goods: For normal goods, as the income of the consumer increases, the demand increases and *vice versa*.
   ii. Inferior goods: In case of inferior goods, with an increase in income, the demand decreases and *vice versa*.

b. ***Future expectations***: Future expectations about the price and availability of the commodity also affect the demand for the commodity. For instance, if the consumer expects that there would be a shortage of the commodity in the future, then he will increase the demand even at the existing price.

Answer 9

Given

Initial price $(P) = Rs\,10$

Final price $(P_1) = Rs\,12$

Initial Quantity $(Q) = 8$

Price elasticity $(e_s) = 1.25$

Let the final quantity be Q_2

Now,

$$e_s = \frac{P}{Q} \times \frac{\Delta Q}{\Delta P}$$

$$1.66 = \frac{P}{Q} \times \frac{\Delta Q}{\Delta P}$$

$$1.25 = \frac{10}{8} \times \frac{\Delta Q}{(12-10)}$$

$$\Delta Q = 2$$

So, final quantity $= (8+2) = 10$ units

Answer 10

According to the utility analysis, if a consumer consumes two goods, then he strikes his equilibrium when the last rupee spent on Good X or Good Y yields the same level of satisfaction.

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

In other words, a consumer is at equilibrium or derives maximum satisfaction when the rupee worth of marginal utility derived from the two commodities is equal.

This can be better understood with the help of the following example:
Suppose a consumer consumes two commodities *X* and *Y*, both priced at Rs 5 per unit. He has a total of Rs 140 with him. The marginal utility schedule of the two commodities is given below:

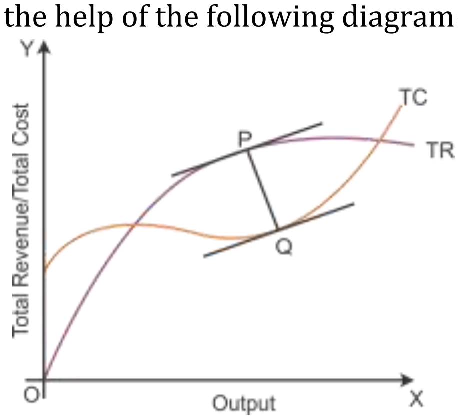
Units	**Marginal Utility of X (utils)**	**Marginal Utility of Y (utils)**
1	30	40
2	25	35
3	20	28
4	15	20
5	10	10
6	0	0

The consumer would strike equilibrium at the point where

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

Now, because the price of the two commodities is equal, the equation becomes
$MU_x = MU_y$
The consumer strikes equilibrium where he consumes 3 units of Commodity X and 4 units of Commodity Y, where the marginal utility of both commodities is equal to 20.

Answer 11
According to the TR–TC approach, a producer strikes equilibrium at the point where the difference between total revenue and total cost is maximum, or in other words, where the total profits are maximised.
This corresponds to the situation of marginal revenue equal to marginal cost and rising marginal cost.
This can be understood with the help of the following diagram:



According to the diagram, TR and TC are the total revenue and total cost curve, respectively. The difference between the two is maximised at PQ.

Note that at this point, the slope of TR, i.e. MR (as given by tangent at Point P) is equal to slope of TC, i.e. MC (as given by tangent at Point P).
Moreover, at Point Q, TC is increasing at an increasing rate. So, MC is rising at this point.

Answer 12

Monopolistic Competition	***Monopoly***
There are a large number of buyers and sellers.	There is a single seller against a large number of buyers.
The entry of new firms in the market is not restricted.	There is restriction to the entry of new firms.
A firm under monopolistic competition faces a relatively more elastic demand curve.	The demand curve faced by the firm is relatively less elastic.
A single firm has only partial control over the price.	The monopolist has complete control over the price.
Due to differentiated products, selling costs are highly essential.	No selling costs are required under monopoly.
In the long run, a firm under monopolistic competition earns normal profits.	In the long run, a monopoly firm earns super normal profits.

