CBSE
Class XII Economics
Delhi Board Paper Set 1 – 2012

Time: 3 hrs **Max. Marks: 100**

Note:

- Please check that this question paper contains 12 printed pages.
- Code number given on the right hand side of the question paper should be written on the title page of the answer-book by the candidate.
- Please check that this question paper contains 32 questions.
- **Please write down the Serial Number of the question before attempting it.**
- 15 minutes time has been allotted to read this question paper. The question paper will be distributed at 10.15 a.m. From 10.15 a.m. to 10.30 a.m., the students will read the question paper only and will not write any answer on the answer-book during this period.

General Instructions:

(i) **All** questions in both the sections are compulsory.
(ii) Marks for questions are indicated against each question.
(iii) Questions No. **1 – 5** and **17 – 21** are very short-answer questions carrying **1** mark each. They are required to be answered in one sentence each.
(iv) Questions No. **6 – 10** and **22** – **26** are short answer questions carrying **3** marks each. Answers to them should normally not exceed **60** words each.
(v) Questions No. **11– 13** and **27– 29** are also short answer questions carrying **4** marks each. Answers to them should normally not exceed **70** words each.
(vi) Question number **14 – 16** and **30 – 32** 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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1. Give meaning of an economy. [1]

2. What is market Demand? [1]

3. What is the behaviour of average fixed cost as output increases? [1]

4. What is the behaviour of average revenue in a market in which a firm can sell more only by lowering the price? [1]

5. What is a price taker firm? [1]

6. What is opportunity cost? Explain with the help of a numerical example. [3]

7. Given price of a goods, how does a consumer decide as to how much of the good to buy? [3]

8. Draw Average Variable Cost, Average Total Cost ad Marginal Cost curves in a single diagram. [3]

9. An individual is both the owner and the manager of a shop taken on rent. Identify implicit cost and explicit cost from this information. Explain. [3]

10. Explain the implication of large number of buyers in a perfectly competitive market. [3]

OR

Explain why firms are mutually interdependent in an oligopoly market.

11. Define an indifference curve. Explain why an indifference curve is downward sloping from left to right. [4]

12. When price of good is Rs7 per unit a consumer buys 12 units. When price falls to Rs6 per unit he spends Rs72 on the good. Calculate price elasticity of demand by using the percentage method. Comment on the likely shape of demand curve based on this measure of elasticity. [4]

13. What does the Law of variable Proportions show? State the behaviour of total product according to this law. [4]

OR

Explain how changes in prices of other products influence the supply of a given product.

14. Explain how do the following influence demand for a good: [6]

i. Rise in income of the consumer.
ii. Fall in prices of the related goods.

15. Explain the conditions of a producer's equilibrium in terms of marginal cost and marginal revenue. Use diagram. [6]

16. Market for a good is in equilibrium. There is simultaneous "increase" both in demand and supply of the good. Explain its effect on market price. [6]

OR

Market for a good is in equilibrium. There is simultaneous "decrease" both in demand and supply of the good. Explain its effect on market price.

17. Define stock variable. [1]

18. Define capital goods. [1]

19. What are demand deposits? [1]

20. Define a Tax. [1]

21. Give meaning of managed floating exchange rate. [1]

22. Calculate Gross Value Added at Factor Cost: [3]

i.	Units of output sold (units)	1,000
ii.	Price per unit of output (Rs)	30
iii.	Depreciation (Rs)	1,000
iv.	Intermediate cost (Rs)	12,000
v.	Closing stock (Rs)	3,000
vi.	Opening stock (Rs)	2,000
vii.	Excise (Rs)	2,500
viii.	Sales tax (Rs)	3,500

23. Explain the significance of the 'Store of Value' function of money. [3]

24. Outline the steps taken in deriving saving curve from the consumption curve. Use diagram. [3]

25. Find national income from the following: [3]
Autonomous consumption = Rs100
Marginal propensity to consume = 0.80
Investment = Rs 50

26. Distinguish between Revenue Expenditure and Capital Expenditure in a government budget. Give examples. [3]

OR

Explain the role of Government budget in allocation of resources.

27. Giving reason explain how should the following be treated in estimating national income: [4]

i. Expenditure on fertilizers by a farmer.
ii. Purchase of tractor by a farmer.

28. Explain the components of Legal reserve Ratio. [4]

OR

Explain 'bankers' bank, function of Central bank.

29. Explain 'Revenue Deficit in a Government budget? What does it indicate? [4]

30. Find out (a) national income and (b) net national disposable income: [6]

S. No.	Items	(Rs crores)
i.	Factor income from abroad	15
ii.	Private final consumption expenditure	600
iii.	Consumption of fixed capital	50
iv.	Government final consumption expenditure	200
v.	Net current transfers to abroad	(-) 5
vi.	Net domestic fixed capital formation	110
vii.	Net factor income to abroad	10
viii.	Net imports	(-) 20
ix.	Net indirect tax	70
x.	Change in stocks	(-) 10

31. Explain the concept of 'excess demand' in macroeconomics. Also explain the role of 'open market operation' in correcting it. [6]

OR

Explain the concept of 'deficient demand' in macroeconomics. Also explain the role of Bank Rate in correcting it.

32. Explain the distinction between autonomous and accommodating transactions in balance of payments. Also explain the concept of balance of payments 'deficit' in this context. [6]

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Answer 1

Economics is a system spread over a particular area which reveals the nature and level of economic activities in that area. It shows how people of the concerned area earn their living.

