Quick Revision Question and Answers for Low Achievers

FREQUENTLY ASKED QUESTIONS – CBSE BOARD EXAMINATION

One Mark Questions (1M)

1. What is opportunity cost?
   Opportunity cost refers to the cost of the next best alternative foregone.

2. Define Marginal rate of transformation.
   It is the amount of one good that must be given to produce one additional unit of a second good. It is also known as marginal opportunity cost.

3. Give two examples of Micro economic variables/ studies.
   a. Individual demand

   b. Individual savings

4. Why does an economic problem arise?
   It is due to unlimited wants and limited resources.

5. What is meant by inferior goods in economics?
   Inferior goods refer to those goods whose demand decreases with rise in income of the consumer.

6. Define budget line.
   Budget line shows all combinations of two goods that a consumer can buy with his income at a given price.

7. What is a demand schedule?
   It is a tabular representation of different quantities demanded at different levels of prices

8. Define normal goods.
   Normal goods are those goods whose demand rises with increase in income of consumer.

9. Define indifference curve.
   It shows the various combinations of two goods which provide same level of satisfaction to the consumer.

10. Define price elasticity of demand.
    Price elasticity of demand refers to the degree of responsiveness of the quantity demanded to changes in price.

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

11. Define production function.
    It refers to the functional relationship between inputs and outputs.

12. Define Marginal physical product.
    It refers to the addition made to the total product

13. Define revenue.
    It refers to total money income from the sale of output

14. Define marginal revenue.
    It refers to the addition made to the total revenue.

15. Why is the ATC greater than AVC
    ATC is greater than AVC because ATC includes AVC and AFC

16. Define fixed cost.
    Fixed costs refer to cost which remains constant as output changes. For e.g.: rent

17. Define equilibrium price.
    Equilibrium price refers to a price at which market demand and market supply are equal.

18. In which market form the products are differentiated.
    Monopolistic competition

19. In which market form a firm is a price taker?
    Perfect competition

20. Why is demand curve under oligopoly indeterminate (uncertain)?
    Demand curve is indeterminate because of price war between the sellers.

21. Define Macro Economics?
    Macro economics studies the economy as a whole.

22. What is an Economic Territory?
    It refers to the area of a country where there is free movement of goods, human resources and capital.

23. Who is a normal resident?
    A persons or an institution who lives in a country and whose centre of interest lies in that country is called a normal resident of that country.

24. Is transfer income included in national income? Why?
    No, because transfer income does not result in the production of goods and services.

25. What is meant by Cash Reserve Ratio (CRR)?
    It is the percentage of net deposits of the commercial bank which are maintained by the RBI

26. What is meant by Bank rate?
    It is the rate at which the central bank lends money to the commercial bank.

27. What is meant by double coincidence of wants?
    It means that one person's desire to buy and sell must coincide with the other person's desire to buy and sell.

28. What is legal tender money?
    Money that is declared legally as a medium of exchange by the government is called legal tender money.

29. Define involuntary unemployment.
    Involuntary unemployment refers to a situation in which people who are willing to work are unable to get work

30. What is the relationship between MPC and MPS?
    MPC + MPS = 1

31. What is meant by excess demand (inflationary gap)?
    Excess demand occurs when AD is greater than AS at the level of full employment equilibrium

32. What is deficient demand (deflationary gap)?
    Deficient demand arise when AD is less than AS at the level of full employment equilibrium

33. What is meant by autonomous investment?
    Investment which is made without depending on the profit of the enterprise

34. Define multiplier.
    Multiplier is the ratio of change in income to the change in investment

    $$\text{Multiplier (k)} = \frac{\Delta Y}{\Delta I}$$

35. Define government budget.
    Government budget shows the estimated receipts and estimated expenditure of the government for one year.

36. Define revenue deficit in government budget.
    When the revenue expenditure of the government is greater than the revenue receipts it is called revenue deficit

    Revenue expenditure > Revenue receipts

37. What is primary deficit?
    Primary deficit is the difference between fiscal deficit and interest payments made by the government

    Primary deficit = Fiscal deficit – Interest payments

38. What is fiscal deficit?
    When the total government expenditure is greater than total government receipts excluding borrowing it is known as fiscal deficit.

Fiscal deficit = Total Government Expenditure – Total Government Receipt (excluding borrowings)

39. What is meant by foreign exchange rate?
Foreign exchange rate refers to the rate at which one currency is exchanged for another currency

40. Name the two accounts in the balance of payments
a. Current account: It shows the imports and exports of goods and services and transfer payments
b. Capital Account: It shows the assets and liabilities of the government

41. Why a production possibility curve is concave?
Ans. It is due to increasing marginal opportunity cost.

42. What is primary deficit?

Ans. Primary deficit= fiscal deficit – interest payment.

43. What is revenue deficit?
Ans. When revenue expenditure is more than revenue receipts.

44. A rise in the price of a goods, results in an increase in expenditure on it. Is its demand elastic or inelastic?
Ans. Inelastic because there is direct relation between price and expenditure.

45. What is consumption function?
Ans. The relationship between income and consumption is called consumption function.

46. What is saving function?
Ans. The relationship between income and saving is called saving function.

47. What is Barter system?
Ans. Exchange of goods for goods is called barter system.

48. Define APC?
Ans. APC= C/Y.The ratio of income to consumption is called APC.

49. Define APS?
Ans. APS=S/Y .The ratio of income to saving is called APS.

50. What is excess demand?
Ans. When AD>AS at the full employment level.

51. What is deficient demand?
Ans. When AD<AS at the full employment level.

52. A rise in the income of the consumer X leads t a fall in the demand for that good by the consumer .What is the good X called?
Ans. Normal good.

53. When demand for good falls due to rise in its own price. What is the change in demand called?
Ans. Contraction of demand.

54. What happens when demand and supply curve don't intersect each other?
Ans. Economically non –viable industry.

55. What is abnormal profit?
Ans. It is the profit earned over and above normal profit.

56. What is break- even price?
Ans. It is the price at which firms make zero normal profit.

57. What is cartel?

Ans. It is a group of firms which jointly sets output and price so as to exercise monopoly control.

58. What are patent rights?
Ans. It is an exclusive license or right granted to a company or an Individual to produce a particular product or use a particular technology.

59. What are advertising costs/persuasive advertising?
Ans. When the expenditure incurred by a find to persuade the potential consumer to present their brands/products as different/ better compared to other brands/products is known as advertising costs/persuasive advertising.

60. What is induced investment?
Ans. It is a kind of investment which is profit motive in nature.

61. What is autonomous /public investment?
Ans. It is a kind of investment which is not profit motivated.

62. What is linear consumption function?
Ans. It is a consumption function which is given on the basis of constant marginal propensity to consume.

$$C=c+bY$$

Where c =autonomous consumption

B=marginal propensity to consume.

63. What is the relationship between APC and APS?
Ans. APC+APS=1.

64. What is the relationship between MPC and MPS?
Ans. MPC+MPS=1.

65. What is the relationship between multiplier and MPC?
Ans. The value of multiplier varies directly with MPC.

K=1/1-MPC.

66. What is multiplier?

Ans. It is the no. by which change in investment must be multiple in order to determine the resulting change in income and output.

67. What is fiscal deficit?

Ans. When TE(RE+CE)>TR(RR+CR)of the govt.,excluding borrowing. It is called fiscal deficit .

68. What does fiscal deficit in govt. budget mean?

Ans. It means more borrowing on the part of the govt.

69. What is deficit budget?

Ans. When expenditure of the govt. is more than its receipts, it is called deficit budget.

70. What is surplus budget?

Ans. When receipts of the govt. are more than its receipts, it is called surplus budget.

71. Why borrowing treated as capital receipts?

Ans.Because it increases the liability of the govt.

72. Why payment of interest treated as revenue expenditure?

Ans. Because it does not cause any reduction in liability of govt..

73. What is factor market?

Ans. It consists of factors of production namely land, labour, capital and organization.

74. Define product market?

Ans. It consists of final goods and services.

75. What is the alternative name of micro economics?

Ans. Price theory

76. What is the alternative name of macro economics?

Ans. Income theory.

77. Why is change in stock is considered a part of final expenditure?

Ans. Unsold stocks left with producers are assumed as purchased by the producers themselves. That is why it is treated as investment expenditure by the producers.

78. The balance of trade shows a deficit of Rs 300 crore.The values of exports are Rs 500 crore. What is the value of imports?

Ans. Since Balance of trade=Export-Import

300=500-Import

Import=300+500=800crore

79. Why does an economic problem arises?

Ans. It arises due to

1) Scarcity of resources.

2) Alternative uses of resources.

3) Unlimited wants and limited resources.

80. Define opportunity cost?

Ans.It is the cost of foregone alternative.

81. What was rightward shift of PPC indicate?

Ans. It indicates growth of resources.

82. What does leftward shift of PPC indicate?

Ans. It indicates underutilization of resources.

83. What is production function?

Ans. The technological relationship between input and output of a firm is called production function.

85. What is govt. budget?

Ans. It is an estimated receipts and expenditure of the govt. in an accounting year.

86. What is fixed exchange rate?

Ans. It is the rate of exchange which is fixed by the govt.

87. What is flexible exchange rate?

Ans. It is the rate of exchange which is determined by the forces of demand and supply of foreign exchange in the market.

88. What is foreign exchange rate?

Ans. It is the rate at which export and import of a country are valued.

89. What is balance of trade?

Ans. It is the difference between export and imports of a country are valued.

90. What is balance of payment?

Ans. It is a systematic record of all economic transaction of a country with the rest of the world in an accounting year.

91. What is "marginal rate of transformation" (Or) "marginal rate of substitution"(or) "marginal opportunity cost".

Ans. It is the ratio of units of one good scarified to produce one more unit of other good.

92. Define market supply?

Ans. It refers to the sum of outputs of all the producers of a good at a price during a given period of time.

93. Define marginal cost?

Ans. It is the change in total cost by producing one more or less unit of output.