SECTION B

Answer 13

The two sources of revenue receipts are tax receipts (direct taxes and indirect taxes) and non-tax receipts (such as receipts from interest, fines and interests).

Answer 14

The correct answer is (b). It is the fiscal deficit which indicates the total borrowing requirements of the government. Fiscal deficit refers to a budgetary situation where the total receipt of the government (excluding borrowings) is less than the total expenditure of the government.

Answer 15

APC can never be zero because consumption can never be zero. Even at zero level of income, consumption is not zero (there is autonomous consumption). Accordingly, APC cannot be zero.

Answer 16

The correct answer is option (b). Excess demand increases the general price level (inflation) i.e. continuous increase in price without any increase in the output and employment.

Answer 17

a. ***Medium of exchange***: Money is used as a medium of exchange in various transactions. It is accepted as a mode of payment in various transactions of goods and services. With money as a medium of exchange, selling and buying can be conducted independently. That is, purchasing and selling can be done at different points of time.

b. ***Standard of deferred payments***: Standard of deferred payments means making payments in the future. With money as a medium of exchange, such transactions can also be undertaken wherein payments are not made immediately. In this way, money enables borrowing and lending operations in the economy, which in turn helps in capital formation.

Answer 18

The Central Bank is called the banker to the government as it performs the various banking functions for it. It acts as a banker, agent and advisor to the government. In doing so, it performs the following functions for the government:

i. Maintaining a current account for cash balances of the government
ii. Accepting receipts and making payments on behalf of the government
iii. Carrying out exchange remittances and various other banking operations
iv. Providing loans to the government
v. Managing public debt
vi. Advising the government on economic, financial and monetary matters

Answer 19

We know,

National Income, $Y = C + I$

Now,

$C = \bar{C} + cY$

So,

$Y = \bar{C} + cY + I$

$Y = 150 + 0.80Y + 60$

$0.20Y = 210$

$Y = \text{Rs } 1{,}050 \text{ crore}$

Answer 20

Private income = Income from domestic product accruing to private sector + Net factor income from abroad + Current transfers from government + Current transfers from ROW

= 3,000 + 50 + 100 + 30

= Rs 3,180 crore

Answer 21

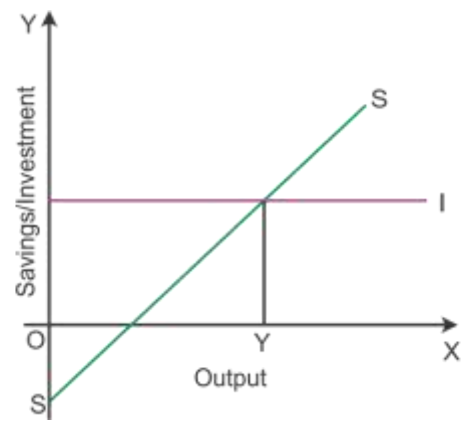
Government budget refers to an annual financial statement which presents the estimated receipts and expenditures of the government during a financial year.

Government budget helps in bringing stability in the economy. Every economy witnesses fluctuations in the form of inflation or deflation. Different budgetary policies are used to combat different phases in business cycles. In the phase of inflation, policy of surplus budget is followed. On the other hand, in the phase of deflation, policy of deficit budget is followed.

Another major objective of the government budget is economic growth. For this, the budgetary policies aim at stimulating the rate of saving and investment in the economy. Various provisions and policies are followed such that they raise the rate of saving and investment in the economy.

Answer 22

According to the saving–investment approach, equilibrium is attained at the point where planned saving is equal to planned investment.



According to the diagram, equilibrium is attained at Point E, where the saving curve SS intersects the investment curve I. Corresponding to this, the equilibrium level of output is OY.

In case of any deviation from the equilibrium level of output, a readjustment would start which would again bring back the economy to equilibrium.