Answer 2

Market demand for various quantities of a good is the sum of all the consumers in the market who are willing to buy a good at different possible prices at a point of time.

Answer 3

Average fixed cost (AFC) is the fixed cost per unit of output produced. The AFC curve slopes downward to the right. It shows that AFC decreases as the output increases. It means that the product of AFC and the output is equal to TFC which remains constant at all levels of output.

TFC = AFC * Q

Answer 4

Average revenue (AR) of a firm is the total revenue per unit of output sold. AR = p * q/q = p. When AR equals the market price, the firm can sell any amount of good at a given price. If the firm sells more quantity of output by lowering the price, then the AR curve slopes downwards.

Answer 5

A firm which does not have any control over the prevailing market price is known as a ***price taker firm***. In this situation, the price is determined by the market and the firm must accept the prevailing market price to sell the goods.

Answer 6

Opportunity cost refers to the value of a factor in its next best alternative use.

Assuming that resources and technology remain constant, an economy is producing Good X and Good Y. Different combinations of production of Good X and Good Y are given in the production possibilities schedule:

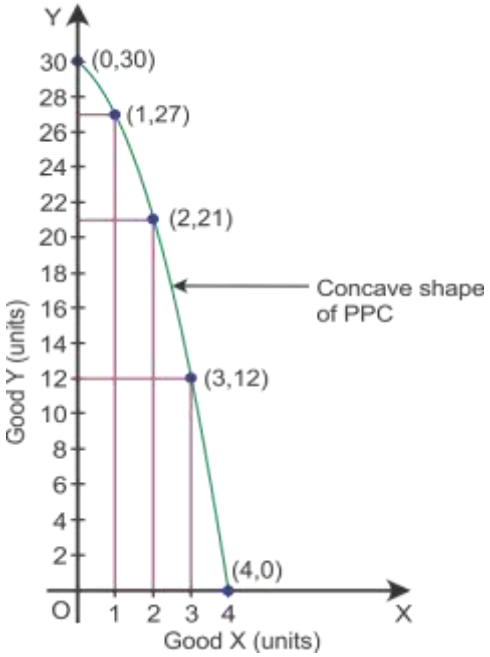
Production Possibilities	**Good X**	**Good Y**	$MOC=\frac{\Delta Y}{\Delta X}$
I	0	30	**-**
II	1	27	**−3**
III	2	21	**−6**
IV	3	12	**−9**
V	4	0	**−12**

At the production point II, 1 unit of Good X and 27 units of Good Y are produced. To produce an additional unit of Good X, 3 units of Good Y must be sacrificed.

Here, the opportunity cost is

$$\text{Opportunity cost from I to II} = \frac{\Delta Y}{\Delta X} = \frac{\text{Amount of good Y sacrifed}}{\text{Amount of good X gained}} = \frac{27-30}{2-1} = -3$$

Thus, the opportunity cost of getting an additional unit of Good X is 3 units of Good Y.

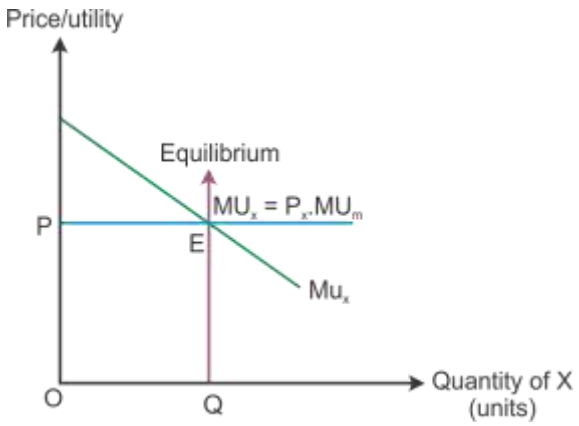


Answer 7

Given the price of the good, a consumer will decide the amount of goods to buy. So, the consumer compares the price of the good with its utility. A rational consumer will be at equilibrium only when the marginal utility is equal to the price paid for the good.

$MU_X = P_X$

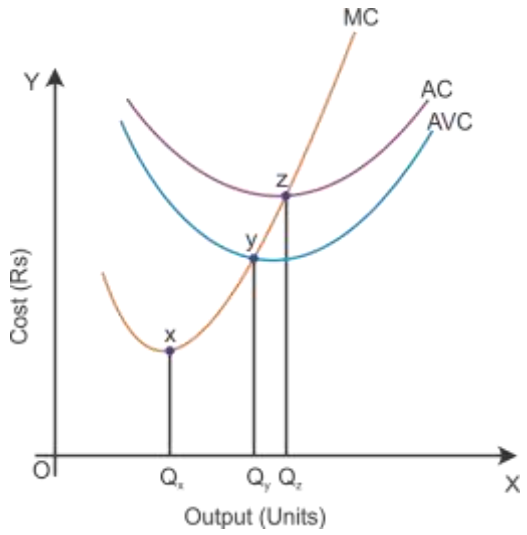
The marginal utility is greater than the price paid for the good, i.e. $MU_X > P_X$ implies that the consumer is not in equilibrium and buys more of a good. While the marginal utility is lesser than the price paid for the good, i.e. $MU_X < P_X$ implies that the consumer is not in equilibrium and buys less of that good.



