

Economics 2019 Delhi - Set 2

General Instructions :

- (i) All questions in both the 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** each.
 - (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.
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Question 1

If the market supply of a commodity X changes due to improvement in technology, the market supply curve will _____. (Fill up the blank)

OR

If the market supply of a commodity X changes due to rise in price of a factor input, the market supply curve will _____. (Fill up the blank)

SOLUTION:

If the market supply of commodity X changes due to improvement in technology, the market supply curve will shift rightwards.

OR

If the market supply of commodity X changes due to rise in price of factor input, the market supply curve will shift leftwards.

Question 2

The average product curve in the input-output plane, will be _____. (Choose the correct alternative)

- (a) an 'S' shaped curve
- (b) an inverse 'S' shaped curve

- (c) a 'U' shaped curve
- (d) an inverse 'U' shaped curve

SOLUTION:

The average product curve in the input-output plane, will be an inverse 'U' shaped curve.

Hence, the correct answer is option (D).

Average fixed cost curve _____. (Choose the correct alternative)

- (a) is a straight line parallel to X-axis.
- (b) is straight line parallel to Y-axis.
- (c) falls, as more units are produced
- (d) rises, as more units are produced

OR

Which of the following formula is correct for calculating marginal cost?

(Choose the correct alternative)

- (a) $MC_N = TFC_N - TFC_{N-1}$
- (b) $MC_N = AC_N - AC_{N-1}$
- (c) $MC_N = AVC_N - AVC_{N-1}$
- (d) $MC_N = TC_N - TC_{N-1}$

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SOLUTION:

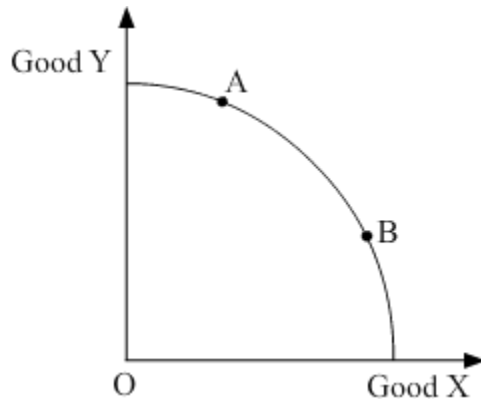
Average fixed cost curve falls as more units are produced. Hence, the correct answer is option (c).

OR

The correct formula of calculating marginal cost is $MC_n = TC_n - TC_{n-1}$
Hence, the correct answer is option (D).

Question 4

In the given figure, the movement on the production possibility curve from point A to point B shows _____. (Choose the correct alternative)



- (a) Growth of all the resources in the economy.
- (b) Underutilisation of resources.
- (c) Production of more units of Good X and less units of Good Y.
- (d) Production of more units of Good Y and less units of Good X.

SOLUTION:

In the given figure, the movement on the production possibility curve from point A to point B shows production of more units of good X and less units of Good Y.
Hence, the correct answer is option (C).

Question 5

Identify and discuss the nature of the following newspaper reports in terms of positive or normative economic analysis :

- (i) "India jumped 23 points in the World Bank's ease of doing business index to 77th place, highest in 2 years." – *The Economic Times*
- (ii) "Government should further liberalise the business rules." – *The Economic Times*

SOLUTION:

- (i) The given statement is positive in nature. This is because positive Statements are the factual statements and describe what was, what is and what would be. These statements can be tested, proven or disproven. These statements do not involve any personal value judgment. Since, the given statement is verifiable in nature therefore it is positive statement.
- (ii) The given statement is normative in nature. This is because normative Statements describe what should be or what ought to be. These statements cannot be tested and verified. Unlike positive statements, normative statements involve personal value

judgments. Usually, these statements are debatable in nature. Since, the given statement about government is opinion based statement, therefore it is normative in nature.

Question 6

Good X and Good Y are substitute goods. If price of Good X increases, discuss briefly its likely impact on the demand for Good Y.

OR

If the income of a consumer increases, discuss briefly its likely impact on the demand for a inferior good, Good X.