94. Define marginal revenue?

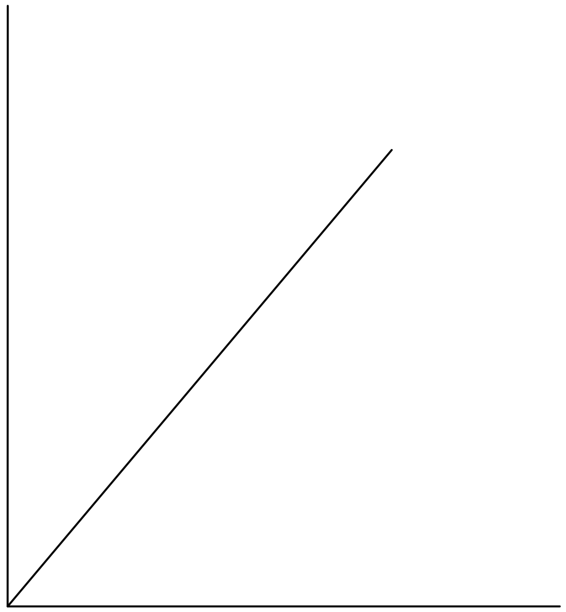
Ans. It is the change in total revenue by selling one more or less unit of commodity.

95. Which cost may there when output is even zero?

Ans. Fixed cost.

96. Draw unitary elasticity of supply?

Ans.



97. When there is a surplus in the balance of trade?
Ans. When export >import (when export is more than import).

98. When there is a deficit in the balance of trade?
Ans. When import > export.

99. Define cost?
Ans. It refers to the money expenditure incurred on the production of a given amount of commodity.

100. What induces new firms to enter an industry?
Ans. Abnormal profit induces new firms to enter an industry.

101. What happens to equilibrium of a commodity if there is decrease in its demand and increase in its supply?
Ans. The equilibrium price will decrease.

102. What is involuntary unemployment?
Ans It refers to a situation when person are willing and able to do work at a given wage rate but unable to get the work.

103. What is voluntary unemployment?
Ans. It refers to a situation when person are not willing to do work at prevailing market wage rate, although they are getting a work.

104. Give two sources of not tax revenue?
Ans. Escheat, special assessment, income from public enterprises, fees and fines etc.

105. Why entertainment tax is is indirect tax?
Ans. Because its burden can be shifted to others.

106. What is CRR?
Ans. It is the ratio of bank deposit that the commercial banks must keep with the central bank.

107. What is bank rate?
Ans. It is the rate of interest at which central bank gives loan and advance to the commercial banks.

108. Define change in demand?
Ans. When change in demand occurs due to change in factor other than price, it is called change in demand.

109. Define change in quantity demanded?
Ans. When change in demand occurs due to price alone, it is called change in quantity demanded.

110. Define utility?
Ans. wants satisfying power of a commodity is called utility.

111. Define marginal utility?
Ans. It is the change in total utility by consuming one more or less unit of commodity.

112. What is meant by the term "price taker" in the context of a firm?
Ans. It means that firm does not have any control over the price and it has to follow that price which is determined by the industry.

113. What is the price elasticity of supply of a commodity whose straight line supply curve passes through the origin forming an angle of 45 degree /75 degree?
Ans. Unitary elastic (es=1).

114. If MPC And MPS are equal, what is the value of multiplier?
Ans. MPC=MPS=1/2

Therefore K=1/MPS=1/1/2=2/1=2 [Multiplier K=2].

115. What is meant by SLR(Statutory liquidity ratio)?
Ans. It is the ratio of total demand and time deposits of commercial bank which it has to keep in the form of specified liquid assets.

116. What will be the effect of a rise/fall in bank rate on money supply?
Ans. It will reduce/ increase the money supply.

117. If planned savings are greater/smaller than planned investment, what will be its effect on inventories?
Ans. It will increase/decrease the inventories.

118. Define money?
Ans. "Money is what money does."

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(Or)

Money is any thing which is accepted as a medium of exchange and at the same time act as a store of value.

119. How is TVC derived from MC?
Ans. TVC=Sigma MC.

120. Define revenue of a firm?
Ans. It is the sale receipts or money receipts from the sale of a product.

121. What is average cost?
Ans. It is the cost per unit of output.

122. Define tax?
Ans. It is a compulsory payment made by household and firm to the government.

123. In which form of market demand curve is more elastic and why?
Ans.Demand curve is more elastic under monopolistic because of availability of close substitute.

124. Define production possibility curve (PPC)?

Ans. Ppc shows various combination of a pair of goods, which can be produced with the given resources and technique of production, which are fully and efficiently utilized.

125. Is import of machinery recorded in current or capital account?

Ans.It is recorded in current account because it is deal as the purchase of goods.

126. Can GDP can be greater than GNP?

Ans. Yes, GDP can be greater than GNP if NFIA is negative.

127. Can GNP can be greater than GDP?

Ans. Yes, GNP can be greater than GDP if NFIA is positive.

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Three or Four Marks Questions (3M/4M)

1. Explain the central problems of an economy
   a) What to produce?
   It refers to that what goods and services are produced and in what quantities.

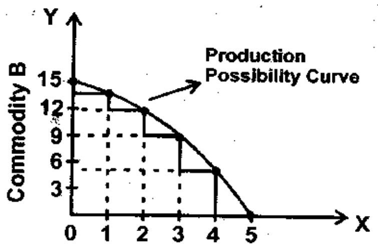
   b) How to produce?
   It refers to the choice of methods of production of goods and Services.

   c) For whom to produce?
   It refers to the distribution of income and wealth.

2. Explain the problem of How to Produce?

It refers to the choice of methods of production of goods & services i.e. whether labour intensive or capital intensive technique is to be adopted taking into consideration the proportion of capital and labour in an economy.

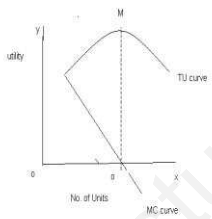
3. Explain Production Possibility curve with the help of diagram?
<u>Production Possibility Curve</u> refers to a curve which shows the various production possibilities that can be produced with given resources and technology.



If the economy devotes all its resources to the production of commodity B, it can produce 15 units but then the production of commodity A will be zero. There can be a number of production possibilities of commodity A & B

If we want to produce more commodity B, we have to reduce the output of commodity A & vise versa.

4. Explain the relationship between Total utility and Marginal utility?



a) TU increases at diminishing rate when MU is declining and Positive.
b) TU is maximum, when MU is ‘0’ (Zero)
c) When MU becomes Negative, TU declines.

5. State the Properties of Indifference Curve?
   1. Indifference curves slopes downward from left to right
   2. Indifference curves are Convex to the origin
   3. Two Indifference curve never intersects each other
   4. A Higher IC gives more satisfaction than the Lower IC.

6. State the Law of Diminishing marginal utility?
Law of Diminishing marginal utility: As a consumer goes on consuming more and more units of a commodity the additional satisfaction that he derives from the extra unit of consumption goes on falling.

Schedule

Quantity Consumed	Marginal Utility (Units)
1	10
2	8
3	6
4	4
5	2

7. State any three causes of decrease in demand?

(Or)

Mention any three causes for leftward shift in demand curve

a) Decrease in income of the consumer.
b) Fall in the price of substitute good
c) Rise in the price of complementary goods.

8. State any three causes of Increase in demand?

(Or)

Mention any three causes for rightward shift in demand curve?

a) Increase in the income of consumer
b) Price of substitute goods rise.
c) Price of complementary goods fall
d) Tastes & preferences of a consumer rises

9. At price of Rs. 20 Unit the quantity demanded is 300 units. Its price falls by 10% its quantity demanded rises by 60 units. Calculate price elasticity.

Rise in Price = 10% (Given)

∴ Rise in Quantity = $\underline{\Delta Q}$ /Q x 100

= $\underline{60/300}$ x 100

= 20%

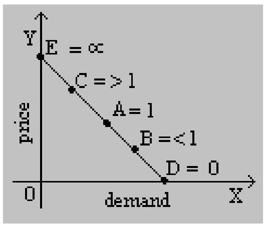
∴ **ED** = $\dfrac{\text{Percentage change in Quantity demanded}}{\text{Percentage change in price}}$

= 20 /10

= 2

∴ Elasticity is greater than unity ∴ ED > 1

10. Draw a straight line demand curve and show on it a point at which

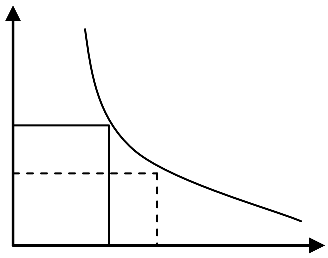


a) ed>1 b) ed<1,c) ed=1?

11. State the law of demand with help of a schedule and diagram?
Law of demand states that there is an inverse relationship between the price of a commodity and it quantity demanded assuming all other factors affecting demand remain constant.

When price of a good falls, the demand for the good rises and when the price rises the demand falls.

Price	Quantity Demanded
5	1
4	2
3	3
2	4
1	5



12. State the relationship between Average Product and Marginal Product?
    1. When MP >AP, AP is rising
    2. When MP =AP, AP is maximum
    3. When MP<AP, AP is falling

13. What are the reasons for diminishing returns to factor?
    A. Over utilization of fixed factors-As more and more units of the variable factor continues to be combined with the same fixed factor, the fixed factor gets over utilized.

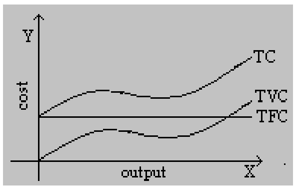
B. Imperfect factor substitution-More and more of variable factor cannot be continuously used in place of fixed factor.

14. Distingush between Fixed cost and variable cost.

Fixed Cost	**Variable Cost**
1. It will not change with changes in levels of output. 2. It can never be zero 3. Examples : Salary to Permanent employees, Rent	1. It changes with changes in levels of output. 2.It is zero when output is zero 3. Examples: Salaries to Temporary employees, Fuel charges.

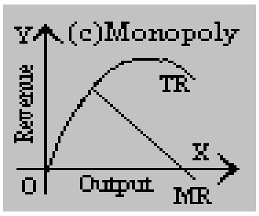
15. Explain the relationship between Average Variable Cost (AVC) Average Total Cost (ATC) and marginal Cost (MC)?
   1. When MC < AVC & ATC, AVC & ATC are falling
   2. MC cuts ATC and AVC at their minimum point
   3. When MC > AVC & ATC, AVC & ATC are rising.

16. Draw TFC, TVC and TC in a single diagram.



17. Give the relationship between Total Revenue (TR) and Marginal Revenue (MR)?
   1. When MR is positive, TR increases but at diminishing rate.
   2. When MR is Zero, TR becomes maximum.