In the diagram, OP is the price of the good given on the Y-axis and OQ is the utility given on the X-axis. The marginal utility curve MU_X slopes downwards because the marginal utility diminishes with every additional consumption of X. The consumer reaches equilibrium at Point E, where the marginal utility is equal to the price paid for the good.

Answer 8

Average Variable Cost (AVC), Average Total Cost (ATC) and Marginal Cost (MC) curves:



Answer 9

Implicit cost is the ***estimated value of self-owned inputs and there is no payment involved***. Hence, the value of a manager's service in his own business is the implicit cost.

Explicit cost is the ***actual money expenditure on inputs and there is payment for hiring factor services***. Hence, the rent paid for the shop is an explicit cost.

Therefore, the total cost of production of good includes not only the actual cost incurred in the firm, i.e. explicit cost but also implicit cost, i.e. the inputs supplied by the owners of the firm.

Answer 10

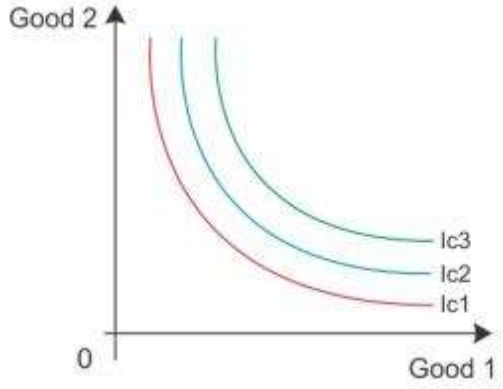
A perfectly competitive market is a market which consists of buyers and sellers. They produce a homogeneous product. When the number of buyers is more, the demand of an individual buyer is only a small portion of the market demand. Individual buyers cannot influence the market price of a good by varying their demands, and thus, ***an individual buyer is a price taker and not a price maker.***

OR

In an oligopoly market, there are only few firms. The price and level of output of one firm impact the price and level of output of rival firms. Keeping this impact in mind, a firm decides the price and output in accordance with prevailing market conditions. Hence, a high degree of interdependence exists among competing firms, especially with regard to price and quantity of output.

Answer 11

An indifference map refers to a set of indifference curves which represent consumer preferences over all the bundles of two goods. An indifference curve shows all the combinations which create the same level of satisfaction. We can present an indifference curve with high or low level of satisfaction, i.e. to the right and above another show a higher level of satisfaction to the consumer. Here, IC_3 shows higher level of satisfaction than IC_2. Thus, the indifference curve also relates to a higher level of income of the consumer. However, all these curves have the same level of satisfaction.



The indifference curves slope downwards because an increase in the amount of Good 1 along the indifference curve is associated with a decrease in the amount of Good 2, as the preferences are monotonic.

Answer 12

Quantity (Q)	**Price (P)**	**Total Expenditure (TE)**
12	Rs 7	
12	Rs 6	72

Given that

$\text{Price} \times \text{Quantity} = \text{Total expenditure}$

$6 \times \text{Quantity} = 12$

or, $\text{Quantity} = 12$

$$E_d = \frac{\text{Percentage change in quantity}}{\text{Percentage change in price}}$$

$$\text{Percentage change in quantity} = \frac{\Delta Q}{Q} \times 100 = \frac{12-12}{12} \times 100 = 0$$

$$\text{Percentage change in price} = \frac{\Delta P}{P} \times 100 = \frac{6-7}{7} \times 100 = 14.28$$

By substituting the values in the formula of price elasticity of demand, we get

$$E_d = \frac{0}{14.28} = 0$$

Thus, the demand is perfectly inelastic, then the demand curve is a vertical straight line parallel to the price-axis.

Answer 13

Law of variable proportion

Law of variable proportion states that as more of the variable factor input is combined with the fixed factor input, a point will eventually be reached where the marginal product of the variable factor input starts declining.

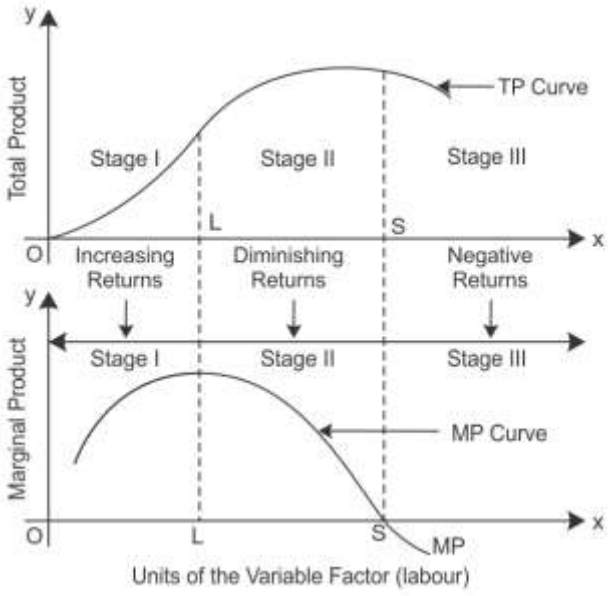
Units of Fixed Factor	Units of Variable Factor	TP	MP	Stages
1	1	4	4	Increasing MP (Increasing returns to a factor)
1	2	12	8	
1	3	24	12	
1	4	32	8	Diminishing MP (Diminishing returns to a factor)
1	5	34	2	
1	6	34	0	
1	7	30	−4	Negative MP (Negative returns to a factor)
1	8	21	−9	
1	9	10	−11	

Let us consider the above table.