SOLUTION:

Substitute goods refer to those goods that are consumed in place of each other. For example Tea and coffee, etc. In the given question, two goods X and Y are substitute goods. If the price of Good X increases, the demand for Good Y will increase. If the price of the X (substitute good) rises, then demand for X will fall. As X and Y are substitute goods, so the demand for Y will increase since it is a cheaper good now. This shifts the initial demand curve for Y parallelly rightwards.

OR

Inferior goods are those which are low in quality. The demand for such goods share a negative relationship with the income such that the demand for inferior goods will decrease as the income increases and vice-versa. This is because with an increase in income, the consumers will now shift to better quality goods. So, the demand for inferior goods will decrease with an increase in income.

Question 7

Complete the following cost schedule:

Quantity (in Units)	0	1	2	3	4
Total cost (in ₹)	200	.....	.....	.....	.....
Total variable cost (in ₹)	0	.....	180	.....	.....
Average variable cost (in ₹)	—	100	.....	80	.....

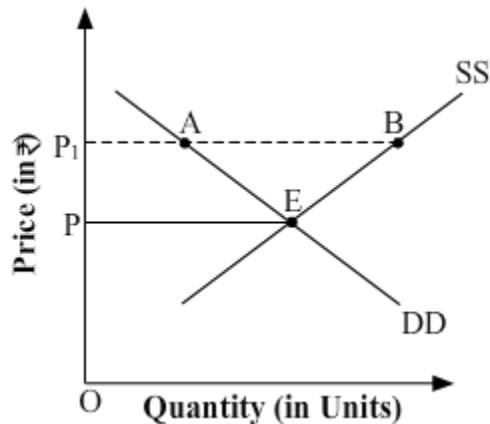
SOLUTION:

Quantity	Total Cost	Total Variable Cost	Average Variable Cost	Total Fixed Cost
0	200	0	—	200
1	300	100	100	200

2	380	180	90	200
3	440	240	80	200
4	490	290	72.5	200

Question 8

In the given diagram, OP is the market determined price and OP_1 is the price fixed by the government.



- Identify if the diagram represents, price ceiling or price flooring.
- Discuss the likely behavior of the market in the given condition.

OR

Suppose the demand and supply equations of a commodity X in a perfectly competitive market are given by :

$$Q_d = 1700 - 2P$$

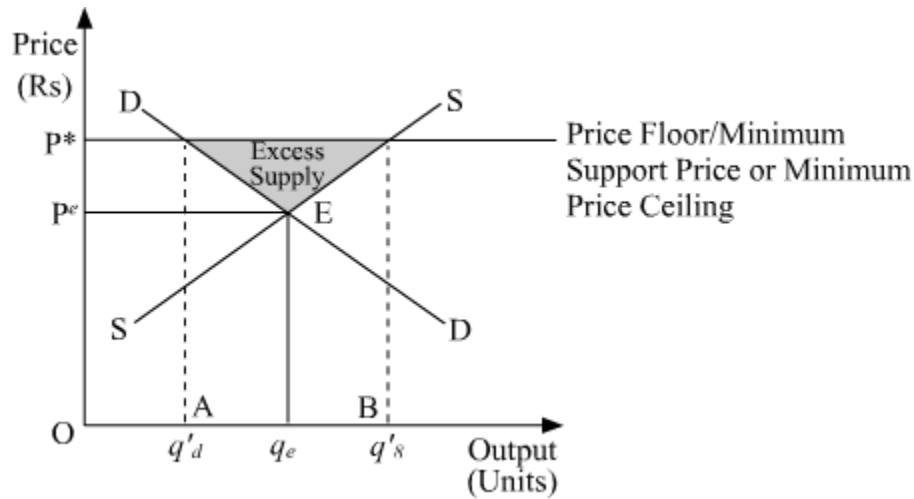
$$Q_s = 1300 + 3P$$

Calculate the value of equilibrium price and equilibrium quantity of the commodity X .