18. When MR is negative, TR starts declining but remains positive



19. State the law of supply with a help of a schedule and diagram?
Other things being constant, there is a direct relation between price of a commodity and its quantity supplied i.e. higher the price more the supply and vice-versa.

Price	Quantity Supplied
1	1
2	2
3	3
4	4
5	5

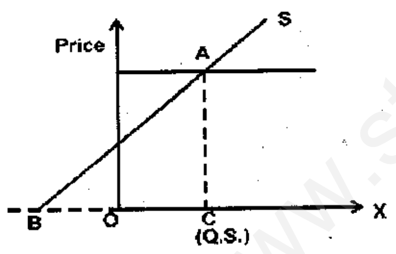
20. As the price of peanut packets increases by 5 % , the quantity supplied of peanut rises by 8 % . What is elasticity of supply?

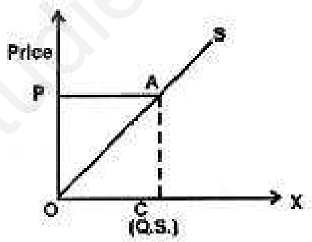
Es = percentage Change in quantity supplied/ percentage change in Price

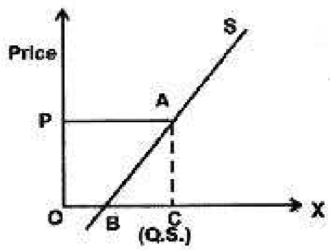
= 8/5

= 1.6 (Hence the supply is elastic)

21. What will be the price elasticity of supply at any point on a straight line curve if 1) supply curve intersects ox axis in its negative range 2) supply curve intersects ox axis in its positive range.3)supply curve passes through the origin?







Geometric Method:-

Es > 1 Es = 1 Es < 1

22. List the three main features of oligopoly?
   A. Few sellers in the market
   B. Price Rigidity.
   C. Firms sell homogenous or differentiated products.
   D. Behavior of each firms dependence on the other firms.

23. State any three features of Monopoly?
   1. A Single seller
   2. No close substitute available.
   3. No freedom of entry of new firms.

4. Possibility of price discrimation.

24. How is equilibrium price determined in perfect competition market?
Equilibrium price is the price at which quantity demanded is equal to quantity supplied. It is determined at the point where the demand curve intersects supply curve.

Price	Quantity Demanded	Quantity Supplied
1	50	10
2	40	20
3	30	30
4	20	40
5	10	50

25. Explain the effect of an increase in demand of a commodity on its equilibrium price and quantity?
Increase in demand causes a rightward shift in demand curve keeping the same supply curve. As a result the equilibrium price and quantity both will increase.

26. What happens to the equilibrium price when increase in demand is equal to increase in supply?
In case of equal increase in demand and supply the equilibrium price remains unchanged but the equilibrium quantity rises.

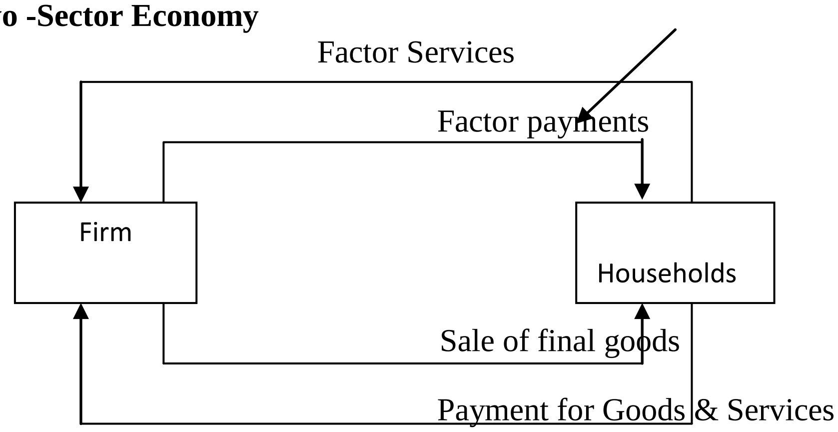
27. Difference between Micro and Macro economics

Micro Economics	Macro Economics
1. It is the study of individual units of an economy	1. It is the study of the whole economy
2. It deals with allocation of resources	2. It deals with growth and development of resources
3. It is also called price theory	3. It is also called income theory

28. Explain the circular flow of Income in a two sector model
There are only two sectors namely Firms and households. Households provide factor services to the firms and firms hire factor services from the households. Household spend their entire income on consumption of goods and services and firms sell their entire goods to the households.

There are two types of market in this economy: Factor market - for Factors of Production and Product market for goods and Services.

Two -Sector Economy



29. Explain briefly the income approach to measure national income. Under income method to calculate the National Income, following steps have been taken into account:-
    i) First of all production units which use factor services are identified.
    ii) Estimate the following factor incomes:-
        a) Compensation of employees
        b) Rent, Interest, Profits
        c) Mixed Incomes.

    The sum total of the above factor income is NDPFC

    Add net factor income from abroad to the NDPFC to arrive at National Income.

30. Explain the following terms
    a) Business fixed investment
    b) Inventory Investment
    c) Residential construction Investment
    d) Public Investment.

    a) Business Fixed Investment: - It is the amount spent by business units on purchase of newly produced plants and equipments.
    b) Inventory Investment: - It refers to the net change in inventories of final goods, semi-finished goods, raw material etc.
    c) Residential Construction Investment: - It is the amount spent on the building of housing units.
    d) Public Investment:- It includes all capital formation carried by the Govt. such as building of roads, hospitals , schools.

31. Name the components of aggregate demand (AD). Explain any one of them.
    Following are the components of AD

$$AD = C + I + G + (X-M)$$

Simplifying AD= C + I, Where 'C' refers to Household consumption demand and 'I' refers to Investment Demand.

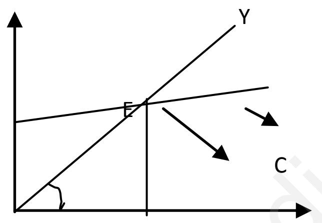
32. Distinguish between APC and MPC. The value of which of them can be more than one and when?
APC is the average consumption level of the people. Which is equal = APC = C/Y.

MPC is the addition in consumption due to increase in income i.e. MPC = $\Delta C / \Delta Y$. APC can be more than one when consumption is greater than Income.

33. Explain the relationship between MPC and MPS.
Increase in income is either increase in consumption or increase in saving. Therefore $\Delta Y = \Delta C + \Delta S$ (Dividing both sides with ΔY)

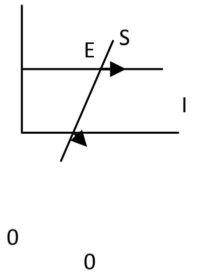
$$\frac{\Delta Y}{\Delta Y} = \frac{\Delta C}{\Delta Y} + \frac{\Delta S}{\Delta Y} \qquad \therefore 1 = MPC + MPS$$

34. What is consumption function? Explain using suitable diagram.
Functional relationship between Consumption and disposable income.



X axis measures income and y axis measures consumption. Point E shows equality between consumption and income. This is Break Even point. To the left of this point consumption is more than income. So it is –ve savings. To the right of point E is +ve savings.

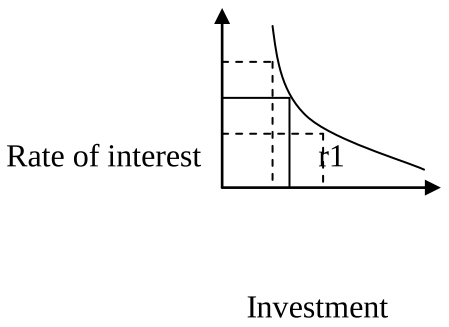
35. What is Break Even point? Explain with the help of saving function.
Breakeven point is a point where consumption equals income and saving is equal to zero. As explained below.



At point E saving is equal to zero, so point E is called Break Even point. To the left of point saving are –ve, and to the right of E saving are +ve.

36. Explain diagrammatically Investment demand as a component of AD.

The Business demand for investment depends upon rate of interest and marginal efficiency of capital. As is explained in the following diagram.



37. What is inflationary gap? Explain with diagram.
When at full employment level AD > AS, the situation of excess demand exists. In this situation the gap between AD and AS is called the inflationary gap.

38. What are impacts of deficient demand or deflationary gap on the level of income, output, employment and prices?
Income level will fall, Output level will fall

Prices level will fall, Employment level will reduce

39. What will be the impact on income /output and price of excess demand (Inflationary gap)?
In the situation of excess demand (Inflationary gap) there will be upward pressure on price .So Price will increase. Real output and employment can't increase as economy has achieved full employment. So resources are not available. But due to increase in price nominal income will increase. Economy will remain at full employment level but at higher prices

40. Explain the fiscal measures to correct the situation of deficient demand and excess demand.
Fiscal measures are the government's budgetary policy which includes taxation and government expenditure policy.

Deficient Demand:-

i) Govt. Expenditure:- Government will increase expenditure. This will increase AD to restore full employment level.
ii) Taxes: - Government will decrease taxes. This will increase disposable income. AD will increase.

Excess Demand:-

i) Govt. Expenditure:- Govt. will decrease its expenditure .So AD will decrease.
ii) Taxes :- Government Should increase taxes. It will reduce the disposable income of the household and aggregate demand will decrease.

41. What is monetary policy? What monetary measure can be adopted to control the situation of excess demand?

It is the policy adopted by central bank exercising control over money rate of interest and credit conditions. In the situation of excess demand following monetary measures are adopted.

i) Increasing the rate of interest.

ii) Reducing availability of credit

42. Distinguish between planned and actual saving and investment.

There is a difference between i) planned S and I and ii) Actual saving and investment. Planned saving is what house hold plan to save and planned investment is what the investors plan to investment. As they are different set of people, planned saving and investment may or may not be equal.

But actual saving investment form an accounting identity and are, there bound to be equal. This is because:

$C + S = Y = C + I$

$Y = C + S$

$Y = C + I$

Therefore, $S = I$.

43. Differentiate between full employment equilibrium and Underemployment equilibrium.

When equality between AD and AS is at full employment level it is called full employment equilibrium. But when equality between AD and AS is established before full employment equilibrium, it is called Underemployment Equilibrium.