Stage I: As more units of factor input are used, MP tends to rise till 3 units of factor input are used. Here, the total product increases at an increasing rate which is called increasing returns to the factor input.

Stage II: However, when the 4th unit of factor input is used, the diminishing returns sets in, where MP starts decreasing and TP increases at a decreasing rate. Diminishing MP reduces to zero. The total output is the maximum when the marginal output is zero.

Stage III: When MP is negative, TP starts declining from 34 to 10 when the 9th unit is employed.



OR

The price of other goods influence the supply of goods, it implies that the prices of the substitute goods and complementary goods will affect the supply of goods in the market. There is positive relationship between the supply of good and the price of its substitute and complementary goods.

If the price of the ***substitute goods*** decline, the consumer will shift their wish to buy that good. So, there will be decline in the demand of the good and in turn no profit to supply this good. Hence, the supply of the good will decrease. For example: tea and coffee

If the price of the ***complementary goods*** decline, the consumer will shift their wish to buy that good. So, there will be raise in the demand of the good and in turn more profit to supply more of that good. Hence, the supply of the good will increase. For example: petrol and car

Answer 14

i. Rise in the Income of the Consumer

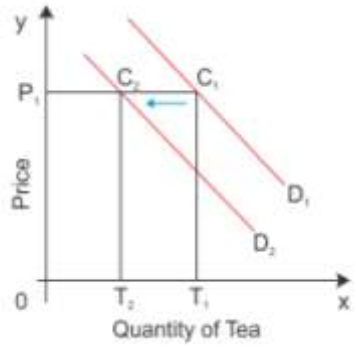
An increase in the consumer's income has corresponding changes in the demand for different types of goods in the market. The effects of change in income on demand for different types of goods are as follows:

Normal goods are goods which have a ***positive relationship*** between income and quantity demanded. Assume that other things remaining constant, an increase in the consumer's income will lead to an increase in the quantity demanded.

Inferior goods are goods which have a ***negative relationship*** between income and quantity demanded. Assume that other things remaining constant, an increase in the consumer's income will lead to a decrease in the quantity demanded.

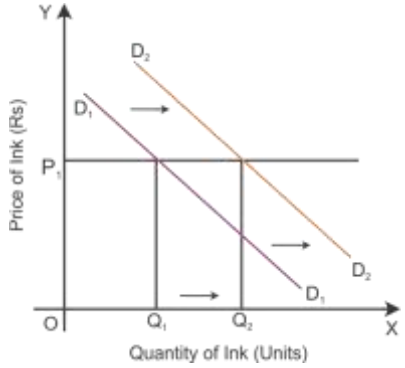
ii. Fall in Prices of the Related Goods

Substitute good: When the price of one good falls, it becomes cheaper in relation to another good. As a result, one good is substituted for the other good such as coffee and tea. Assume tea and coffee are two substitute goods. D_1 is the demand curve for the demand of tea in diagram.



When there is a decrease in the price of the substitute good coffee, the demand curve for tea shifts to the left even when its price is constant. When the price of tea is OP_1, the quantity demanded is OT_1 as shown in the diagram. Now, the consumer is willing to buy P_1C_2 quantity of tea which is equal to OT_2. Thus, the consumer shifts from D_1 to D_2, consuming less of tea even when the price of tea is constant. This is a situation of backward shift in the demand curve.

Complementary good: Complementary goods are purchased jointly such as ink and ink pens. If there is a decrease in the price of a good, then the demand for another good will increase. So the demand curve shifts parallel to the right, i.e. from D_1D_1 to D_2D_2.



Answer 15

The producer's equilibrium refers to the situation in which he maximises his profits. A producer strikes an equilibrium when two conditions are satisfied.

i. MR = MC
ii. MC is rising or the MC curve cuts the MR curve from below.

MR, MC Schedule and Producer's Equilibrium:

Output	MR	MC
1	10	8
2	10	7
3	10	6
4	10	8
5	10	10
6	10	13

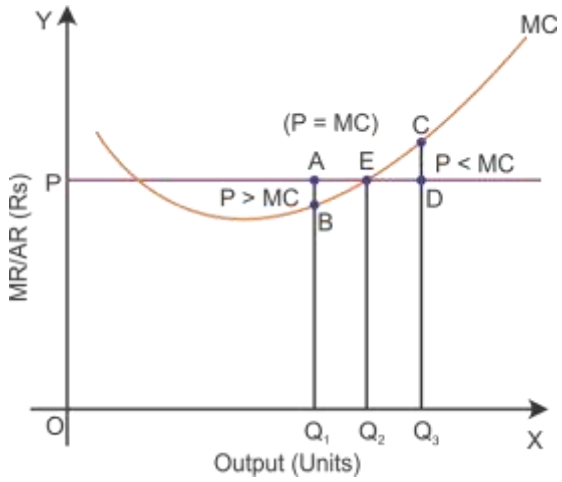
Here, it is assumed that price (AR) is constant, so that MR is constant, i.e. = Rs 10 under perfect competition. This table indicates that the two conditions of equilibrium are satisfied only when 5 units of output are produced. It is here that (i) MR = MC = Rs 10 and (ii) MC is rising.