SOLUTION:

- The diagram represents price flooring.
- Price floor implies legislated or government fixed minimum price that should be charged by the seller. The minimum price is fixed above the equilibrium price. In the following figure, DD represents the market demand and SS represents the market supply. The point ' E ' represents the market equilibrium point, where the market demand and market supply intersect. The equilibrium price is OP^e and equilibrium output is Oq^e . Now, assume that the government imposes price floor at price OP_1 . At this price, the quantity demanded is $q'd$, whereas, the quantity supplied is $q's$ units. As quantity

supplied ($q's$) is more than quantity demanded ($q'd$), so there exists a situation of excess supply of AB units of a given good. (i.e. $q's - q'd$).



OR

At the point of equilibrium demand is equal to supply in a perfectly competitive market.

$$\text{So, } Q_d = 1700 - 2P$$

$$Q_s = 1300 + 3P$$

At point of equilibrium,

$$Q_d = Q_s$$

$$= 1700 - 2P = 1300 + 3P$$

$$= 1700 - 1300 = 3P + 2P$$

$$= 400 = 5P$$

$$400/5 = P_e$$

$$80 = P_e$$

$$Q_e = 1700 - 2(80)$$

$$= 1700 - 160$$

$$= 1540$$

The equilibrium price is equal to 80 and equilibrium quantity is equal to 1540 units of a commodity X.

Question 9

Explain the law of diminishing marginal utility using a hypothetical schedule.

OR

What is a budget line ? Why the budget line is left to right downward sloping?

SOLUTION:

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. This can be understood with the help of the following schedule:

Number of Units Consumed of Commodity X	Total Utility (TU) (utils)	Marginal Utility (MU) $MU_n = TU_n - TU_{n-1}$ (utils)
1	50	$50 - 0 = 50$
2	100	$100 - 50 = 50$
3	130	$130 - 100 = 30$
4	150	$150 - 130 = 20$
5	160	$160 - 150 = 10$
6	160	$160 - 160 = 0$
7	150	$150 - 160 = -10$

From the schedule, we can clearly see that with additional units of the good being consumed, the marginal utility of the consumer tends to decline.

OR

Budget Line represents the different combinations of two goods that are affordable and are available to a consumer given his/her level of income and the market prices of the

goods. The equation of the budget line is represented as follows. $P_1X_1 + P_2X_2 = M - \frac{P_1}{P_2}$

represents the slope of budget line. This is also called the **price ratio**. The negative sign depicts the negative slope of the budget line from left to right.

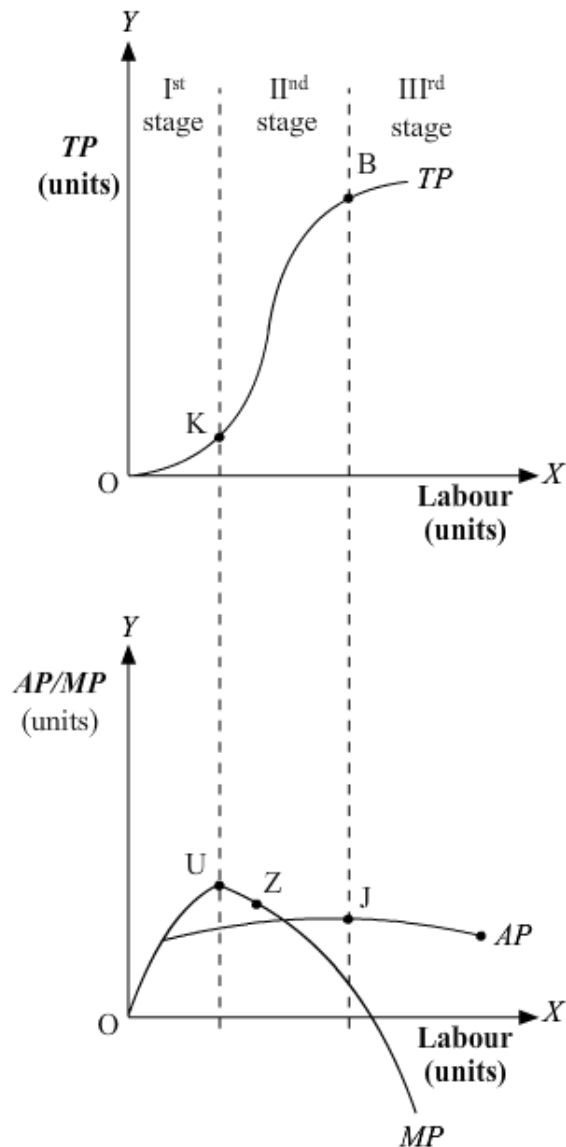
The budget line slopes downward from left to right because with a given income, a consumer cannot buy a higher amount of both goods. Rather, to increase the purchase of one good, the consumer will have to reduce the purchase of the second good. Thus, the curve slopes downward.

