



**INDIAN SCHOOL DARSAIT**  
**First Model Examination, December 2017**  
**ECONOMICS (030)**  
**Answer Key**



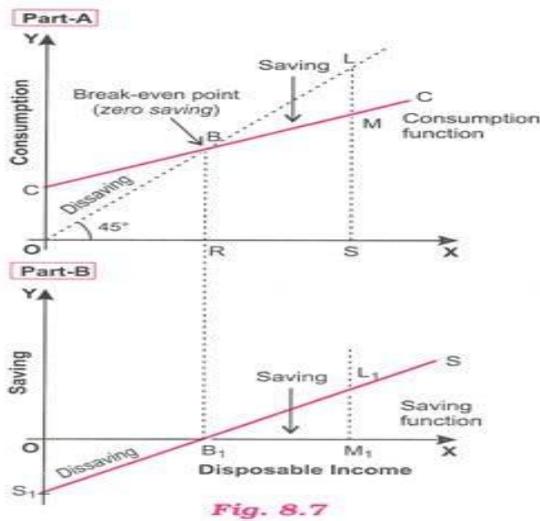
SECTION A		
1.	(a) In case of monopoly	1
2.	Price discrimination is a feature of monopoly form of market in which a firm charges different price from different set of customers.	1
3.	(b) Scarcity at any point of time due to limited amounts of productive resources	1
4.	(c) Perfect oligopoly	1
5.	This problem is related with 'for whom to produce'. It is concerned with the distribution of income and wealth among different factors of production who contribute in the production process. This problem refers to selection of the category of people who will be the ultimate consumers whether to produce goods for the rich or poor section of the society.  OR  Production Possibility Frontier (PPF) is a concave curve. It is due to increasing Marginal Rate of Transformation (MRT) as more quantity of one good is produced by reducing quantity of the other good. MRT increases because it is assumed that not all resources are equally efficient in production of all goods.	3
6.	State giving reasons, whether the following statements are true false. (a) False. When marginal revenue is positive and constant, Total Revenue will increase at a constant rate and AR will be equal to MR. (b) True. Average Variable Cost falls even when Marginal Cost is rising. As MC curve cuts Average Variable Cost curve at its minimum point.	1 ½  1 ½
7.	When the demand of a commodity does not change as a result of change in its price, the demand is said to be perfectly inelastic.  $Ed = \frac{\% \text{ change in quantity demanded}}{\% \text{ change in price}}$ Let price elasticity of demand of good Y be 1 Therefore, Ed of good X = 2 % change in quantity demanded for Good X will rise by 10 and for good Y, the %	1  3

	change in quantity will fall by 5.	
8.	<p>When the consumer finds that <math>MU_x/P_x &gt; MU_y/P_y</math> per rupee, he is not in equilibrium. So he will buy more of good X and less of good Y. As he consumes more of good X due to law of diminishing marginal utility <math>MU_x</math> will start falling. The consumer will continue to consume good X till <math>MU_x/P_x = MU_y/P_y</math> and equilibrium is attained.</p> <p style="text-align: center;">OR</p> <p>When the consumer finds that <math>MU_x/P_x &lt; MU_y/P_y</math> per rupee, he is not in equilibrium. So he will buy more of good Y and less of good X. As he consumes more of good X due to law of diminishing marginal utility <math>MU_y</math> will start falling and he will continue to consume good Y till <math>MU_x/P_x = MU_y/P_y</math> and equilibrium is attained.</p>	4
9.	<p>(a) Reduction in per unit tax. Due to reduction in tax, the cost of production will reduce and profit margin of the producer will increase. As a result, the producer will be willing to supply more. It will lead to increase in supply.</p> <p>(b) Subsidy on the production of that good. Government provides subsidy on production of some goods. When subsidy is gives on a good, cost of production falls. It will lead to increase in supply of that good.</p>	2  2
10.	<p>For some crops fall in price below a certain level is not good for the farmers. Hence, the government fixes minimum price for these crops. This is referred to as price floor. Price Floors are minimum prices set by the government for certain commodities and services. Minimum support price is set by the government higher than the equilibrium price for the product.</p> <p style="text-align: center;">OR</p> <p>The policy of liberalization encourages new firms to enter the industry. This raises output of the industry. Supply of the commodity increases. Total market demand remaining unchanged, price starts falling. Consumers now get the good at a cheaper price.</p> <div style="text-align: center;"> </div> <p>In the diagram, S1 is the initial supply curve, due to entry of new firms supply increases. The new supply curve is S2. The price of the commodity falls from P1 to P2.</p>	6