44. What are drawbacks of barter system?

1) Both sale and purchase should occur simultaneously implying double coincidence of wants.
2) There is no common unit of exchange in a barter system, accordingly exchange remains limited.
3) Barter system does not allow any convenient method of storage of value
4) Division of goods in exchange may not be possible so some wants may remain unsatisfied.

45. Explain the Primary functions of money.

Primary functions:-

A. Medium of Exchange:- It means that money acts as an intermediary for the goods and services in an exchange transaction
B. Measure of value or unit of value money:- serves as a measure of value in terms of unit of account.

46. Explain the Secondary or Subsidiary function:-
   A. Standard of deferred payments:- Money is functioning as deferred Payments because its price remains relatively stable.
   B. Store of Value:- It is convenient to store value in terms of money because storage of money does not need much space.
   C. Transfer of Value:- Because of its general acceptability and the merit of liquidity, money can be easily transferred from

47. Write the six agency function of the Commercial Bank.

1) Transfer of funds
2) Collection of funds
3) Purchase and sale of securities.
4) Collection of dividends
5) Payment of bills & insurance
6) Acting as executors and trustees of wills.

48. How the Bank rates control the credit?
Bank rate is the rate of interest at which Central bank lends to Commercial banks. By raising the bank rate central bank raises the cost of borrowing. This forces the Commercial banks to raise in turn the rate of interest from the public. As lending rate rises, demand for loan for investment and other purposes falls.

49. Write any three objective of government Budget.
The objective that are pursued by the government through the budget are-

i) To achieve economic growth.

ii) To reduce in equalities in income and wealth.

iii) To achieve economic stability.

50. Explain the basis of classifying government receipts into revenue receipts & capital receipts.
<u>Revenue Receipts:-</u>A government revenue receipts are those receipts

i) which neither create liability
ii) Nor reduces assets of the government Eg. Taxes, Non-Tax Revenue

<u>Capital Receipts: -</u> Capital Receipts refer to those receipts of the government which

i) Tend to create a liability or
ii) Causes reduction in its assets of the government. eg. Borrowings, Income from Disinvestment

51. Distinguish between direct tax and indirect tax

<u>Direct Tax</u>	<u>Indirect Tax</u>
1. Liability to pay and burden of direct tax falls on same person. 2. Levied on income and property of person. 3. Eg. Income tax	1. 1. Liability to pay and burden of direct tax falls on some other person. 2. Levied on goods and services on their sale, production, import and export. 3. 3. eg. Sales tax

52. Define revenue receipts. Write the groups in which they are classified.

Any receipts which do not either create a liability or lead to reduction in assets is called revenue receipts. Revenue receipts consist of

1) Tax Revenue and

2) Non-Tax Revenue.

53. Distinguish between Revenue and Capital expenditure.

Revenue Expenditure	Capital Expenditure
1. It does not result in creation of assets 2. It is for short period and recurring in nature 3. Eg. Expenditure on salaries of employees	1. It result in creation of assets 2. It for long period and non-recurring in nature 3. Eg. Expenditure on acquisition of assets like land, building etc.

54. Write a note on plan and non-plan expenditure of the government with example.

Plan Expenditure:- Plan expenditure refers to the estimated expenditure which is provided in the budget to be incurred during the year on implementing various projects and programmes included in the plan. Such expenditure is incurred on financing the central plan relating to different sectors of the economy

Non – Plan Expenditure:- This refers to the estimated expenditure provided in the budget for spending during the year on routine functioning of the government. Its examples are expenditure incurred on government administrative services, salaries and pension etc.

55. Distinguish between development and non-developmental Expenditure.

Developmental Expenditure	Non-developmental Expenditure
1. It refers to expenditure on activities which are directly related to economic & social development of the country 2. It directly contribute to national product 3. Eg. expenditure on education health etc.	1. It refers to expenditure incurred on essential general services of the government 2. It does not contribute directly to national product 3. Eg. Expenditure on defence, subsidy on food etc.

56. State four main sources of demand for foreign currency

The four main sources of demand for foreign currency are:-
1. To purchase goods and services from other countries.
2. To send a gift abroad.
3. To purchase financial assets in a particular country and
4. To speculate on the value of foreign currencies

57. State three main source of supply of foreign currencies into the domestic economy.

1. Foreigners purchasing home country's goods and services through exports.
2. Foreign investment in home country through joint ventures or through financial market operation and
3. Foreign currencies flow into the economy due to currency dealers and speculators.

58. Differentiate between balance of payment and balance of trade.

Balance of Trade	**Balance of Payments**
1) Balance of trade is a record of only visible items i.e. exports and imports of goods.	1. Balance of payments is a record of both visible items (goods) and invisible items (services)
2) Balance of trade is a narrower concept as it is only a part of the balance of payments account.	2. Balance of payments is a wider and more useful concept as it is a record of all transactions in foreign exchange.
3) Balance of trade can be in a deficit, surplus or balanced	3. Balance of payments must always balance

59. Explain the components of capital account

It records are international transactions that involve a resident of the domestic country changing his assets with a foreign resident or his liabilities to a foreign resident.

Various forms of capital account transactions :-

1) Private Transactions :- There are transactions that effect the liabilities and assets of individuals.
2) Official Transactions :- Transactions affecting assets and liabilities by the govt. and its agencies.
3) Portfolio Investment :- It is the acquisition of an asset that does not give the purchaser control over the asset.
4) Direct Investment :- It is the act of purchasing an asset and at the same time acquiring control of it.

The net value of the balance of direct and portfolio investment is called the balanced on Capital Account.

60. Differentiate between autonomous and accommodating items.

Autonomous Items	Accommodating Items
1. Autonomous items refer to international economic transactions that take place due to some economic motive such as profit maximization. These transactions are	1. This refers to transactions that occur because of other activity in the BOP, such as government financing.

independent of the state of the country's BOP. 2. These items are often called above the line items in the BOP.	2. These items are called below the line items.

Four Marks Questions (4M)

61. Explain any four precautions to be taken in estimating national income by expenditure method?

The following precautions are to be taken while calculating N.I. by the expenditure method.

i) Do not include expenditure on intermediate goods and services:-Intermediate expenditure is a part of final expenditure hence its inclusion leads to double counting.
ii) Do not include expenditure on second- hand goods;-Expenditure on these goods was accounted when they were purchased new.
iii) Do not include expenditure on financial assets:-Purchasing of financial assets only leads to transfer of money from one person or one institution to another person or institution.
iv) Include imputed expenditure on own account produced output used for consumption and investment:-The imputed value of owner occupied house, self consumed output by farmers etc must be taken into account while estimating final expenditure.

62. Explain the steps taken in estimating N.I. by product/ value added method?

i) Classify all the production units:- Locate the domestic territory into distinct industrial sectors ie primary, secondary and tertiary sectors.
ii) Estimate value of output:- As sum of sales and change in stock of all the 3 sectors.
iii) Estimate value of intermediate consumption:-A sum of value of intermediate consumption of all the 3 sectors.
iv) Estimate GVAmp:- Value of output – Intermediate consumption.
v) Estimate NVAmp:- Deduct the value of depreciation from GVAmp.(NVAmp= NDPmp).
vi) Estimate NDPfc:- Deduct the value of Net Indirect Taxes from NDPmp.
vii) Estimate NNPfc :- Add the value of Net Factor Income from Abroad with NDPfc to reach NNPfc or the N.I.

63. Calculate the Gross Domestic Product at market price from the following data.

	(Rs. In crores)
Consumption of fixed capital	50
Closing stock	40
Private final consumption expenditure	500
Opening stock	60
Net factor income from abroad	(-) 35

Exports	25
Government final consumption expenditure	200
Imports	40
Net indirect tax	100
Net domestic fixed capital formation	210
Change in stock	90

GDP mp = iii + vii + (x + xi +i) + (vi – viii)

= 500 + 200 + (210 + 90 + 50) + (25 – 40)

= 500 + 200 + 350 + (-15)

= **Rs.1035 Crores.**

64. Write down some of the limitations of using GDP as an index of welfare of a country

i) The N.I. figures give no indication of the population, skill and resource of a country. Therefore the level of welfare remains low.

ii) A higher N.I. may be due to greater area or due to concentration of some resources in one particular country.

iii) N.I. does not consider the level of prices in a country. People may be having high income but due to high prices they might not be able to enjoy a high standard of living.

iv) High N.I. of a country may be due to large contributions made by a few industries.

65. Explain any four functions of money.

OR

Explain briefly any two functions of money.(2006,2007,2009)

(i) Medium of exchange – Money can be used to make payments for all transactions of goods and services.

(ii)Measure of value – Money works as a common denomination in which values of all goods and services are expressed.

(iii)Store of value – Wealth can be conveniently stored in the form money without loss of value.

(iv) Standard of deferred payments – Money has simplified the borrowing and lending operations.

66. Explain the process of money creation by commercial banks.(2010)

OR

How does a commercial bank create money? (2010)

Commercial banks are able to create credit which is many times more than the deposits received by banks. Money creation or credit creation by the banks is determined by-

(a)The amount of initial deposits, and (b) The legal reserve ratio (LRR).

(Explain with an example)

Given the amount of fresh deposits and the LRR, the total money created is calculated as:

Total money creation = Initial deposit × 1/LRR

If the LRR is 20% and there is fresh (initial) deposit of Rs. 10000,

Tthe total money created = 10000 * 1/20% = Rs.50000.

67. Explain any four functions of a central bank(2007, 2008, 2009,2010)

(i) Issue of currency:- Central bank is the sole authority for the issue of currency in the country.

(ii) Banker to the govt(both central and state Govt.:- It carries out all the banking business of the govt. and also manages the public debt.

(iii) Bankers bank and superviser.- It keeps a part of cash reseves of banks, lends them short term funds and provides centralized clearing facilities.

(iv) Lender of last resort:- The central bank has to provide funds to commercial banks as and when they need financial help.

68. What is bank rate policy? How does it operate as a method of credit control? (2008, 2009,2010)

Bank rate is the rate at which the central bank gives loans to the commercial banks. An increase in the bank rate leads to increase in interest of loans. This discourages borrowers from taking loans. It reduces credit creation. A decrease in bank rate will have the opposite effect.

69. What are open market operations? What is its effect on availability of credit? (2008, 2009)

Open market operations means the purchase and sale of govt securities by the central bank from/to the public and commercial banks. Sale of govt. securities reduces the reserves of commercial bank and in turn reduces credit. Purchase of securities increases the reserves and raises their ability to give credit.