Equilibrium is not struck when MR > MC. In such a situation, producing an additional unit would add more to TR than to TC. This implies that the gap between TR and TC tends to widen or that profits are still to be maximised.

Condition 1:

i. If MR > MC:

Suppose OQ_1 is the output level at the price AQ_1 and the marginal cost is BQ_1, then it would be $AQ_1 > BQ_1$. Here, OQ_1 is not the level of output at which the profit is maximised. So, the firm can increase its profit by increasing the production to the OQ_2 level of output.



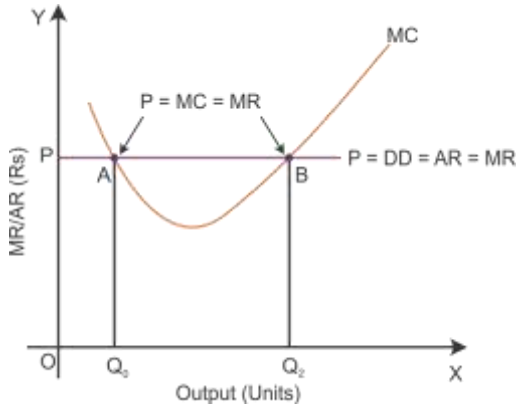
ii. If Price (MR) < MC

Suppose OQ_3 is the output level at the price DQ_3 and the marginal cost is CQ_3, then it would be $DQ_3 < CQ_3$. Here, OQ_3 is not the level of output at which the profit is maximised. So, the firm can increase its profit by decreasing its output level to OQ_2. Thus, the firm's

equilibrium level of output to maximise output is that MR = MC and MC should be rising at the point of intersection with MR.

Condition 2:

In the given diagram, the MC curve intersects the price line (or MR) at two points—A and B. Here Condition 1 of profit maximisation MR = MC is satisfied at these two points. Next, let us consider Condition 2.



i. Intersection point at A

At intersection point A, price is equal to MC but MC is falling, and it is a downward-sloping curve. If the output is increased more than the OQ_0 level, then the price is more than MC. This means that the firm can increase the production more than the OQ_0 level of output to maximise profit.

ii. Intersection point at B

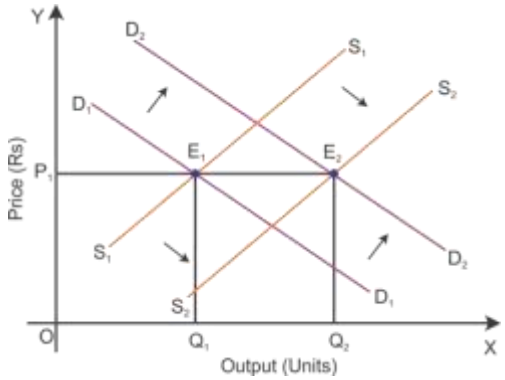
At intersection point B, if the output is increased more than output OQ_2, the price is more than MC. This states that the firm can increase the production more than the OQ_2 level of output to maximise profit. While if the firm produces higher level of output than OQ_2, then the price is less than MC. This clearly states that high profit is possible by decreasing the output level to OQ_2. Thus, Point B is the producer's equilibrium and OQ_2 is the output level to maximise profit by satisfying the two necessary conditions (i) Price = MC and (ii) the MC curve is rising.

Answer 16

When there is a simultaneous increase in demand and supply, the equilibrium point of price of output will depend on the basis of proportion of changes in demand and supply. Let us understand the effects through the following conditions:

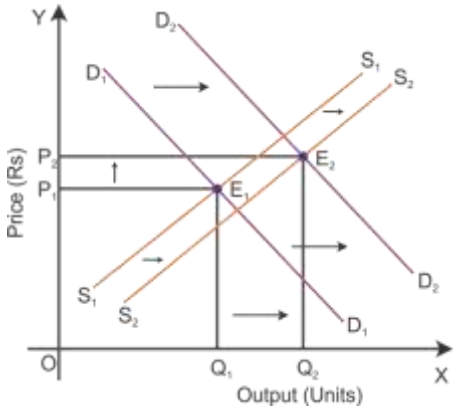
i. If increase in demand is equal to increase in supply

When the demand increases from D_1D_1 to D_2D_2 and the supply increases from S_1S_1 to S_2S_2 in the same proportion, the new equilibrium price will be OP_1 and the new equilibrium output will be OQ_2. This new price and output intersect each other at Point E_2 and will arrive at new equilibrium. As the increase in demand is equal to the increase in supply, ***the price remains the same at the new equilibrium point.***



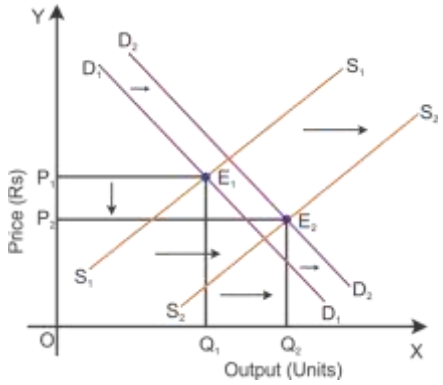
ii. If increase in demand is more than increase in supply