Question 10

What is meant by "diminishing returns to a factor" ? Discuss any two reasons for the operation of diminishing returns to a factor.

SOLUTION:

The diminishing returns to a factor depicts a particular phase under the law of variable proportion. Under this stage, the returns to a variable factor input or the marginal product is diminishing in nature, thereby giving the name 'diminishing returns to a factor'. This can be better understood with the help of the given diagram.



Here, the Diminishing Returns to a Factor is the stage that starts from point K and continues till point B on the TP curve. During this stage, the TP increases but at a decreasing rate and attains its maximum point at B, where it remains constant. On the other hand (in the figure ii), the MP curve continues to fall and cuts AP from its maximum point Z, where MP equals AP. When TP attains its maximum point, corresponding to it, MP becomes zero. AP, in this stage initially rises, attains its maximum point at Z and thereafter starts falling.

Reasons for Decreasing Returns to a Factor

a. Fuller utilisation of fixed factor- In this stage, the fixed factor is utilised to its maximum level as more and more of labour inputs are employed.

b. Imperfect substitutability between labour and capital- The variable factors are imperfect substitute for the fixed factor. Therefore, the firm cannot substitute labour for capital and as a result diminishing returns takes place.

c. Optimum Proportion/ Ideal Factor Ratio- The optimum proportion (or ideal factor ratio) is a fixed ratio in which the labour and capital inputs are employed. These factors will be the most efficient if they are employed as per the optimum proportion. If this proportion is disturbed (by combining more of labour inputs to the fixed units of capital), then the efficiency of the factors will fall, thereby leading to the diminishing returns to the factor.

Question 11

Elaborate three main features of oligopoly form of market.

OR

Distinguish between perfect monopoly and monopolistic competition on the basis of the following:

- (a) Number of sellers
- (b) Nature of product
- (c) Selling cost

SOLUTION:

The following are the features of Oligopoly:

1. **Few Large Firms-** 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.

2. **Mutual Dependence-** There exists a very high degree of mutual interdependence between the firms in an oligopoly market. The price and the quality decisions of a particular firm are dependent on the price and the quality decisions of the rival (other) firms. Hence, a firm must take into consideration the probable rival reactions, while formulating its own price and output decisions.

3. **Restricted Entry-** 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.

OR

Characteristic	Monopoly Competition	Monopolistic Competition
Number of Sellers	Under Monopoly Competition market, there exist a single seller in the market	Under Monopolistic Competition market, there exist a large number of sellers for a commodity. However, in certain cases due to barriers such as patents, etc., the entry may be restricted to some extent.
Nature of Product	Firm under this market sells unique products with no substitutes available	Firms under this market structure produce similar yet differentiated products that are 'close' substitutes of each other.
Selling Cost	There is no selling cost involved under this market	The selling cost under this market is huge as all the firms spend a lot of money on advertisement and other selling techniques.

Question 12

(a) Define price elasticity of demand.

(b) If the price of a commodity rises by 40% and its quantity demanded falls from 150 units to 120 units, calculate coefficient of price elasticity of demand for the commodity.