70. What is the investment demand function?

Investment demand function is the relationship between rate o interest and investment demand. There is an inverse relationship between rate of interest and investment demand. Higher interest rate implies lower level of investment demand. This is because higher rate of interest is to be matched with equally higher marginal efficiency of capital. MEC starts reducing as investment level is raised. Accordingly, investment demand would increase only corresponding to lower level of MEC along with lower level of rate of interest.

71. What is deficient demand in an economy? What is its impact on output, employment and price?

Deficient demand refers to the situation when aggregate demand (AD) is short of aggregate supply (AS) corresponding to full employment in an economy.

Effect on output: Low level of investment and employment implies low level of output**.**

Effect on employment: Because of deficiency of demand investment level is reduced.Accordingly level o employment tends o fall.

Effect on price: Fall in prices is the immediate cosequence of deficient demand.

72. What is fiscal policy? What possible fiscal policy measures can be taken with respect to expenditure and income to correct excess demand and deficient demand in the economy?

Fiscal policy is the revenue and expenditure policy of the government with a view to combat the situation of inflationary or deflationary gap in the economy.

Fiscal measures to correct excess demand: Govt. expenditure on public works, public welfare, defence etc should be reduced. Public expenditure on transfer payments and subsidies should be reduced. Taxes should be increased to lower disposable income with the people. Deficit financing must be restricted to check the flow of money. Purchasing power should be mopped up through greater public borrowings.

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73. Explain the concept of deflationary gap. Explain any two measures by which a Central Bank can attempt to reduce the gap.

Deflationary gap is the shortfall in aggregate demand from the level required to maintain full employment equilibrium.

Central bank can reduce this gap by adopting following two measures:

Bank rate: Central Bank should decrease the bank rate. A decrease in bank rate lowers the rate of interest and credit becomes cheap. Accordingly, the demand for credit expands and aggregate demand increases.

Open Market Operations: By buying the government securities Central Bank injects additional purchasing power into the system which results in the expansion of credit.As a result aggregate demand increases.

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76. Define govt. budget. Explain briefly any three of its objectives. (2007, 2008, 2009)

Govt. budget is an annual statement of the Govt. which shows the item wise estimates of receipts and expenditure during a fiscal year.

Objectives of govt. budget:

(i) Redistribution of income and wealth – Govt. with the help of taxation, subsidies, and transfer payments brings about fair distribution income.
(ii) Reallocation of resources – The govt. aims to reallocate resources so that the social (public welfare) and economic (profit maximisation) objectives are met .
(iii)Economic growth and stability – Govt. tries to prevent business fluctuations and maintains price and economic stability. The budget tries to raise the overall rate of saving s and investments.

77. What is a tax? Explain with the help of suitable examples the basis of classifying taxes into direct and indirect taxes.(2008, 2009, 2010)

OR

Define a tax. Distinguish between direct taxes and indirect taxes with the help of examples.

Tax is a legally compulsory payment imposed on the people by the govt. There are two types of taxes—

(a) Direct taxes: When the liability to pay tax and the burden of that tax fall on the same person, it is called direct tax. Examples are – income tax, wealth tax, corporation tax, gift tax etc.
(b) Indirect taxes: When the liability to pay tax is on one person and the burden of that tax falls on other persons, it is called indirect tax. Examples are – sales tax, excise duty, VAT, tax on services etc.

78. Distinguish between revenue expenditure and capital expenditure with examples.(2007, 2009, 2010)

Revenue Expenditure:- Any expenditure that does not result in the creation of physical or financial assets, or reduction in liability. It is financed out of revenue receipts. Examples: expenditure on payment of salary, pension, interest on loans taken by the govt. etc.

Capital expenditure:- Any expenditure that will lead to creation of an asset or reduction in liability. It is financed out of the capital receipts of the govt. Examples: Expenditure on construction of roads, bridges, canals, grant of loans by the central govt. to the state govt.

79. What is meant by fiscal deficit? What are its implications? (2007,2008,2010)

Fiscal deficit is defined as the excess of total expenditure over total receipts, excluding borrowings. Fiscal deficit = Total expenditure (Rev. Exp. + Cap. Exp.) – Total Receipts (Rev. Rec. + Cap. Rec.) excluding borrowings.

<u>Implications:</u>

(i) High fiscal deficit implies a large amount of borrowings wherein the govt. takes more loans to repay it. It increases the liability of the govt.
(ii) It leads to inflationary pressure in the economy.
(iii)It creates a large burden of interest payments in the future.
(iv)It increases the dependence of the govt. on foreign countries.
(v) It hampers the future growth and development prospects of the country.

80. Explain how foreign exchange rate is determined under flexible exchange rate system. Use diagram.(2007, 2008, 2009)

Under flexible exchange rate system, the equilibrium exchange rate is determined where demand for foreign exchange is equal to the supply of foreign exchange.

Demand for foreign exchange = Supply of foreign exchange.

<u>Demand for foreign exchange is made to:</u>

(i) Purchase goods and services,(imports),
(ii) Send gifts and grants,
(iii)Speculate on the value of foreign currences,
(iv)Invest and purchase financial assets

There is an inverse relation between exchange rate and demand for foreign exchange.

<u>Supply of foreign exchange:</u>

(i) By exports of goods and services,
(ii) Direct foreign investment in home country,
(iii)For speculative purchases by non-residents in the home country,
(iv)Remittances from abroad

There is a direct relationship between foreign exchange rate and demand for foreign exchange.

81. Give the meanings of (i) fixed exchange rate, (ii) Flexible exchange rate, (iii) managed floating.

(i) **Fixed exchange rate system (pegged exchange rate system): It is a system in which exchange rate of a currency is fixed by the govt. This system ensures stability in foreign trade and capital movement.**

(ii) Flexible (Floating) exchange rate system: It is a system in which exchange rate is determined by forces of demand and supply of foreign currencies concerned in the foreign exchange market. There is no official intervention in the foreign exchange market.

(iii)Managed floating rate system: It is a system in which foreign exchange rate is determined by market forces and central bank is a key participant to stabilize the currency in case of extreme appreciation or depreciation.

82. Distinguish between current account and capital account of balance of payment account. Mention any two transactions of capital account.

A balance of payment account (BOP) account is a statement of all economic transactions that take place between a nation and the rest of the world during a given period. BOP account broadly comprises of (i) Current account and (ii) Capital account.

Current account:-It is that account which records imports and exports of goods and services and unilateral transfers.

Capital account:-It is that account which records capital transactions such as foreign investments, loans, banking, capital, rupee debt service, other capital and monetary movements.

Components of capital account: (a) Foreign investment

(b) Foreign loans

(C) Banking capital and other capital

(d) Monetary movements.

83. Distinguish between visible and invisible items in the BOP. Give one example of each.

Visible items: All types of goods which are exported and imported are called visible items. These are visible as these are made of some matter or material. The record of these items is available with the ports.

Examples: Tea, Jute items, Petroleum etc.

Invisible items: All types of services which are rendered to or received from abroad are called invisible items. These are invisible as these are not made of any matter or material. The record of these items is not available with the ports.

Examples: Transport services, Insurance and banking schemes.

Six Marks Questions (6 M)

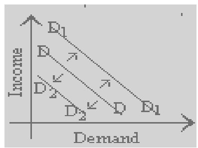
1. Explain the effect of the following on quantity demanded.
   A. Income of the consumer

B. Price of related goods.

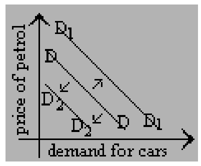
A) Incase of normal good - An increase in income leads to increase in quantity demanded of a normal good and decrease in income leads to decrease in quantity demanded of a normal good.
Incase of inferior good - An increase in income leads to decrease in quantity demanded of inferior good and an decrease in income leads to increase in quantity demanded of an inferior good.

B) Price of related goods

a) Substitute goods – When the price of substitute goods rises they become dearer when the price substitute goods falls they become cheaper. When the price of one good rises the consumer will substitute the other good.



b) Complimentary goods – When the price of complimentary goods falls, along with the rise in its demand. The demand for complimentary goods will rise. Incase of complimentary goods price of one good and quantity demanded for other good are inversely related.



2. State the causes of increase in demand and explain any two of them.
   A. Increasing the income of the buyers for normal goods
   B. Increase in the price of substitute goods.
   C. Decrease in the price of complimentary goods.
   D. Favorable changes in the taste and preference for the goods.

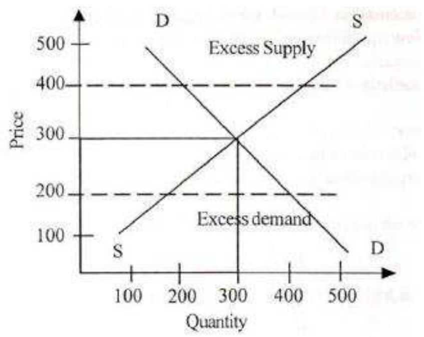
Increase in the income of the consumer increase the purchasing power of the buyer. At the same price he can buy more of goods so demand increases. When the price of substitute good rises the given good is used in the place of substitute good so the demand for given good increases.

3. Define equilibrium price and explain its determination with the help of diagram and schedule.

Equilibrium price is the price at which the demand and supply are equal. At price 200 there is excess demand as demand is greater than supply. At price 400 there is excess supply as supply is greater than demand. Therefore equilibrium is attained at price 300 where demand is equal to supply

DEMAND AND SUPPLY SCHEDULE

Price (Rs.)	Demand (units)	Supply (units)
100	500	100



200	400	200
300	300	300
400	200	400
500	100	500

This can be shown in the Diagram

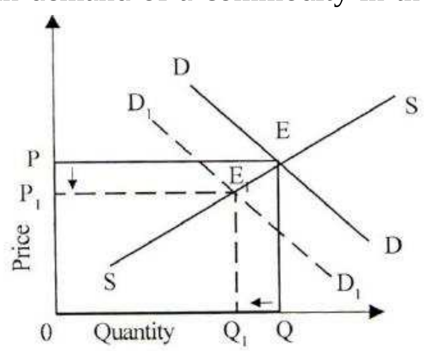
When there is excess demand there will be competition among the buyers leading to rise in price, fall in demand and rise in supply. These changes continue till price rises to Rs.300, which is the equilibrium price. When there is excess supply there will be competition among the sellers leading to fall in price it leads to rise in demand and fall in supply. These changes continue till price falls to Rs. 300, which is the equilibrium price.