When the demand increases, the demand curve will shift to D_2D_2 and the increase in supply will shift the supply curve to S_2S_2. Here, the increase in demand is more than the supply; hence, there will be a new equilibrium price and a new equilibrium output which intersects at Point E_2. As the increase in demand is more than the decrease in supply, ***the equilibrium price increases at the new equilibrium point.***



iii. If increase in demand is less than increase in supply

When the demand increases, the demand curve will shift to D_2D_2 and the increase in supply will shift the supply curve to S_2S_2. Here, the increase in demand is less than the supply; hence, there will be a new equilibrium price and a new equilibrium output which intersects at Point E_2. As the increase in demand is less than the increase in supply, ***the equilibrium price decreases at the new equilibrium point.***

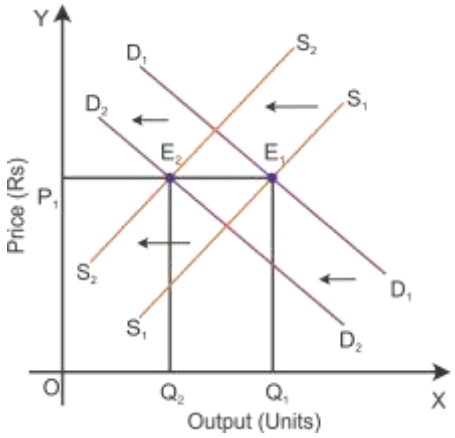


OR

When there is simultaneous decrease in demand and supply, the equilibrium point of price of output will depend on the basis of proportion of changes in demand and supply. Let us understand the effects through the following conditions.

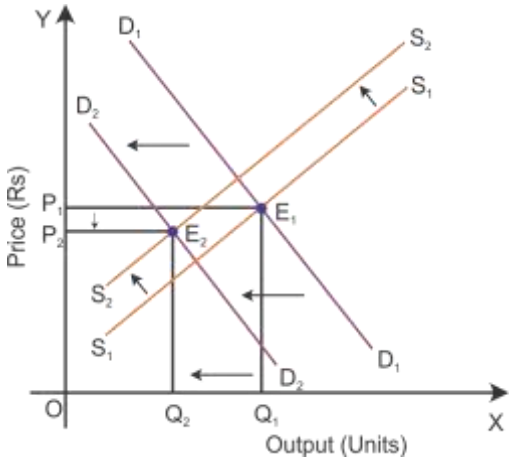
i. If decrease in demand is equal to decrease in supply

When the demand decreases from D_1D_1 to D_2D_2 and the supply decreases from S_1S_1 to S_2S_2 in the same proportion, the new equilibrium price will be OP_1 and the new equilibrium output will be OQ_2. This new price and output intersect each other at Point E_2 and will arrive at new equilibrium. As the decrease in demand is equal to the decrease in supply, ***the price remains the same and the quantity will decrease at the new equilibrium point.***



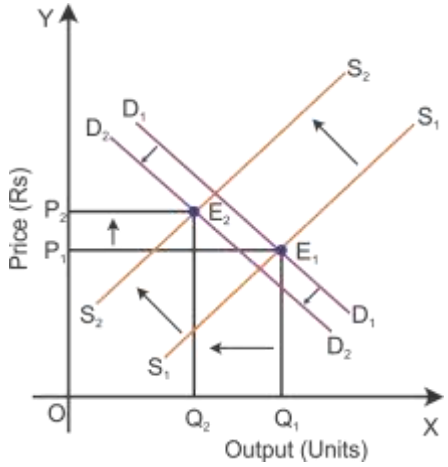
ii. If decrease in demand is more than decrease in supply

When the demand decreases, the demand curve will shift to D_2D_2 and the decrease in supply will shift the supply curve to S_2S_2. Here, the decrease in demand is more than the supply; hence, there will be a new equilibrium price and a new equilibrium output which intersects at Point E_2. As the decrease in demand is more than the decrease in supply, ***the equilibrium price decreases and the equilibrium quantity level decreases at the new equilibrium point.***



iii. If decrease in demand is less than decrease in supply

When the demand decreases, the demand curve will shift to D_2D_2 and the decrease in supply will shift the supply curve to S_2S_2. Here, the decrease in demand is less than the supply; hence, there will be a new equilibrium price and a new equilibrium output which intersects at Point E_2. As the decrease in demand is less than the decrease in supply, ***the equilibrium price increases and the equilibrium output decreases at the new equilibrium point.***



Answer 17

A stock is a quantity measured at a particular period of time. For example, the amount of money in a bank account at particular period of time.

Answer 18

Capital goods are those goods which are utilised in the production process for many years and are of high value. These goods are fixed assets of the producers. Examples: Plant and machinery

Answer 19

Demand deposits are not for any specific period of time. They can be withdrawn as and when required. These deposits are chequable deposits.

Answer 20

A tax is a compulsory payment imposed on individuals or companies by the government to meet expenditures. There are progressive and regressive taxes, value added and specific taxes, and direct and indirect taxes.

Answer 21

The managed floating exchange rate is the system in which the exchange rate is determined by the market forces and controls the value of currency appreciation or depreciation by the Central Bank.

