SET – 2

Subject Code: 030

COMMON PRE-BOARD EXAMINATION 2017-2018

ECONOMICS ANSWER KEY

CLASS XII Maximum Marks: 80

<table>
<tr><td></td><td>SECTION- A</td><td></td></tr>
<tr><td>1</td><td>b). Government should be concerned with how to reduce unemployment</td><td>1</td></tr>
<tr><td>2</td><td>Relation between variable input and output keeping all other inputs constant.</td><td>1</td></tr>
<tr><td>3</td><td>Owner working as a manager but not taking salary
(Or any other valid example)</td><td>1</td></tr>
<tr><td>4</td><td>d) None of the above</td><td>1</td></tr>
<tr><td>5</td><td>MOC/MRT can be defined as the rate of sacrifice of one good per unit increase in the production of other good.
$MRT = \frac{\text{Unit of one good sacrificed}}{\text{more units of the other good produced.}}$
$= \frac{\text{Change in Good Y}}{\text{Change in good X}}$
<table><tr><th>Good 1</th><th>Good 2</th><th>MRT</th></tr><tr><td>0</td><td>10</td><td>-</td></tr><tr><td>1</td><td>9</td><td>1</td></tr><tr><td>2</td><td>7</td><td>2</td></tr><tr><td>3</td><td>4</td><td>3</td></tr><tr><td>4</td><td>0</td><td>4</td></tr></table>Diagram with explanation.
OR
The economy has to decide what goods and services are to be produced. For instance which of the consumer goods like cloth, sugar etc are to be produced and which of the capital goods like machines, tractors etc are to be produced.
When an economy has taken a decision as to what goods or services are to be produced, then it has to decide about its quantity.</td><td>3</td></tr>
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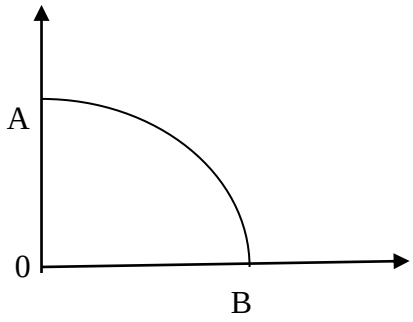
	 If the entire resources of the economy are diverted to produce good Y, then it will produce OA level of good Y or if the entire resources are diverted to produce good X, then it will produce only good X (ie. OB level). Economy can also select any other point on PPC. Explanation with Production possibility Curve.	
6	i) Demand decreases, demand curve shift to the left ii) Demand increases, demand curve shift the right iii) Demand decreases, demand curve shift to the left (Use diagrams)	1 1 1
7	Ed = % Change in quantity demanded/ % change in price -2 = 50%/ % change in price % Change in Price = 25 New Price = 8- 2 =6	4
8	Fixing of price above equilibrium price. To protect the interest of producers, labourersetc Excess supply Unless government prepares to buy, excess supply- price fall (Implications with a diagram.) OR Chain effects of 'decrease' in demand. Diagram- decrease in demand, while supply remains unchanged leads to excess supply. Decrease in equilibrium price, contraction of supply takes place and equilibrium quantity also falls. Explanation with diagram.	4
9	Decrease in supply: Decrease in supply means fall in supply for a product due to changes in factors other than price. Diagram Reasons are: • increase in unit tax • increase in input price • Deterioration in technology • Increase in price of other products	2