SOLUTION:

It is the measure of the degree of responsiveness of the demand for a good to the changes in its price. It is defined as the percentage change in the demand for a good divided by the percentage change in its price.

$$ed = \frac{\text{Percentage change in demand for good}}{\text{Percentage change in price of that good}}$$

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

Where $\Delta Q = Q_2 - Q_1$, change in demand

$\Delta P = P_2 - P_1$, change in price

P_1 = Initial price

Q_1 = Initial quantity

(b) Given : $Q_1 = 150$

$$Q_2 = 120$$

Price rises by 40%

$$\text{Elasticity of demand} = \frac{\text{Percentage change in Quantity Demanded}}{\text{Percentage change in Price}}$$

$$\begin{aligned} \text{Percentage change in Quantity demanded} &= \frac{Q_2 - Q_1}{Q_1} \times 100 \\ &= \frac{150 - 120}{120} \times 100 = 25\% \end{aligned}$$

$$\text{Elasticity of demand} = \frac{\text{Percentage change in Quantity Demanded}}{\text{Percentage change in Price}} = \frac{25}{40} = 0.625$$

Question 13

What is meant by primary deficit ?

OR

What is meant by fiscal deficit ?

SOLUTION:

Primary deficit refers to the difference between the fiscal deficit and the interest payments. Since, fiscal deficit reflects the borrowing requirements of the government, it can be said that the primary deficit refers to the difference between the government's borrowing requirements and its interest liabilities.

$$\text{Primary Deficit} = \text{Fiscal Deficit} - \text{Interest Payments}$$

OR

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

$$\text{Fiscal Deficit} = \text{Budget Expenditure} - \text{Budget Receipts (other than borrowing and liabilities)}$$

Question 14

Give any two examples of flow concept.

SOLUTION:

Two examples of flow concept are: capital formation, interest on capital.

Question 15

Define the term 'tax'.

SOLUTION:

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.

Question 16

Suppose in a hypothetical economy, the income rises from ₹ 5,000 crores to ₹ 6,000 crores. As a result, the consumption expenditure rises from ₹ 4,000 crores to ₹ 4,600 crores. Marginal propensity to consume in such a case would be _____. (Choose the correct alternative)

- (a) 0.8
- (b) 0.4
- (c) 0.2
- (d) 0.6

SOLUTION:

Suppose in a hypothetical economy, the income rises from ₹ 5,000 crores to ₹ 6,000 crores. As a result, the consumption expenditure rises from ₹ 4,000 crores to ₹ 4,600 crores. Marginal propensity to consume in such a case would be 0.6.

The correct answer is option (D).

Question 17

If in an economy :

Change in initial Investment (ΔI) = ₹ 700 crores
Marginal Propensity to Save (MPS) = 0.2

Find the values of the following :

- (a) Investment Multiplier (k)
- (b) Change in final income (ΔY)

SOLUTION:

(a) We know,

$$k = \frac{1}{MPS} = \frac{1}{0.2} = 5$$

So, investment multiplier is 5.

(b) We also know,

$$k = \frac{\Delta Y}{\Delta I}$$

$$5 = \frac{\Delta Y}{700}$$

$$\Delta Y = 3,500$$

So, change in income is ₹ 3,500 crores

Question 18

Define the problem of double counting in the computation of national income. State any two approaches to correct the problem of double counting.

OR

"Gross Domestic Product (GDP) does not give us a clear indication of economic welfare of a country. "Defend or refute the given statement with valid reason

SOLUTION:

Double counting refers to a situation where the value of a good is taken into account (counted) more than once. Such a problem occurs because for every producer, the commodity he sells is the final commodity. Thus, if every time the value of the good is taken into account, then it will lead to the estimation of the value of the product more than once.

For instance, in the example of production of cloth, for the cotton farmer cotton is the final product and he sells it for Rs 500. Thus, for him the cost of the final output is Rs 500. Similarly for the weaver, who sells weaved cotton for Rs 700, weaved cotton is the final product and cost of the final output is Rs 700. Next, the textile producer converts the weaved cotton into cloth and sells it to retailer for Rs 900, for him the cloth is the final product and cost of the final output is 900. The retailer then sells the cloth for Rs 1100.

The total value of the final output in the process is Rs 3,200 (i.e. Rs 500 + Rs 700 + Rs

900 + Rs 1,100). But, in this manner, the value of cotton is counted four times, value of thread three times and that of cloth twice.

In other words, there is an **overestimation of the value of the goods produced**.

Efforts must be taken to reduce double counting by the following two approaches:

- a. By considering only the value added by each production unit
- b. By considering only the final goods and services (i.e. excluding intermediate consumption) in the estimation of the national income.