Answer 22

Gross Value Added at Factor Cost (GVA_{FC}) = Total Value of Sales + Change in Stock − Intermediate Consumption − Net Indirect Taxes

$\Rightarrow$ GVA_{FC} (or GDP_{FC}) = (1000 × 30) + (3000 − 2000) − 12000 − (3500 + 2500)

Or GVA_{FC} = ₹13,000

Answer 23

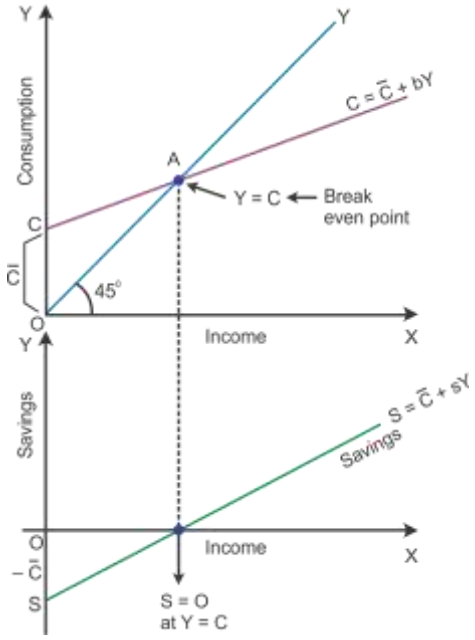
Store of Value: People keep their wealth in the form of money because money is the most liquid form of wealth. Savings in the form of money is maintained for purchasing commodities in the future. In this case, the values of commodities are being stored. Hence, money acts as a store of value.

However, the store of value is completely absent under the barter system. Wealth is stored in terms of goods as there was no money in existence. There were many problems such as storage of goods cost, loss of value and movement of transfer. Hence, it is not practically possible to store people's purchasing power.

Money facilitates exchange beyond limits. Here, the store of value function does not create value loss over a period of time.

Answer 24

In the diagram, the consumption curve is given as $\bar{C} + bY$, where $\bar{C}$ represents the autonomous consumption, Y is income and b is the rate at which C increases corresponding to an increase in Y. The aggregate supply curve is the 45° line. Consumption is equal to income at Point E.



Derivation of saving function from consumption function:

$-\bar{C}$ is the saving function where negative savings are equal to autonomous consumption at Y = 0. This is shown on the negative axis in the lower panel at Point S. Here, all the income is spent on consumption expenditure. Hence, there is no saving which is shown as the breakeven point. After this point, S and Y are joined to have a straight line sloping curve.

Answer 25

$C = Rs\ 100$

$MPC(b) = 0.80$

$I = Rs\ 50$

At equilibrium,

$Y = C + I$

or, $Y = \bar{C} + bY + I$

By substituting the values, we get

$Y = 100 + 0.8Y + 50$

$0.2\,Y = 150$

$Y = Rs\ 750$

$\therefore$ National Income $= Rs\ 750$

Answer 26

Basis of Difference	Capital Expenditure	Revenue Expenditure
Meaning	A decline in the government liabilities and creates assets for the government	No decline in government liabilities and does not create assets for the government
Examples	Purchase of shares and bonds	Salaries, pensions and interest payments

OR

Reallocation of resources:

Through the budgetary policy, the government can reallocate resources so that social and economic objectives can be met.

i. A tax is a legally compulsory payment imposed by the government on households and producers. The government impose taxes on socially unsafe goods such as alcohol and tobacco. Thereby resources will be shifted to the production of socially essential goods.

ii. Subsidies do not reduce the liability of the government and it does not add to the assets of the government. The government also provides subsidies for necessary goods such as wheat, rice and sugar. Thereby the resources are shifted from the production of goods for the rich to the production of goods for the poor.

Answer 27

i. Expenditure on fertilisers by a farmer will not be included in the estimation of National Income because it is an intermediate consumption to improve crop productivity.

ii. Purchase of a tractor by a farmer will be included in the estimation of National Income because it is part of gross domestic capital formation.

Answer 28

Commercial banks have to maintain minimum reserves according to the legal reserve requirements in order to control the credit creating power of these banks. They maintain reserves in the following ways:

i. Cash Reserve Ratio (CRR)

The cash reserve ratio (CRR) is the necessary minimum percentage of a bank's total deposits which is to be kept with the Central Bank. According to the RBI Act, 1934, every commercial bank needs to maintain with the Central Bank a certain percentage of their deposits in the form of cash reserves. By an amendment of the Act in 1962, the Central Bank can vary the CRR between 3 and 15% of the total deposits of commercial banks.

During inflation, the Central Bank increases the CRR, and thereby, the funds for providing loans with commercial banks decrease. In this process, the flow of credit and the aggregate demand are reduced. Thus, the process of credit creation by the commercial bank is checked and helps control inflation. On the other hand, the RBI reduces the CRR to curb the deflation situation.

ii. Statuary Liquidity Ratio (SLR)

Statutory liquidity ratio (SLR) is the fixed percentage of assets in the form of cash or other liquid assets which a bank must maintain with the Central Bank. The Central Bank can vary the SLR between 20 and 40%. If there is a change in SLR, then the freedom of banks to sell government securities or borrow against them from the Central Bank will get affected.

OR

Banker's bank functions of the Central Bank:

The Central Bank is an apex bank of all banks in the country. It has almost the same relation with other banks in the country as a commercial bank has with its customers. The Central Bank keeps some cash balances of the commercial banks as compulsory deposit. This is to help them during financial crises.