If planned saving is more than planned investment, then there would be a rise in the level of inventory. To correct the situation, firms would reduce output and employment till investment and saving become equal to each other.

On the other hand, if planned saving is less than planned investment, then there would be a fall in the level of inventory. To correct the situation, firms would increase output and employment till investment and saving become equal to each other.

Answer 23

National income = Private final consumption expenditure + Government final consumption expenditure + (Net domestic fixed capital formation + Change in stock) − Net imports + Net factor income from abroad − Net indirect taxes

= 500 + 300 + (50 + 20) − (−10) + 15 − 10

= Rs 885 crore

Answer 24

Under a flexible exchange rate regime, the exchange rate is determined by the forces of demand and supply.

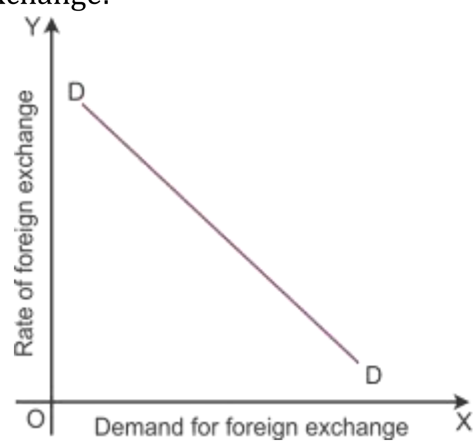
Demand for Foreign Exchange

Demand for foreign exchange arises from the need to make payments in foreign exchange. Reasons for demand for foreign exchange:

i. ***Imports***: Imports refer to purchase of goods and services from abroad. Foreign currency is required to make payments for such purchases.
ii. ***Tourism***: Foreign currency is required for meeting expenses in tourism in foreign countries.
iii. ***Unilateral transfers***: People from a domestic country often send gifts or other such unilateral transfers abroad, for which foreign currency is required.

Demand for foreign exchange varies inversely with the foreign exchange rate. As the foreign exchange rate rises, the demand for foreign exchange falls and *vice versa*.

Demand curve for foreign exchange:



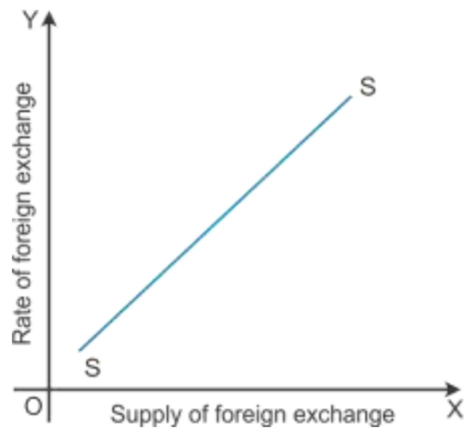
Supply of Foreign Exchange

Supply of foreign exchange arises from the receipts of foreign exchange. Reasons for supply of foreign exchange:

a. ***Exports***: Exports refer to selling of goods and services abroad. On sale of goods and services abroad, foreign exchange is received.
b. ***Foreign investment***: Foreigners may invest in the domestic country, which in turn brings in foreign exchange to the country.
c. ***Unilateral transfers***: People from the domestic country may receive gifts or other such unilateral transfers from abroad, which brings in foreign currency.

The supply of foreign exchange rate varies directly with the foreign exchange rate. As foreign exchange rate rises, the supply of foreign exchange rises and *vice versa*.

Supply curve of foreign exchange:



Equilibrium Exchange Rate

Equilibrium exchange rate is determined at the point where the demand for foreign exchange is equal to the supply of foreign exchange. Graphically, it is determined at the point where the demand curve for foreign exchange intersects the supply curve of foreign exchange.

According to the graph, the equilibrium is determined at Point E, where the demand curve DD intersects the supply curve SS. Here, the equilibrium exchange rate is OR and the equilibrium quantity of foreign exchange is OQ.