OR

GDP does not give us a clear indication of economic welfare of the country. The following observations can be made in this regard.

1. Income Patterns- It is possible that even with the rise in the Real *GDP*, the welfare of the people might not increase. The increase in the *GDP* may be a result of the increase in the income of a few individuals. On the other hand, the majority of people remain deprived of the benefits of the rise in the *GDP*. Hence, a rise in national income may lead to false interpretation of the social welfare.

2. Composition of Output: To know whether with the rise in Real *GDP* reflects a rise in the welfare of the economy, one needs to consider the composition of the output produced that has led to the rise in the level of *GDP*. For example, the production of goods such as guns, narcotic drugs and high-end luxurious goods increases the monetary value of the production, but they do not add to the welfare of the majority of the population.

3. Non-Monetary Exchanges: *GDP* does not take into account those transactions that are not expressed in monetary terms. In less developed countries, there are various non-monetary exchanges, particularly in the rural areas and household sector. Consequently, such transactions remain outside the domain of *GDP* leading to underestimation of the value of *GDP*. Thus, *GDP* cannot be regarded as an index of economic welfare, as it ignores the household and the volunteer sectors.

Question 19

Discuss the working of the adjustment mechanism in the following situations:

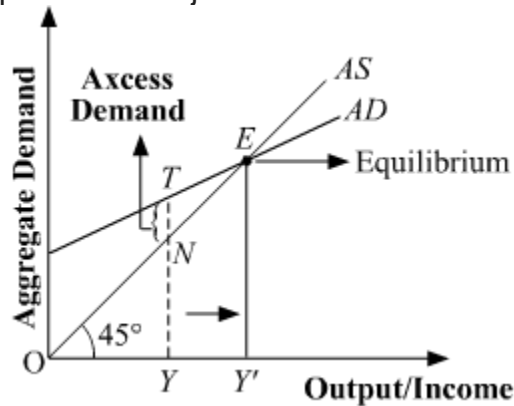
- (a) Aggregate demand is greater than Aggregate supply.
- (b) Ex Ante Investments are lesser than Ex Ante Savings.

SOLUTION:

(a) When Aggregate Demand is greater than Aggregate Supply

In case, if $AD > AS$, then it implies a situation, where the total demand for goods and services is more than the total supply of the goods and services. This implies a situation of excess demand. Due to the excess demand, the producers draw down their inventory

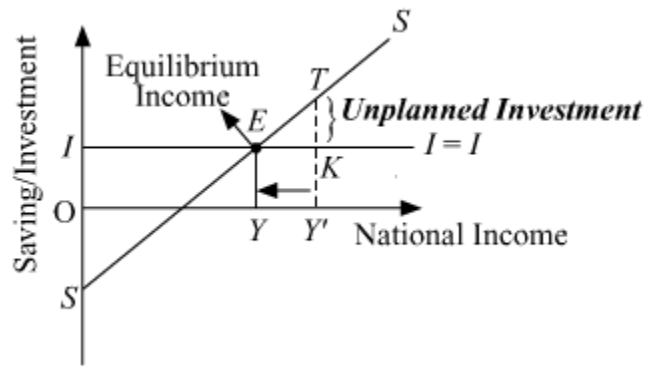
and increase production. The increase in production requires hiring more factors of production, thereby increases employment level and income. Finally, the income will rise sufficiently to equate the AD with AS , thus the equilibrium is restored back. This process of adjustment mechanism is explained below graphically.



In the figure, AD and AS represent the aggregate demand and aggregate supply curves. Let us suppose that the equilibrium is operating at a situation, where aggregate demand exceeds aggregate supply, i.e. $AD > AS$. TY' represents the aggregate demand of output by the economy but the aggregate supply is only of NY' . Hence, the economy is facing excess demand equivalent to TN (i.e. $TY' - NY'$). Due to the excess demand, the producers draw down their inventories and hire more factors of production. This results in increase in the production and employment. The income, output and employment will continue to rise, until all the excess demand is wiped-out. This happens at equilibrium point E , where AD and AS intersect each other. At the equilibrium, OY represents the equilibrium level of output.

(b) When Ex Ante Investments are lesser than Ex Ante Savings.