	Contraction of supply: A fall in supply of a product due to decrease in its price alone is called contraction of supply. Diagrams with explanations	2
10	a) Consumer will be in equilibrium by indifference curve and budget line analysis at that level at which one of the indifference curve is just tangent to the budget line. At this point, Slope of the indifference curve = Slope of the budget line MRS = Price Ratio $\text{MRS} = \frac{\text{Change in X2}}{\text{Change in X1}}$ $\text{MRS} = -\frac{P1}{P2}$ (Diagram) In the diagram, consumer is in equilibrium at point E because at this point MRS = Price ratio and indifference curve is tangent to the budget line. Initially when consumer starts to substitute good 2 for good 1, MRS > Price ratio, hence consumer gains. That is, the utility received from an extra unit of good 1 is more than the utility lost from good 2. At the point of tangency MRS = Price ratio, ie at point E. If consumer further substitute good 2 for good 1, price ratio will be greater than MRS. That is why utility received from an extra unit of good 1 is less than the utility lost from good 2. Consumer will not select any bundle on IC1 like C and D because IC1 consists of the bundles less preferred than the bundles on IC2. Consumer cannot select IC3 because those bundles are budget constraints. . OR a). MU of good X = Price of X Table and diagram b).At equilibrium, If MUx/Px = MUy/Py, Given, MUx/Px =MUy/Py, $10/8 \neq 8/10$ 1.25 not equal to 0.8 So consumer is not in equilibrium. MUx/Px>MUy/Py, then it means that satisfaction of consumer, derived from spending a rupee on Good X is greater than the satisfaction derived from spending a rupee on Good Y. He will reallocate his income by substituting Good X for Good Y. As the consumption of Good X increases the marginal utility derived from it goes on diminishing and reverse proposition occurs for Good Y, this process will continue till MUx/Px becomes equal to MUy/Py.	6 2 4
11	a) TVC is zero at zero level of output. It initially increases at decreasing rate and later it increases at an increasing rate. It is inversely S shaped because of law of variable proportion.	2

b)

Output (Units)	Total Revenue (₹ in crores)	Total Cost (₹ in crores)	MR	MC
1	5	11	5	6
2	10	13	5	5
3	15	17	5	4
4	20	22	5	5
5	25	29	5	7

4

Equilibrium at 4th unit.
MC=MR
And MC greater than MR after MC=MR level (MC rises)

12 — Large number of buyers and sellers
Differentiated products
Partial control over price
Freedom of entry and exit
(Or any other points- points to be explained) — 6

SECTION B

13 — c).As on any point of time — 1

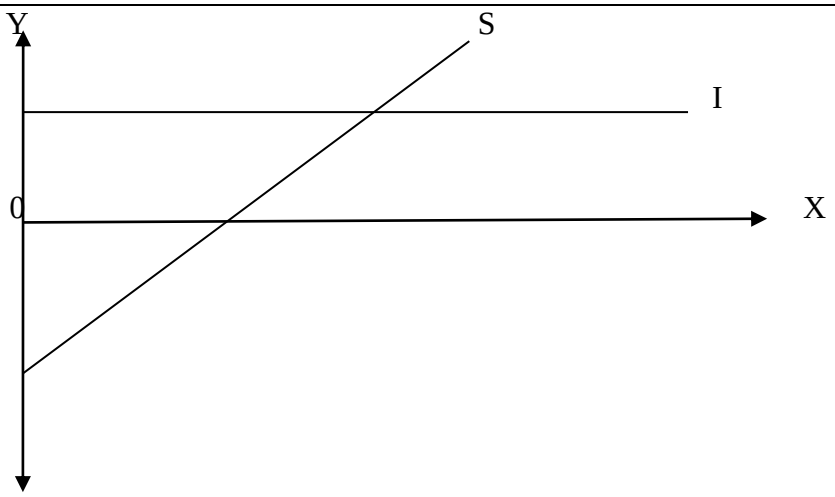
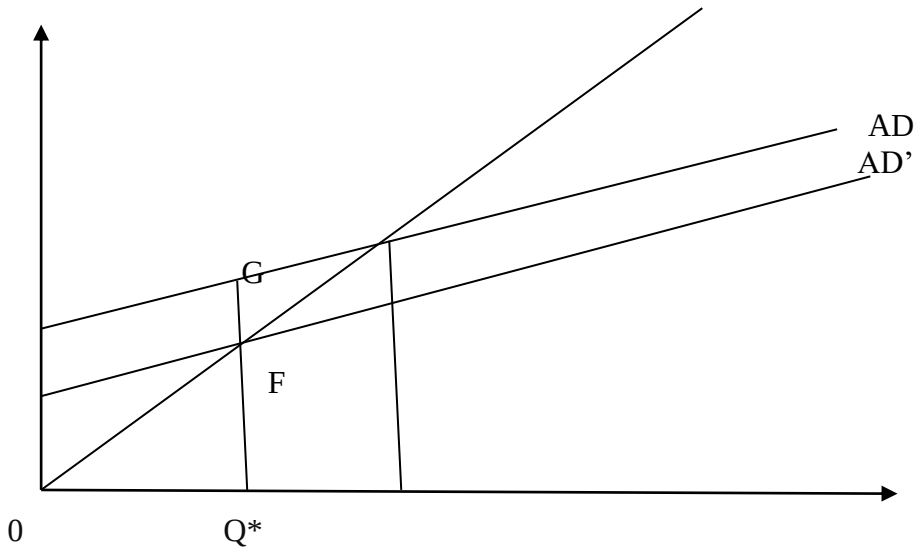
14 — b). Fiscal Deficit — 1