4. Explain the implication of the following features of monopolistic competition.
   A) Differentiated products.
   B) Freedom of entry and exit of firms.

   Products are differentiated on the basis of colour, design, packing, fragrance, shape, brand etc and also act as close substitute. Its implication is that since each firm is known for its product it can influence the price of its product to some extent.

   Freedom of entry and exit.- Firms can freely move in and out of a group. If profitable, new firms will enter if they incur loss they are free to exit. No firm can earn abnormal profit in long run.

5. With the help of diagram explain the effect of decrease in demand of a commodity in the equilibrium price and quantity.



   Effect of decrease in demand of a commodity leads to fall in the equilibrium price and equilibrium quantity.

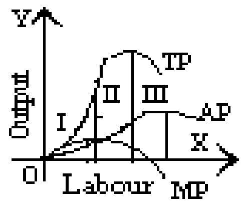
   Demand shifts to leftward showing the decrease in demand (D1D1), Supply (SS) remaining constant.

   The chain effect of the decrease in demand in the equilibrium price: - This leads to excess supply in the market, which results in competition among the producers resulting in fall in equilibrium price. With the fall in price there will be downward movement in supply leading to fall in equilibrium quantity.

6. Explain the Law of Variable Proportions with help of schedule and diagram.

   Law of Variable Proportions- The law states that if producers go on using more and more units of a variable factor (Labour) with a fixed factor(land , Capital) the total output initially increases at an increasing rate but beyond certain point, it increases at a diminishing rate and finally it falls.

This can be studied in three stages (I, II, and III) Total Physical Product (TPP):- The total output of commodity at a particular level of employment of an input (Labour), Average Physical Product (APP):- Dividing the TPP by the number of inputs. Marginal Physical Product (MPP):- An addition made to the TPP by employing an additional unit of a variable input



TPP & MPP Relationship:- a) When MPP is positive, TPP increases at increasing rate (I stage) b) When MPP is zero, TPP is maximum,(II stage) c) When MPP is negative, TPP is falling(III stage)

APP & MPP Relationship:- a) When APP rises, MPP >APP (I stage) b) When APP is maximum , APP = MPP (Stage II) and c) When APP decline, MPP<APP. (III Stage) (use schedule and diagram).

Labour	1	2	3	4	5	6	7	8	9	10
TPP (TP)	3	7	12	16	19	21	22	22	21	19
APP (AP)	3	3.5	4	4	3.8	3.5	3.14	2.75	2.33	1.9
MPP (MP)	3	4	5	4	3	2	1	0	-1	-2

7. Explain the consumer's equilibrium in case two commodities (IC) approach.

Consumer equilibrium refers to a situation when he spends his given income on purchase of a commodity (or commodities) in such a way that yields him maximum satisfaction.

Condition of equilibrium: -MU in terms of money = Price.

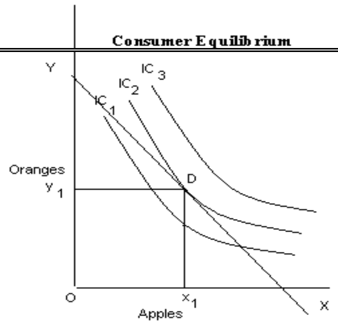
MU of product / MU of a Rupee = Price

Consumer equilibrium through indifference curve:-

Budget line: - It refers to all combinations of goods which a consumer can buy with his entire income and price of two goods.

Indifference curve: - the combination of two goods which gives consumer same level of satisfaction

Indifference Map: - Group of indifference curves



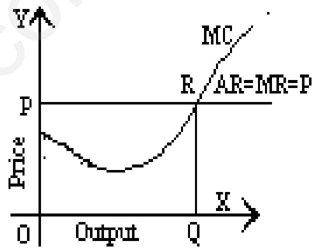
Marginal rate of Substitution (MRS):- it is the rate at which a consumer is willing to give up one good to get another good.

Consumer equilibrium:- At a point D where budget line is tangent/ touches the higher indifference curve of IC 2. MRS = P_X / P_Y , i.e., Ratio of prices of two goods.

8. Explain the producer's equilibrium with the help of MC and MR approach.

<u>Producer's Equilibrium:-</u> A producer (a firm) is said to be in equilibrium when it earns maximum profits. Profit maximization of a firm means maximizing the difference between total revenue and total cost. When the profits of the firm are maximum, the firm is in equilibrium. Firm attains equilibrium position, i.e., maximizes profits at the level of output where i) MR= MC ii) MC is rising. MC is greater MR after equilibrium level of output.

In a perfectly competitive firm maximizes profits i.e. attains producer's equilibrium when price is equal to the marginal cost. In a perfectly competitive market, the marginal revenue and average revenue of a firm coincide and equal to the market price (AR=MR=P.) A competitive firms equilibrium is, therefore, established at the level of output where i) MR= MC, and ii) MC is rising.



Total Revenue = OQ×OP=OPRQ .

Profit = OPRQ – OSRQ

Units of commodity	MR	MC
1	10	9
2	9	7
3	8	6
4	7	7
5	6	8
6	5	9

9. Comparison of different forms of Market Structure

Perfect Competition	**Monopoly**	**Monopolistic competition**
1. A very large number of sellers. No sellers	1. A single seller (firm) of Product	1. Number of seller is fairly large but each

can influence the price and supply		seller has some control over price and supply.
2. Products are Homogenous	2. Product has no close substitute.	2. Differentiated products with closely substitutable
3. Free entry and exit of the firm	3. Very difficulty entry of new firm	3. Freedom of entry and exit.
4. Firm is a price taker not the price maker	4. Firm is price maker not price taker	4. Firm is a price maker (not absolutely)
5. Price is conform in the market and Price = MC	5. Due to price discrimination price is not uniform Price > ME	5. Firm has limited control over price through product differentiation
6. Perfect knowledge	6. Price discrimination	6. High Selling cost
7. AR and MR Curve are straight line parallel to x axis ie AR = MR	7. AR and MR Curve are downward sloping from left to right but less price elastic MR < AR	7. AR and MR curve are downward sloping but more price elastic MR < AR

10. From the following data calculate National Income by
(a) Income Method
(b) Expenditure method

	Rs.(Crores)
1. Compensation of Employees	800
2. Private Final Consumption Expenditure	1200
3. Profit	500
4. Rent	200

5. Govt. Final Consumption Expenditure	800
6. Interest	150
7. Net Factor Income from Abroad	20
8. Net Indirect Tax	190
9. Mixed income of Self Employed	630
10. Net Exports	(-) 30
11. Net Domestic Capital Formation	500
12. Consumption of Fixed Capital	150

<u>National Income (Income Method)</u>

	Compensation of Employees	800
(+)	Profit	500
(+)	Rent	200
(+)	Interest	150
(+)	Mixed Income of Self employed	630
	NDPFC	= 2280
(+)	Net Factor Income From Abroad	20
	NNPFC	=2300 Cr.

<u>National Income (Expenditure Method)</u>

	Private Final Consumption Expenditure	1200
(+)	Govt. Final Consumption Expenditure	800
(+)	Net Exports	(-) 30
(+)	Net Domestic Capital Formation	500
	NDPMP	= 2470
(+)	Net Factor Income From Abroad	20
	NNPMP	= 2490
(-)	NIT	190
	NNPFC	=2300 Cr.

11. Calculate GDPmp by (a) Product Method and (b) Income Method:

Items	Rs. (Cr.)
1. intermediate consumption of :	
a) Primary Sector	500
b) Secondary Sector	400
c) Tertiary Sector	300
2. Value of Output of:	
a) Primary Sector	1000
b) Secondary Sector	900
c) Tertiary Sector	700
3. Rent	10
4. Compensation of Employees	400
5. Mixed income of self employed	650
6. Operating surplus	300
7. Net factor income from abroad	(-) 20
8. Interest	5
9. Consuption of fixed capital	40
10. Net indirect tax	

Product method:

Value of output of primary sector	1000
(-) Inter mediate consumption of primary sector	500
(+) Value of output of secondary sector	900
(-) Inter mediate consumption of secondary sector	400
(+) Value of output of tertiary sector	700
(-) Inter mediate consumption of tertiary sector	300

Gross value added mp=Gross domestic product mp=1400 Cr

Income Method

Compensation of employees	400
(+) Mixed income	650

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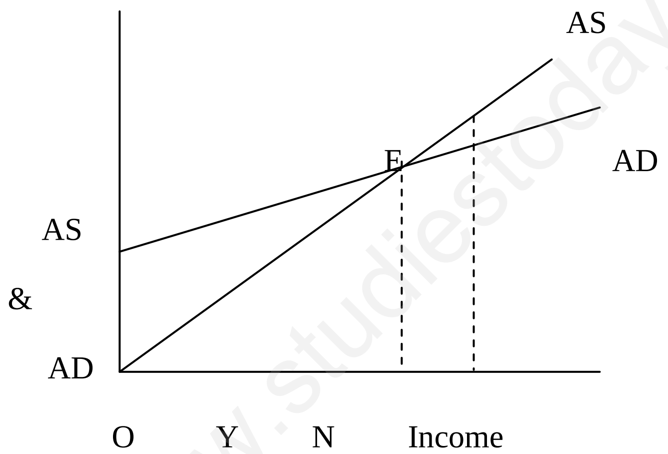
(+) Operating surplus	300
NDP at fc	= 1350 Cr
(+) Consumption of fixed capital	40
GDP at fc	= 1390 Cr
(+) Net Indirect Tax	10
GDP at mp	= 1400 Cr

12. In an economy aggregate demand is less than aggregate supply. Is the Economy in equilibrium? If not, explain he changes that will bring the economy in equilibrium.