17.	<p>Complete the following table:</p> <table border="1" data-bbox="312 152 1168 528"> <thead> <tr> <th>Income (₹)</th> <th>Consumption Expenditure (₹)</th> <th>Marginal Propensity to Save</th> <th>Average Propensity to Save</th> </tr> </thead> <tbody> <tr> <td>0</td> <td>80</td> <td>-</td> <td>-</td> </tr> <tr> <td>100</td> <td>140</td> <td>0.4</td> <td><u>-0.4</u></td> </tr> <tr> <td>200</td> <td><u>200</u></td> <td><u>0.4</u></td> <td>0</td> </tr> <tr> <td>300</td> <td>240</td> <td><u>0.4</u></td> <td>0.20</td> </tr> <tr> <td>400</td> <td>260</td> <td>0.8</td> <td>0.35</td> </tr> </tbody> </table> <p> <math>Y = C + S</math>  <math>MPS = \Delta S / \Delta Y</math>  <math>APS = S / Y</math> </p>	Income (₹)	Consumption Expenditure (₹)	Marginal Propensity to Save	Average Propensity to Save	0	80	-	-	100	140	0.4	<u>-0.4</u>	200	<u>200</u>	<u>0.4</u>	0	300	240	<u>0.4</u>	0.20	400	260	0.8	0.35	3
Income (₹)	Consumption Expenditure (₹)	Marginal Propensity to Save	Average Propensity to Save																							
0	80	-	-																							
100	140	0.4	<u>-0.4</u>																							
200	<u>200</u>	<u>0.4</u>	0																							
300	240	<u>0.4</u>	0.20																							
400	260	0.8	0.35																							
18.	<p> <math>MPC = 1 - 0.10 = 0.9</math>  <math>Y = \bar{C} + MPC(Y) + I</math>  <math>900 = \bar{C} + 0.9 \times 900 + 80</math>  <math>\bar{C} = 10</math> </p>	3																								
19.	<p>Money creation (or deposit creation or credit creation) by the banks is determined by (1) the amount of the initial fresh deposits and (2) the Legal Reserve Ratio (LRR), the minimum ratio of deposit legally required to be kept as cash by the banks. It is assumed that all the money that goes out of banks is redeposited into the banks.</p> <p>Any numerical example with value of Initial deposits and LRR. Given the amount of fresh deposit and the LRR, the total money creation is:</p> <p>Total money creation = Initial deposit <math>\times \frac{1}{LRR}</math></p> <p>OR</p> <p>Commercial banks are required to maintain two types of reserves with the central bank – Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR). These are the components of Legal Reserve Ratio. By varying these reserve requirements, the central bank manages credit control. An increase in CRR and SLR, reduces the cash reserves of the commercial banks which, in turn, reduces credit creation capacity of commercial banks. On the other hand, decrease in CRR and SLR will increase credit creation capacity of commercial banks.</p>	4																								
20.	<p>Externalities refer to harmful effects or beneficial effect that have impact on members of society but for which they are not penalized or paid.</p> <p>The smoke and air pollution caused by production enterprises have harmful effects on the society. These are negative externalities.</p> <p>The public parks and health centers provide a positive impact on well-being of the people. This is a positive externality.</p> <p>Since these externalities are not considered in estimation of GDP so there is limitation in using GDP as an index of welfare.</p>	4																								

21.	<p>There is direct relation between foreign exchange rate and supply of foreign exchange. When foreign exchange rate rises, this causes increase in exports, tourism and investment in domestic country. As a result, supply of foreign exchange to the country rises.</p> <p>There is an inverse relation between foreign exchange rate and demand of foreign exchange. When foreign exchange rate rises, there is fall in imports, tourism to abroad and investment in foreign country. As a result, demand for foreign exchange falls.</p> <p style="text-align: center;">OR</p> <p>The current account records transactions relating to the export and import of goods and services, income and transfer receipts and payments during a year. Since sale of machinery is an export of good, it is recorded in the current account. Because its inflow of foreign exchange it will be recorded on credit side.</p>	4  4
22.	<p>(i) In Part A of the diagram, CC is the consumption curve and OL is the 45° Income line.</p> <p>(ii) At zero level of income, autonomous consumption is equal to OC. It means saving at zero level of income will OS1. Since <math>OC = OS1</math></p> <p>(iii) Consumption curve CC cuts income curve OY at point E which is the break-even point. At point E, income (Y) = Consumption (C)</p> <p>(iv) Corresponding to point E, we derive point B1 at which saving is zero.</p> <p>(v) Joining points S1 and B1 and further extending it we get saving curve SS1.</p>	6



23.	<p>Expenditure that neither creates an asset nor reduces a liability is called revenue expenditure. E.g. Payment of salaries etc.</p> <p>Expenditure that either creates an asset or reduces a liability is called Capital expenditure. E.g. Construction of roads etc.</p> <p>Government can impose higher rate of tax on income of the rich and on the goods consumed by the rich. This will bring down disposable income of the rich. The amount so collected can be spent on providing free services, like education, subsidized food to the poor people.eg. This will raise disposable income of the poor reducing the gap between rich and poor.</p> <p style="text-align: center;">OR</p> <p>The receipts which create corresponding liability for the government or which lead to reduction in assets of the government are termed as capital receipts, e.g. loans taken by the government, disinvestment of any PSUs, etc.</p> <p>Revenue receipts are those receipts which do not cause any reduction in assets of the government and which do not create any liability for the government. E.g. taxes, fees, etc.</p> <p>Economic stability is one of the important objectives of budgetary policy of the government. During the period of depression, the government adopts the policy of deficit budgeting. Under this policy, the government needs to increase its spending and cut down its taxation. These fiscal measures help to increase aggregate demand in the economy.</p> <p>On the other hand, during the period of inflation, the government adopts the policy of surplus budgeting. Under this policy, the government is required to increase taxation and reduce spending in order to control rising aggregate demand.</p>	6
24.	<p>NDP<sub>fc</sub> = compensation of employees + operating surplus + mixed income  = 1500 + 300 + 400 + 500 = 2700</p> <p>GDP<sub>mp</sub> = 2700 + 100 + 250 = 3050</p> <p>Factor income from abroad = 2800 – 3050 + 250 + 120 = 120</p>	<p>2</p> <p>2</p> <p>2</p>