15 — CRR- It specifies the fraction of their deposits that banks must keep with RBI — 1

16 — 1
a) Revenue Receipts
Tax
b) Capital Receipts
Borrowing
(or any other relevant examples)

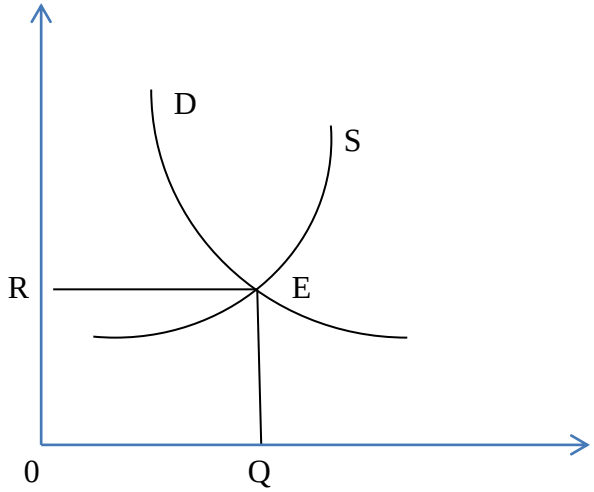
17 — 3

Income (Y)	MPC	Savings (S)	Consumption	APC
0		(-)30	30	-
100	0.75	**(-)5**	105	**1.05**
200	0.75	**20**	180	**0.9**
300	0.75	**45**	255	**0.85**

18	 In the diagram on the Y axis we measure planned saving and investment. Investment curve is parallel to X axis because we assume investment is autonomous and independent of its determinants. Saving curve begins from the negative segment of the Y axis because at low levels of income savings can be negative. As income increases saving also increases. Therefore it is positively sloped. The economy will be in equilibrium by S and I approach at that level of output at which planned saving = planned investment. In the above diagram, the economy is in equilibrium at OM level of output. If the planned savings exceeds planned investments (beyond OM level of output) accumulation of inventories takes place. Firms would respond to this by reducing the employment hence output. This process will continue till the equilibrium level of output where planned savings = planned investments. . OR If AD for a level of output is more than the full employment level of output, it is called excess demand. 	3

