CBSE
Class XII Economics

Time: 3 hrs **Max. Marks: 80**

General Instructions:

i. **All** questions in both sections are compulsory.
ii. Marks for questions are indicated against each question.
iii. Question Nos. **1–4** and **13–16** are very short answer questions carrying **1** mark each. They are required to be answered in one sentence.
iv. Question Nos. **5–6** and **17–18** are short answer questions carrying **3** marks each. Answers to them should normally not exceed **60** words each.
v. Question Nos. **7–9** and **19–21** are also short answer questions carrying **4** marks each. Answers to them should normally not exceed **70** words each.
vi. Question Nos. **10–12** and **22–24** are long answer questions carrying **6** marks each. Answers to them should normally not exceed **100** words each.
vii. Answers should be brief and to the point, and the above word limits should be adhered to as far as possible.

SECTION A

1. Why does AC continue to decline even when MC is rising? [1]

2. At the point where MR is equal to MC, [1]
a. TR is equal to TC
b. (TR – TC) is maximum
c. TR is maximum
d. TC is zero

3. What is product differentiation? [1]

4. When price falls with rise in output, then the revenue from every additional unit will be less than AR. As a result: (Choose the correct alterative) [1]
a. AR and MR curves coincide in a horizontal straight line parallel to the X-axis
b. TR curve is a positively sloped straight line
c. AR and MR curves slopes downwards from left to right
d. AR curve increases as long as MR curve is greater than AR curve

5. The income of a consumer is Rs 50. He purchases two Goods X and Y, the prices of which are Rs 5 and Rs 10, respectively. Present the budget line with the given information. Also, present the corresponding diagram. [3]

6. What is meant by price floor? Explain its effects with the help of a diagram. [3]

7. What is meant by an increase in demand? What are the factors which cause an increase in demand of a commodity? [4]

8. Complete the following table: [4]

Units of labour	***Average Product***	***Marginal Product***
1	5	-
2	10	-
3	-	8
4	2	-
5	-	3

9. Explain the concept of marginal opportunity cost with the help of a schedule and a diagram. [4]

10. Using the utility analysis, explain how much units of a commodity should a consumer buy at the given price. [6]

11. Explain producer's equilibrium with the help of the MR–MC approach. [6]

12. Distinguish between perfect competition and monopoly. [6]

SECTION B

13. State one measure to reduce revenue deficit. [1]

14. Which of the following conditions must be satisfied for a receipt of the government to be classified as revenue receipt? [1]

a. It should lead to creation of liability
b. It should not lead to reduction in assets
c. Either 1 or 2
d. Both 1 and 2

15. What is involuntary unemployment? [1]

16. Give that aggregate demand is greater than aggregate supply, state the difference between full employment and under employment equilibrium. [1]

17. State the reasons for demand of money. [3]

18. How does the Central Bank act as a banker's bank to commercial banks? [3]

19. From the following information, calculate the equilibrium level of national income and the consumption expenditure at the equilibrium level of income. [4]

C = 400 + 0.75 Y

Investment = Rs 2,000 crore

20. Calculate the value of consumption of fixed capital from the following information: [4]

	Particulars	In Rs crore
i.	GDP at market price	300
ii.	Indirect taxes	20
iii.	Net factor income from abroad	10
iv.	Subsidies	5
v.	NNP at factor cost	250

21. Classify the following expenditures as expenditure on intermediate goods and final goods: [4]

a. Purchase of stationary by an employer for office use

b. Purchase of bread by a household

22. What is excess demand? How can the bank rate be used to correct the situation? [6]

23. a. Explain the differences between fixed exchange rate system and flexible exchange rate system.

b. How would the foreign exchange rate change if there is a rise in the demand for imports? [6]

24. Calculate gross national disposable income from the following information: [6]

	Particulars	In Rs crore
i.	Private final consumption expenditure	300
ii.	Indirect taxes	50
iii.	Government final consumption expenditure	60
iv.	Subsidies	30
v.	Net current transfers to abroad	4
vi.	Net factor income to abroad	20
vii.	Net domestic fixed capital formation	40
viii.	Consumption of fixed capital	20
ix.	Change in stock	-20
x.	Net imports	-10

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Solution

SECTION A

Answer 1

AC continues to fall even when MC is rising till MC is less than AC.

Answer 2

The correct answer is option (b). At the point where MR is equal to MC, the difference between TR and TC is maximum. This is the point where a firm maximises profit.

Answer 3

Product differentiation refers to slightly differentiating the product size, shape and colour. This is done by firms with the objective of increasing market share.

Answer 4

The correct answer is option (C). When price falls with rise in output, then the revenue from every additional unit will be less than AR. As a result, both AR and MR curves slope downwards from left to right. This is because the firms can increase the volume of sale only by decreasing the sale.