The situation when S exceeds I i.e. when withdrawal from the income is greater than injections into the circular flow of income, then it implies that total consumption expenditure is less than what is required to purchase the available supply of goods and services. In other words, we can understand this as high saving implies low consumption, which means that the required output is less than the planned output. Thus, a portion of the supply remains unsold, which leads to unplanned inventory accumulation. In response to this situation, for clearing this unsold stock, the producers plan a cut in the production in the next period. Therefore reduce the employment of labourers. The reduced employment leads to fall in aggregate income in the economy, consequently, lesser aggregate saving. The saving will continue to fall, until, it becomes equal to the investment. At point, where saving and investment are equal, equilibrium is achieved. This process of adjustment mechanism is explained below graphically.



In the figure, S and I represent the Saving and Investment curves. Let us suppose that the equilibrium is facing a situation, where saving (TY') exceeds investment (KY'). Consequently, the aggregate consumption expenditure is lower than what is required to buy all the goods and services. Therefore, there exists unplanned inventory accumulation of unsold stock equal to TK (i.e. $TY' - KY'$) and the producers respond by reducing the production by reducing employment. Due to reduced employment, the income of the factors of production (of the people) falls. Subsequently, the saving will fall due to reduced income. Hence, the saving will continue to fall, until, saving equates investment at point E . The economy achieves equilibrium at point E , with saving equal to investment and OY level of national income (or output).

Question 20

How are capital expenditure different from Revenue expenditure? Discuss briefly.

SOLUTION:

The 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.

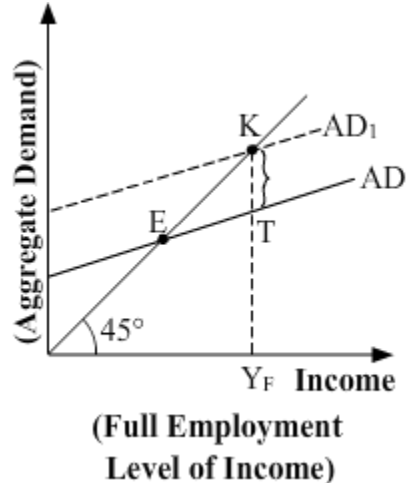
On the other hand, the Capital Expenditure refers to that government expenditure, which causes reduction in the government liabilities as well as creates assets for the government. For example- expenditure on purchasing shares, bonds, etc.

Question 21

State and discuss the components of Aggregate Demand in a two sector economy.

OR

In the given figure, what does the gap 'KT' represent? State any two fiscal measures to correct the situation.



SOLUTION:

The components of Aggregate Demand in a two sector economy are:

1. *Private consumption expenditure*: 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. It shares a positive relationship with the level of disposable income, that is, lower the level of disposable income lower will be the purchasing power and hence lower will be the consumption expenditure. The functional form that depicts the relationship between consumption expenditure and the level of disposable income is known as *consumption function*. There are two types of consumption expenditure- *Autonomous Consumption Expenditure* and *Induced Consumption Expenditure*. Autonomous Consumption Expenditure is independent of the level of disposable income, whereas, Induced Consumption Expenditure depends on the level of disposable income.

2. *Private investment expenditure*: 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. This expenditure by all the private investors on the capital goods add to the total stock of capital thereby increases the overall productive capacity of the economy. Investment depends on the rate of interest and level of income. Broadly, investment can be categorised in two types- *Autonomous Investment Expenditure* and *Induced Investment Expenditure*. The Autonomous Investment Expenditure is independent of the rate of interest and level of income, whereas, the Induced Investment Expenditure depends on the rate of interest and level of income.

OR

The gap 'KT' represents the inflationary gap. This is the situation of excess demand. Fiscal policy refers the policy that is undertaken by the government to influence the

economy through the process of its expenditure and taxation. The fiscal measures to correct the excess demand are given as follows:

1. Government Expenditure: 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. **In case of excess demand**, the government cuts down its expenditures in form of disinvestment. This lowers the level of economic activity, which in turn, reduces the level of employment, thereby reducing the income level. This subsequently reduces the aggregate demand, thus, the situation of excess demand gets corrected.