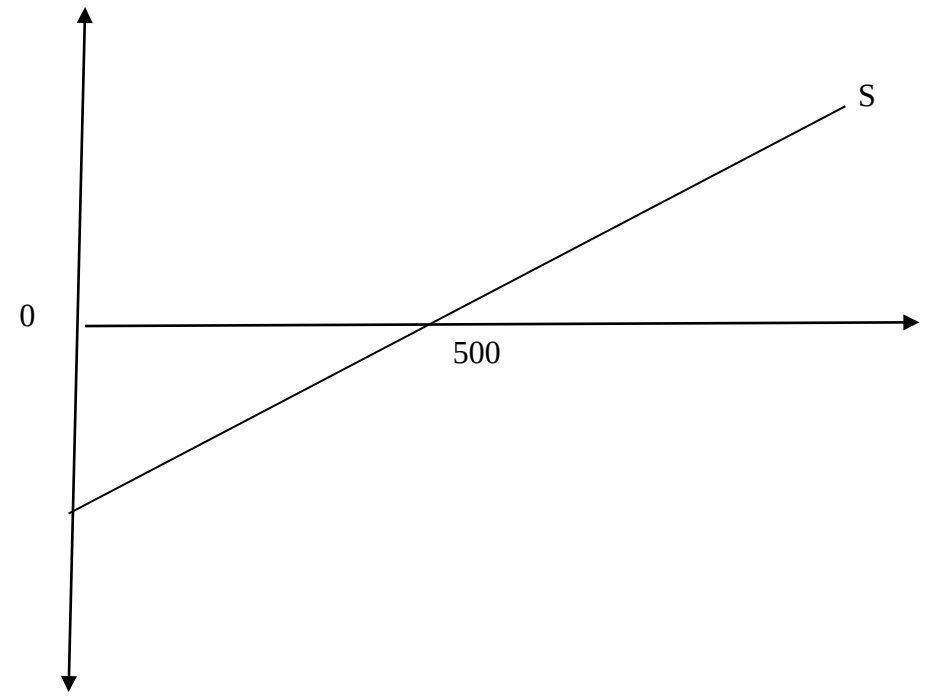
	The inflationary gap is the amount by which the actual aggregate demand exceeds the level of aggregate demand required to establish the full employment equilibrium. In the diagram, economy will be in full employment equilibrium level of output at point F on the AD (C+I) curve and the economy will produce the full employment level of output OQ*. FG is the inflationary gap. The inflationary gap is so called because it sets in motion forces that will cause inflation or arise in the price level. At point G, the aggregate demand curve (C+I) lies above the 45 degree line. As aresult, the aggregate demand Q*G is greater than the level of output OQ*. The effect of this will be tocreate demand pull inflation (an aggregate demand induced rise in the price level). **Fiscal Policy measures**: Fiscal policy measures to increase aggregate demand may be done by either increasing the level of government expenditure or by reducing the amount of taxes. If the government expenditure is increased by an amount equal to the deflationary gap, it will restore the economy to the full employment equilibrium.	
19	The budget is an annual statement of the estimated receipts and expenditure of the government over the fiscal year. a) **Allocation function**: In an economy there are number of public goods required for normal functioning of government and the welfare of the people as a whole. Such goods cannot be provided through market mechanism. Therefore public goods must be provided by the government through budgetary allocation. This is called the allocation function. b) **Distribution function**: Through its tax and expenditure policy, the government attempts to bring about a distribution of income that is considered fair by the society. The government affects the personal disposable income of households by making transfer payments and collecting taxes. In this way government can alter the income distribution. This is called distribution function. c) **Stabilisation function**: The economy tends to be subject to substantial fluctuations and may suffer from prolonged period of deflation or inflation. During excess demand government expenditure must be reduced and tax rates must be increased to control inflation and stabilize the economy. Similarly during deficient demand government expenditure must be increased and tax rate must be reduced to control deflation and stabilize the economy. This is called stabilization function. OR It implies that government is dissaving and using up the savings of the other sectors of the economy to finance a part of government consumption expenditure. This means that the government will have to borrow not only to finance its investment but also for its consumption requirements. This will increase the borrowing liability of the government which in turn force the government to cut productive capital expenditure or welfare expenditure. Increase in borrowing also increases interest payment liabilities. This will increase revenue deficit and create inflation in the economy.	1 3 4