Answer 29

Revenue deficit means the excess of revenue expenditure of the government over its revenue receipts. Revenue deficit = Revenue expenditure − Revenue receipts

Revenue deficit is indicated to the government as follows:

i. Regular receipts of the government are not enough to meet regular expenditures.
ii. The government is using up savings of other sectors of the economy to meet its consumption expenditure.
iii. This gives a signal to either reduce its expenditure or increase its revenue. Curtail expenditure by taking steps to avoid unproductive expenses and increase revenue from various sources of tax and non-tax revenues.

Answer 30

a.

NDP_{MP} = Private Final Consumption Expenditure + Government Final Consumption Expenditure + Net Domestic Fixed Capital Formation + Change in Stock − Net Imports

= 600 + 200 + 110 + (−10) − (−20)

= Rs 920 crore

NNP_{FC} = NDP_{MP} + NFIA − Net Indirect Taxes

= 920 + (−10) − 70

= Rs 840 crore

b.

Net National Disposable Income = NDP_{MP} + NFIA − Net Current Transfers to Abroad

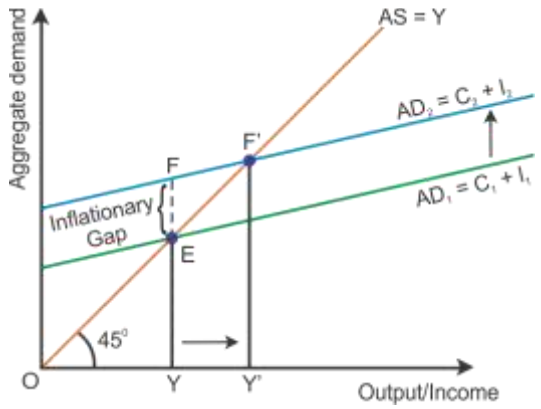
= 920 + (−10) − (−5)

= Rs 915 crore

Answer 31

Excess demand occurs in a situation when aggregate demand is more than aggregate supply corresponding to full employment. It leads to reduction in inventories and inflation in the economy. This situation is considered an inflationary gap—the difference between aggregate demand beyond full employment and aggregate demand at full employment.

Aggregate demand is the AD curve and aggregate supply is the AS curve (as shown in the diagram below). While the aggregate demand curve and the aggregate supply curve intersect each other, the full employment equilibrium is attained at Point E. OY is the full employment level of output, and EY is the aggregate demand at full employment level of output. If the aggregate demand increases beyond the full employment level of output from EY to FY, then the economy will have ***excess demand, i.e. situation of inflationary gap*** (FY − EY = FE).



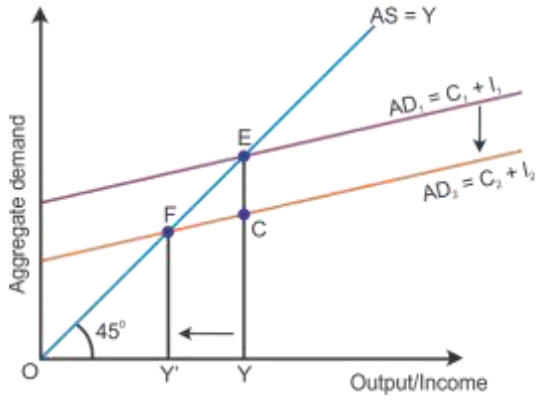
Role of open market operation to curb the excess demand:

Open market operations refer to the sale and purchase of government securities and bonds by the central bank. While controlling inflation, the central bank sells government securities to the public through the banks. This results in the transfer of a part of bank deposits to the central bank account and reduces credit creation capacity of the commercial banks.

OR

Deficient demand means a situation when the aggregate demand is short of the aggregate supply corresponding to full employment in the economy. It leads to a fall in the general price level and results in deflation, i.e. AD < AS.

Aggregate demand is shown by the AD curve and aggregate supply is shown by the AS curve (as shown in the diagram below). While the aggregate demand curve and the aggregate supply curve intersect each other, the full employment equilibrium is attained at Point E. OY is the full employment level of output, and EY is the aggregate demand at full employment level of output. If the aggregate demand decreases below the full employment level of output from EY to CY, then the economy will have ***deficient demand,*** (EY – CY = EC).



Role of bank rate to adjust deficit demand

Bank rate policy is used as the main instrument of monetary control during inflation. When the central bank reduces the bank rate, it is said to have adopted a dear money policy. The decline in bank rate decreases the cost of borrowing which increases commercial banks borrowing from the central bank. Consequently, the flow of money from the commercial banks to the public gets increased. Therefore, deflation arising due to bank credit is controlled.

Answer 32

An ***autonomous item*** in balance of payment refers to international economic transactions when transactions are made independently of the state of the balance of payment, such as profit motive.

An ***accommodating item*** in balance of payment refers to international economic transactions when transactions are not made with the profit motive such as government financing. While deficit or surplus in balance of payment occurs because of autonomous items, the accommodating items are meant to restore the balance of payment identity. Balance of payment always balances because of accommodating items.

Deficit in balance of payments is when receipts of the country coming from autonomous transactions are less than the corresponding payments to the rest of the world during the period of an accounting year. It shows net liabilities towards the rest of the world.

There are certain positive and negative impacts of deficit in balance of payment. When deficit occurs on account of capital import which is required for advancing the process of growth and development, it is a positive impact of deficit in balance of payment. Negative impact is that it shows Indian liabilities to the rest of the world. These liabilities strain the GDP by making payments to the rest of the world.