2. Public Borrowings

Through the measure of public borrowings, the government affects the liquidity (cash balances) held by the public. It is because of the excess liquidity, the people demands more and vice-versa. Therefore, government affects the liquidity balances with the help of public borrowings.

In case of excess demand, the government raises the public borrowings, which reduces the liquidity balances with the public. A reduction in the liquidity lowers the purchasing power of the people, which in turn, lowers the aggregate demand.

Question 23

Given the following data, find the missing values of 'Private Final Consumption Expenditure' and 'Operating Surplus'.

S.No.	Particulars	Amount (In ₹ crores)
(i)	National Income	50,000
(ii)	Net Indirect Taxes	1,000
(iii)	Private Final Consumption Expenditure	?
(iv)	Gross Domestic Capital Formation	17,000
(v)	Profits	1,000
(vi)	Government Final Consumption Expenditure	12,500
(vii)	Wages & Salaries	20,000
(viii)	Consumption of Fixed Capital	700
(ix)	Mixed Income of Self Employed	13,000
(x)	Operating Surplus	?
(xi)	Net Factor Income from Abroad	500
(xii)	Net Exports	2,000

National Income (NNP_{FC}) = 50,000

We know,

$NNP_{FC} = GDP_{MP} - \text{Consumption of Fixed Capital} - NIT + NFIA$

$$50,000 = GDP_{MP} - 700 - 1,000 + 500$$

$$GDP_{MP} = 51,200$$

Now, we know as per the expenditure method:

$GDP_{MP} = \text{Private Final Consumption Expenditure} + \text{Government Final Consumption Expenditure} + \text{Gross Domestic Consumption Expenditure} + \text{Net Exports}$

$$51,200 = P + 12,500 + 17,000 + 2,000$$

$$\text{Private Final Consumption Expenditure} = ₹ 19,700$$

$$\text{Now, } NNP_{FC} = NDP_{FC} + NFIA$$

$$50,000 = NDP_{FC} + 500$$

$$NDP_{FC} = 45,500$$

Also,

$$NDP_{FC} = \text{Wages and Salaries} + \text{Operating Surplus} + \text{Mixed Income}$$

$$45,500 = 20,000 + OS + 13,000$$

$$OS = 12,500$$

So, operating surplus is equal to ₹ 12,500.

Question 24

(a) Define "Trade surplus". How is it different from "Current account surplus" ?

(b) "Indian Rupee (₹) plunged to all time low of ₹ 74.48 against the US Dollar (\$)".

–*The Economic Times*

In the light of the above report, discuss the impact of the situation on Indian Imports.

SOLUTION:

(a) Trade surplus refers to the situation when exports of goods and services exceeds the import of goods and services.

Exports of Goods and Services > Imports of Goods and Service ⇒ Current Account Surplus

Trade surplus is different from "Current Account Surplus" . This is because current account is the account which maintains the records of imports and exports of goods and services as well as the record of unilateral transfers.

Current Account Balance = Balance of Visible Trade + Balance of Invisible Trade + Balance of Unilateral Transfers

(b) Indian Rupee is depreciating against the US Dollar since it is given that " Indian Rupee (₹) plunged to all time low of ₹ 74.48 against the US Dollar (\$)". A high exchange rate makes the imports more expensive. Consequently, a rise in the exchange rate implies a reduction in the demand for imports and *vice-versa*.

When imports falls, net exports (Exports - Imports) of a country rises. The given figure explains this process as follows:

Suppose the initial equilibrium income is given by Y_e that corresponds to a trade

balance equal to Y_{tb} . With the rise in the net export demand, the aggregate demand curve DD shifts upwards to DD' such that the new equilibrium is established at point E' and the equilibrium income rises to Y' .

In the lower panel due to the fall in the imports, the net export rises and the net export curve shifts upwards from NX to NX' . At the new level of income, the net exports is represented by the vertical distance AE' which are necessarily positive (because the total demand curve DD' lies above the aggregate demand curve AD). Thus, with a fall in the imports, there is a trade surplus. This trade surplus is represented in the lower panel by the vertical length DF .