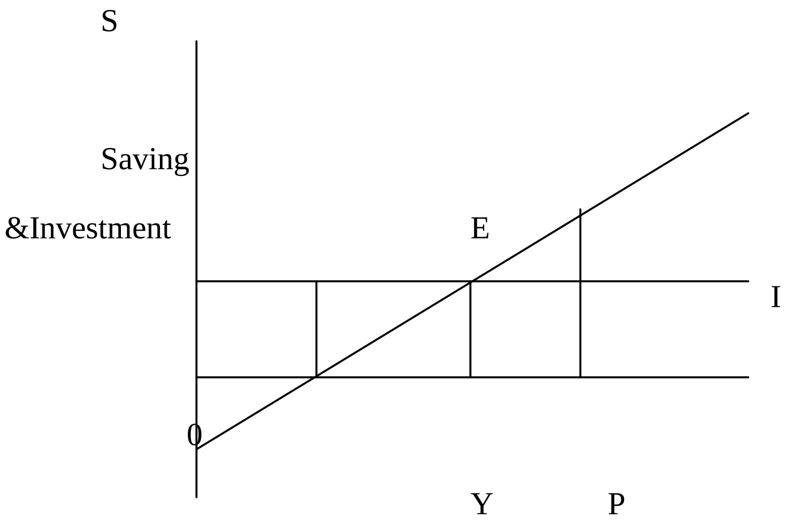
No, in an economy if aggregate demand is less than aggregate supply, economy will not be in equilibrium. An economy is said to be in equilibrium only when aggregate demand is equal to aggregate supply as shown below.



As the diagram explains economy is said to be in equilibrium at E where AD=AS, up to point E AD > AS and after point E AD<AS. When AD<AS economy will face recession. There will be unsold stock of goods and to meet this situation there will be an unplanned stock of inventory. The producer will reduce the use of factors of production to cut down the production level. This will reduce the income level from ON to OY and thus equilibrium between aggregate demand and aggregate supply will be restored at point E.

13. Explain the equilibrium level of income with the help of savings and investment function. If planned savings exceed planned investment what changes will bring about the equality between them.

Economy is said to be in equilibrium when planned savings is equal to planned investment. But we know savings and investment activities are generally done by different sections of the society. Therefore very often we can see a difference between planned saving and planned investment. It means that when S>I or S<I economy will experience disequilibrium as shown in the fig. given below.



As shown in the diagram at point E, S= I. Up to point E, S<I and after point E, S>I. Both show situations of disequilibrium in the economy.

When S>I, it means that the households are savings more than what the firms desires to invest i.e., both household consumption demand and firm's investment

are less. This will induce the producers to reduce production and this will reduce the employment opportunities. National Income will be reduced from OP to OY and thus the economy will regain equilibrium.

14. Discuss the fiscal and monetary measures taken by government to correct disequilibrium between AD and AS.

There are broadly two measures to correct disequilibrium between AD and AS. One is directly implemented by the government known as fiscal policy measures and other one is implemented by the government through the central bank of the country known Monetary policy measures.

Fiscal policy measures:

1) Tax – when AD>AS the economy will face inflation. To check inflationary trend in the economy the government will raise the rate of tax, money will transfer from the society to government, AD will be reduced and become equal to AS and thus disequilibrium is corrected. When AD<AS the economy will face recession. To check deflationary trend in the economy the government will lower the rate of tax, which will leave more money with the people. AD will be increased will become equal to AS and thus disequilibrium is corrected.

2) Public Expenditure – By increasing and decreasing public expenditure government correct disequilibrium between AS and AD. When AD>AS, economy will experience inflation and to check inflationary trend in the economy the government will reduce the public expenditure programmes which will reduce employment opportunities and purchasing power of the people. In short AD gets reduced and become equal to AS, disequilibrium is corrected. When AD < AS reverse operation will take place.

Monetary measures:

1) Bank rate – By lowering and raising bank rate RBI of the country will make credit dearer and cheaper to the society. When AD>AS RBI will raise the bank rate make the credit costlier and thus reduce both the consumption demand and investment demand this will reduce AD and remove the disequilibrium. Reverse operation will take place when AS>AD.
2) Cash Reserve Ratio – By lowering and raising CRR, RBI will bring change to the availability of credit in the society. When AD>AS, RBI will increase CRR which will reduce the availability of credit, results in reduction of AD and AD will be equal to AS. Reverse operation will take place when there is a situation of deficient demand.
3) Open market operations- In a situation of excess demand RBI sells securities to commercial banks which will reduce their capacity to offer loans, it will reduce AD and removes the situation of excess demand. Reverse operation will take place when there is a situation of deficient demand

15. Will the following be included in the National Income of India ? Give reason for your answer:
    1) Salaries paid to non resident Indians working in Indian Embassy in America. No. Because it is part of factor income to Abroad.
    2) Profits earned by an Indian bank from its branches abroad. Yes, it is included in the National income of India because it is a part of factor income from abroad.
    3) Scholarships given by Govt. of India. No, This will not be included because it is transfer payment.

16. While estimating National Income how will you treat the following? Give reasons for your answer.
    1) Imputed rent of self occupied house. - Included in national income because he pays rent to himself and it is counted as a factor payment.
    2) Interest received on debentures- Included in national income because it is the part of Interest payment
    3) Financial help received by flood victims- Not included because it is transfer payment. Transfers are not a productive activity.
    4) Old age pension- Not included in national income because it falls under the category of transfer payment.

17. What are the precautions is to be taken, while we calculate national income by income method and value added method?

    <u>Income Method.</u>

    1. Transfer payment should not be included as they are not against any productive activity.
    2. Income through illegal activities like smuggling, black marketing gambling etc is not included.
    3. Income from the sale of second hand goods or capital gains- Not Included in national income
    4. Free services provided by owners of the production units to be Included in national income.
    5. Wind fall gains such as income from lotteries not to be included.

Value added Method-

1. The value of intermediate goods should not be included. Only the value of final goods should be included.
2. The value of goods retained for self consumption should be included.
3. Domestic services are not included. However production of services by paid employed persons should be included.
4. Sale and purchase of Second hand goods should not be included.
5. Voluntary work done for its own sake or for the community should Not be included.

18. Distinguish between

a. Intermediate goods and final goods
b. Net domestic product and Gross national product.
c. Factor income and transfer income

Intermediate goods	Final goods
1. They are used for production of other goods and services 2. They are meant for resale so Value gets added to these goods 3. They remain within the production boundary 4. Their value is not included in national income	1. They are used for final consumption 2. They are not meant for resale, so no value is Added 3. They remain outside the production boundary 4. Their value is included in National income

Net Domestic Product	Gross National Product
1. It refers to the total money value Of all final goods and services 2. Produced with in the domestic Territory. 3. It does not include net factor Income from abroad. 4. It does not include depreciation	1. It refers to the total They are used for money value of all final goods and services 2. Produced within the Domestic territory plus Net factor income from abroad. 3. It includes net factor Income from abroad. 4. It includes Depreciation.

Factor Income	Transfer Income

1. It is income earned by rendering Productive services. Eg. Wages and salaries 2. It is included in national income	1. It is income earned without rendering any productive Services. Eg. Old age pension ,gift 2. It is not included in national Income.

19. Give an outline of the steps involved in the estimation of National Income with help of Income Method.

First step : Identify the producing enterprise and classify broadly under three sectors as primary, secondary and tertiary sector.

Second step : Net Domestic Income is calculated by adding

1) Compensation of Employees
2) Rent& Royalty
3) Profit
4) Interest
5) Mixed income of Self Employed

Third step : National Income is estimated by adding Net Factor Income from Abroad to Net Domestic Income or NDPfc

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HOTS and Tips for Solving Numerical Problems in Economics

TIPS FOR WORKING SUMS

1. **To convert 'National' to 'Domestic', Subtract Net factor Income from abroad.**
2. **To convert 'Domestic' to 'National' Add Net factor income from abroad.**
3. **To convert 'Market Price' to 'Factor Cost' subtract Net indirect taxes.**
4. **To convert 'Factor Cost' to 'Market Price' Add Net indirect taxes.**
5. **Net factor income from abroad is the difference between factor income from abroad and factor income to abroad.**
6. **Net indirect tax is indirect taxes minus subsidies.**
7. **Net Exports is Export minus Import.**
8. **Gross Domestic Capital formation is Gross domestic fixed Capital formation plus Change in stock.**
9. **Change in stock is 'Closing stock' minus 'Opening stock'.**

10. To convert 'Gross' to 'Net', subtract depreciation.
11. To convert 'Net' to 'Gross', Add depreciation.
12. Depreciation is otherwise called as Capital consumption or consumption of fixed capital.
13. Income Method is otherwise known as Factor income method.
14. Expenditure Method is otherwise known as Final expenditure method.
15. Value added Method is otherwise known as Net Output Method or Production Method.
16. Compensation of Employees includes Wages and Salaries and which are paid in Cash or Kind and Employers' contribution to social security schemes.
17. Operating Surplus is the sum of Rent, Interest and Profit.
18. Profit includes dividend, corporate tax, and corporate savings.
19. Corporate saving is otherwise called as retained earnings or undistributed profits.
20. Personal disposable income is the sum of household savings and household consumption.

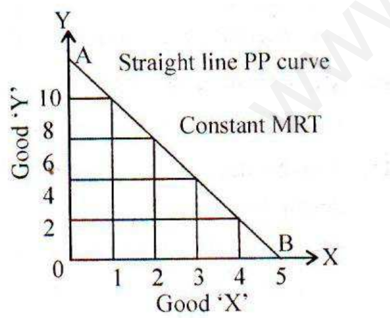
(or)

Personal disposable income = Personal savings + Personal consumption.

HIGHER ORDER THINKING SKILLS (HOTS) QUESTIONS

MICRO ECONOMICS

1. **Draw a production possibility (PP) curve when MRT is constant. Give reason.**
   When marginal rate of transformation remains constants, it means that for every additional unit increase in the production of one good, the sacrifice of the production of other goods remains the same. This happens when resources are equally efficient in the production of different goods in this case we get a downward sloping straight line production possibility curve as shown..



2. **Is the study of cotton textile industry a macro economic study o a micro economic study?**
   The study of cotton textile industry is a micro economic study.

3. **A doctor has a private clinic in New Delhi and his annual earnings are Rs10 lakhs. If he works in a Government Hospital in New Delhi, his annual earnings are Rs 8 lakhs. What is the opportunity cost of having a clinic in New Delhi?**
   The opportunity cost of opening a clinic in New Delhi is Rs8 lakhs, that he could have earned in next best alternative use that is, working in Govt. hospital in New Delhi.

4. A raise in the income of the Consumer X leads to a fall in the demand for that good by that consumer. What is the good X called?
Inferior good.

5. What happens to the demand for a good when the price of Substitute goods falls?
When the price of substitute good falls, then the demand for the given good also falls.

6. Why is coefficient of price elasticity of demand negative?
The coefficient of price elasticity of demand is always negative because there is an inverse relationship between demand and price.