20	a) State any two limitations of GDP as an indicator of economic welfare. b) Complete the following table | Year	Nominal GDP	Real GDP	GDP deflator | |---|---|---|---| | 2014-15 | 6.5 | 6.5 | --- | | 2015-16 | --- | 6 | 140 | | 2016-17 | 9 | --- | 125 |	2 2
21	Illustrate with the help of a hypothetical numerical example the process of credit creation. The amount of credit created by the commercial banks with their available deposits from the public is called credit creation. It depends upon the LRR and deposits available to the bank. Let us assume that the entire commercial banking system is one unit. Also assume that receipts and payments in the economy are routed through the banks. | | Deposits ₹ | Loans ₹ | Cash Reserves (LRR= 20%, ie 0.2) | |---|---|---|---| | Initial 1 Round 11 Round ----- ----- ----- | 100 80 64 ----- ----- ----- | 80 64 51.20 ----- ----- ----- | 20 16 12.80 ---- ---- ---- | | | 500 | 400 | 100 | Money multiplier = $\frac{1}{LRR}$ In the above case LRR is 20% or 0.2. Therefore, Money multiplier = $\frac{1}{0.2} = 5$ The total money creation is thus: Money creation = Initial deposit x $\frac{1}{LRR}$ = 100 x 1/0.2 = 500.	4

22	Expenditure method: GDP @ MP = PFCE + GFCE+ NDCF + Dep + Net export = 4000 + 1000+ (500+40) + (-50) = 5490 NI or NNP @ FC= GDP @ MP- NIT-Dep+NFIA = 5490-300-40+(-30) = 5120 (3 marks) Income method: NNP @fc = Domestic Income+ NFIA = 4000 + 1150+ (-30) = 5120 (3marks)	3 3
23	a). There are two types of account- current account and capital account. 1**. Current Account:** It records the following three items. a) Balance of *visible trade*: b) *Invisible trade*: c) *Unilateral transfers*: **2. Capital Account:**It records all international transactions that involve a resident of the domestic country changing his assets with a foreign resident or his liabilities to a foreign resident. b). Current account and its non-reserve capital account equals to zero. So that current account balance is financed entirely by international lending without reserve movements. c).Undertaken with an economic objective or any other relevant point. OR Flexible exchange rate is that rate which is determined by the general interaction between demand and supply of foreign exchange.  Demand curve for foreign exchange is negatively sloped because there is an inverse relationship between exchange rate and demand for foreign exchange, ie at high rate of exchange less foreign exchange will be demanded and vice-versa. Supply curve for foreign exchange is positively sloped because there is a direct relation between exchange rate and supply of foreign exchange, ie at high rate of exchange more foreign exchange will be supplied and vice-versa.	4 1 1 4

	In the above diagram, exchange rate is determined at the point E, where demand and supply of foreign exchange are equal. Therefore OR is the equilibrium exchange rate. b). Foreign buyers will be able to buy more from one unit of currency as a result of currency depreciation. This makes export cheaper for the foreign buyers. As a result exports are likely to increase (To be explained)	2
24	The relationship between income and saving is called saving function. Let us suppose S= -100 + (1-0.8)Y and also assume MPC is constant.	6

Income (Y)	Consumption (C)	Saving (S)	Change in Income (ΔY)	Change in Saving (Δ S)	MPS (Δ S/Δ
0	100	-100	-	-	-
100	180	-80	100	20	0.2
200	260	-60	100	20	0.2
300	340	-40	100	20	0.2
400	420	-20	100	20	0.2
500	500	0	10	20	0.2
600	580	20	100	20	0.2
700	660	40	100	20	0.2
800	740	60	100	20	0.2
900	820	80	100	20	0.2
1000	900	100	100	20	0.2



	Saving function curve begins from the negative segment of the Y axis because at low level of income, consumption exceeds income which in turn gives rise to dissavings. As income increases saving also increases. Therefore saving function curve positively sloped. In the diagram at the level Rs 500 income, saving= 0. Less than Rs 500 income, consumption exceeds income. Hence there is dissaving. Any level of income more than Rs 500, income exceeds consumption which gives rise to saving.Saving or dissaving is measured by taking the vertical distance between saving function curve and the X axis.	