7. Which of the following commodities have inelastic demand:
1. Salt 2. A particular brand of lipstick 3. Medicines 4. Mobile phone and 5. School uniform

Salt, medicines and school uniform have inelastic demand. The reason being that a consumer has to buy these commodities even though price of these commodities changes. Even a substantial change in price leaves the demand un affected.

8. When MPP is zero, what can you say about TPP?
TPP is at its maximum.

9. When MPP equals APP, what will you say about APP?
APP is at its maximum and constant

10. When APP is at its maximum, what is the relationship between MPP and APP?
MPP=APP

11. What does the AFC curve look like? Why does it look so?
AFC curve is downward sloping to right. As the output increases, the fixed cost gets distributed, i.e., AFC falls.

12. What happens to ATC when MC < ATC?
ATC will fall.

13. Can there be some fixed cost in the long run? If not why?
No, there cannot be any fixed cost in the long run. The reason is that there is no fixed input in the long run.

14. Due to improvement of technology, the marginal costs of televisions have gone down. How will it affect the supply curve of television?
Supply curve will shift to the right due to improvement of technology.

15. If a farmer grows rice and wheat, how will an increase in the price of wheat affect the supply curve of rice?
Supply curve of rice will shift to the left

16. Because of cyclone in a coastal area, the sea water covers a lot of rice fields. This reduces the productivity of land. How will it affect the supply curve of that region?
Supply curve of rice of that region will shift to left due to reduce in productivity of land because of cyclone. Due to cyclone, production of rice will fall. Now, irrespective of

increase in price of rice, production (or supply) cannot rise. In other words, supply of rice will fall at the same price.

17. In which market form are the average and marginal revenue of a firm always equal?
Average and marginal revenue of a firm are always equal under perfect competition

18. In which market form, there is a need for selling/advertising costs?
Under monopolistic competition, there is a need of selling costs because the firms produce different brands of the product

19. What is that market called wherein there are a only two sellers (firms)?
Duopoly refers to a market situation in which there are two sellers.

20. When do we say there is excess demand for a commodity in market?
When at a given price, the quantity demanded of a product exceeds its quantity supplied, there is excess demand for the product.

21. When do we say there is excess supply for the commodity in the market?
When at a given price the quantity supplied of a product exceeds its quantity demanded, there is excess supply for a product.

22. When will an increase in supply imply an increase in price but no change in quantity?
In case of perfectly inelastic demand, an increase in supply leads to an increase in price but no change in quantity.

23. When will an increase in demand imply an increase in quantity demanded but no change in price?
In case of perfectly elastic supply, an increase in demand causes no change in price but it will lead to an increase in quantity.

24. What is price floor? What may be the consequences of price floor?
Price floor refers to the minimum price fixed by the government above the market determined price so that the producers of the essential items like wheat, rice etc may not suffer losses. The consequences of price floor may be: 1. Surplus of the commodity 2. The government may resort to buffer stocks to absorb the surplus in the market at the support price and sells the products to consumers below its cost of production.

25. What is price ceiling? What may be the consequences of price ceiling?
Price ceiling refers to the maximum price fixed by the government below the market determined price (i.e., equilibrium price) so that necessities may be made available to the common people at an affordable price. In India the government has imposed price ceiling on necessary items like wheat, rice, sugar etc. The consequences of price ceiling may be: 1. shortage of the commodity 2. The government may impose rationing i.e., supply of goods in limited quantity at the ration shops. 3. Black market may emerge. A black market is a situation where by the goods are sold at a price above the legal ceiling price. 4. The consumers may get inferior quality goods.

26. Give the formula calculating slope of Budget Line?
Slope of Budget Line is equal to the prices of the two commodities, i.e., Px/Py.

27. What is the slope of indifference Curve?
Slope of indifference curve is equal to MRS, i.e., Marginal Rate of Substitution

28. Explain why is the budget line downward sloping?
Because with given money income if a consumer buys more of one good, he has to buy less of the other good.

29. Why is the indifference Curve convex to the origin?
Indifference curve is convex to the origin due to diminishing marginal rate of substitution.

Suppose your friend is indifferent to the bundles (5,6) and (6,6). Are the preferences of your friend monotonic?

No.

MACRO ECONOMICS

1. **If the NDPFC is Rs. 1,000 crores, and NFA is Rs. (--) 5crores, how much will be national income (NNPFC)?**
   NNPFC = NDPFC+NFA = 1000+(-5) = Rs. 995 crores.

2. **What should be added to NNPMP to get net national disposable income?**
   Net current transfers from abroad should be **added** to NNPMP to obtain national disposable income.

3. **The value of the nominal GNP of an economy was Rs. 2,500 crores. in a particular year. The value of GNP of that country during the same year, evaluated at the prices of some base year was Rs.3,000 crores. Calculate the value of the GNP deflator of the year in percentage terms. Has the price level risen between the base year and the year under consideration?**
   GNP deflator = Nominal GNP/Real GNP * 100

   = 2500/3000 * 100 = 83.3%

   No, the price level has not risen between the base year and the year under consideration. In fact, it has fallen.

4. **Give the alternative name of value added method of estimating national income?**
   The alternative name of value added method of estimating national income is the production method.

5. **State whether output produced for self consumption is included or not included in the value of output?**
   The output produced for self consumption is not included in the value of output.

6. **State whether the sale of old scooter is included in national income?**
   The sale of old scooter is not included in national income because it is not produced in the current year. Its value has already been included in the year it was produced.

7. **Which of the following is a bank?**
   i)Post office saving banks (ii) LIC (iii) UTI (iv) IDBI.

Post office saving banks are not banks in the sense that even though they accept deposits from the public but do not advance loans to others.

(ii),(iii) and (iv) LIC, UTI and IDBI are not banks in the sense that even though they do not accept chequeable deposits but advance loans to others.

8. State why businessmen mostly want to open current account in the bank?
The business men mostly want to open current account in the bank because the deposits in current accounts are payable on demand. They can be drawn upon by cheque without any restriction. The banks offer overdraft facility on these deposits to the business men.

9. Name the institution which acts as a custodian of nation's foreign exchange reserves?
Central Bank is an institution which acts as custodian of nation's foreign exchange reserves.

10. Why can the value of MPC be not greater than one?
The value of MPC will not be greater than one because increment in consumption (ΔC) cannot be more than the corresponding increment in income (ΔY), i.e., $\Delta C < \Delta Y$.

11. What is the value of MPC when MPS is zero?
When MPS = 0, MPC = 1- 0=1.

12. When disposable income rises from Rs. 1,000 to Rs. 1,100, savings rise by Rs. 30. Find out marginal propensity to save and marginal propensity to consume?
$\Delta Y = 1{,}100 - 1{,}000 = 100$, $\Delta S = 30$, $MPS = \Delta S/\Delta Y = 30/100 = 0.30$

1- MPS =MPC

i.e., 1-0.30 = 0.70 = MPC.

13. Does full employment occur when AD = AS or S = I?
It is not necessary that full employment occur when AD = AS or S = I . It means that full employment may or may not occur at AD =AS or S = I.

14. If in an economy intended investment is greater than intended savings, what is the effect of it on national income?
If I>S, the level of national income expands.

15. Why is tax not a capital receipt?
Tax is not a capital receipt because it neither leads to creation of liability nor to reduction in assets. In fact, a tax is a revenue receipt.

16. Why are the borrowings by the Government as capital receipts?
Borrowings by the Government are capital receipts because they create liabilities or reduce assets. The Government is under obligation to return the amount along with interest.

17. Why is repayment of loan a capital expenditure?
Repayment of loan is treated as a capital expenditure because it reduces the liabilities of the Government.

18. Why is recovery of loans treated as a capital receipt?

Recovery of loans is treated as a capital receipt because it leads to decline in financial assets of the Government.

19. Why is interest received categorized as revenue receipt?
Interest received is a revenue receipt because it does not create any liability nor it leads to reduction in assets.

20. Why are receipts from taxes categorized as revenue receipts?
Receipts from taxes are categorized as revenue receipts because they do not create liabilities nor reduction in assets.

21. In a government budget, primary deficit is Rs. 10,000 crores and interest payment is Rs. 8,000 crores. How much is the fiscal deficit?
Primary deficit = Fiscal deficit – interest payments

=>Fiscal deficit = Primary deficit + Interest payments.

= 10,000 + 8,000

= 18,000 crores.

22. Ten US dollars are exchanged for five hundred Indian rupees. What is the exchange rate for Indian currency?
$1 = 500/10 = Rs.50, i.e., $1 = Rs. 50

23. If $9 are needed to buy £2, what is the exchange rate for USA dollar?
£1 = 9/2 = $4.5, i.e., £1 = $4.5.

24. If the value of exports of goods of a country is Rs. 1,000 crores and the value of imports of goods is Rs. 1,200 crores, how much will be the trade balance (or balance of trade)?
Balance of trade = value of exports – value of imports

= 1,000 – 1,200.

= Rs. – 200 crores

25. A country's balance of trade is Rs. 75 crores. Value of imports of goods is Rs. 100 crores. How much is the value of exports of goods?
Balance of trade = value of exports – value of imports

75 = value of exports – 100.
i.e., Value of exports = 100 + 75

= Rs. 175 crores.

26. A country's balance of trade is Rs.500 crores . Value of exports of goods is Rs. 650 crores. How much is the value of imports of goods?
Balance of trade = Value of exports – Value of imports

500 = 650 - value of imports
Value of imports = 650 - 500

= Rs. 150 crores.

27. Differentiate between devaluation and depreciation?

Devaluation means reduction in the external value of a country's currency as a conscious policy measure adopted by the Government of a country. In other words, we make our currency cheaper in terms of foreign currency. This makes our goods cheaper to foreign buyers and foreign goods costlier to our buyers. Hence exports increase, imports fall and the gap in trade balance becomes smaller. When a country suffers from continued deficit in its balance of payments, it may resort to devaluation of its currency with a view to encouraging exports and restricting imports and thus narrowing down or covering its trade gap and balance of payments deficit. It takes place in Fixed Exchange Rate System.

Depreciation of a currency means fall in value of domestic currency in terms of foreign currency. Example: if value of rupee in terms of US dollars falls, say from Rs. 45 to Rs. 50 per dollar, it will be a case of depreciation of Indian rupee because more rupees are required now to buy one US dollar. It occurs in Flexible Exchange Rate System.

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