Answer 5

The equation for the budget line is

$P_1X_1 + P_2X_2 = Y$

Substituting the given values

$5X_1 + 10X_2 = 50$

For the budget line, the x-intercept and the y-intercept can be calculated as follows.

x-intercept:

If the consumer spends the entire income on X_1, then he can purchase

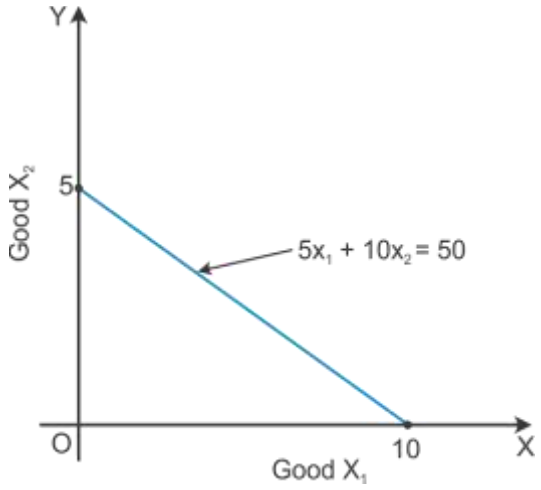
$\frac{50}{5} = 10$ units

y-intercept:

If the consumer spends the entire income on X_2, then he can purchase

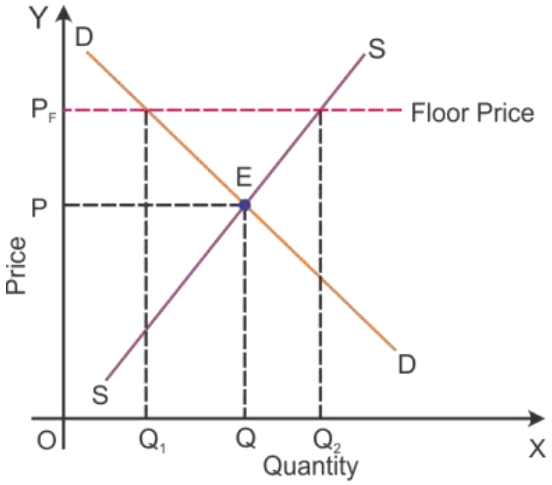
$\frac{50}{10} = 5$ units

So, the budget line can be drawn as follows:



Answer 6

Price floor refers to the minimum price fixed by the government for a commodity. The minimum price as fixed by the government is more than the equilibrium price.



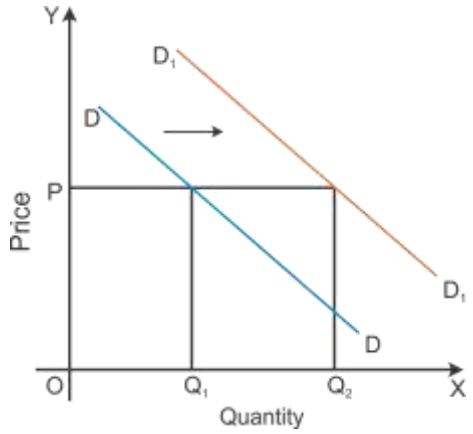
In the diagram, DD is the initial demand curve and SS is the initial supply curve. Point E is the equilibrium point where DD intersects SS. Correspondingly, OQ is the equilibrium quantity and OP is the equilibrium price.

Suppose the government fixes the minimum price at P_f. At this price, the quantity demand is OQ_1 and quantity supplied is OQ_2. That is, there is excess supply in the market. The government purchases this extra stock of the commodity.

Answer 7

Increase in demand refers to an increase in the quantity demanded of a commodity due to factors other than the price of the commodity. In such a situation, the quantity demanded of the commodity increases even when the price of the commodity is constant.

Diagrammatically, it is represented by a parallel rightward shift of the demand curve.



In the given diagram, DD is the initial demand curve. Q_1 quantity of the commodity is demanded at P_1 price. The increase in demand is represented by a parallel rightward shift of the demand curve to D_1D_1. Here, even at the same price, the quantity demanded rises to Q_2.

Factors which cause increase in demand:

i. Increase in income of the consumer
ii. Increase in the price of the substitute good
iii. Fall in price of complementary good
iv. Change in tastes and preferences in favour of the commodity
v. An expectation of the decrease in availability of the commodity in the future

Answer 8

Units of labour	***Average Product***	***Marginal Product***	***Total Product***
1	5	-	5
2	10	15	20
3	4	8	12
4	2	4	8
5	1	3	5

Answer 9

Marginal opportunity cost refers to the number of units of one good which must be sacrificed for the production of each additional unit of the other good. The concept of opportunity cost arises because of the scarcity of resources. Accordingly, to put the resources to one use, they must be withdrawn from the other. Algebraically, marginal opportunity cost is represented as

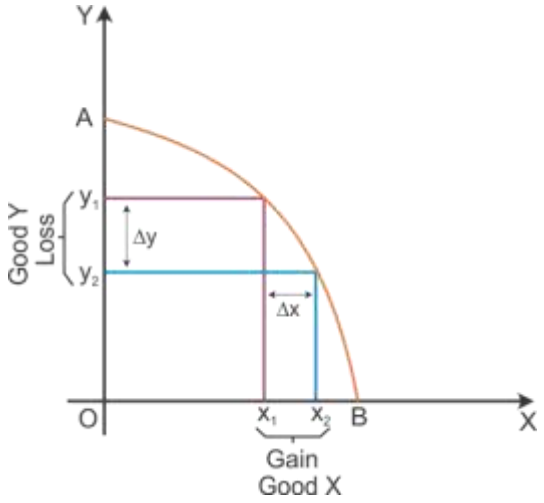
$$\frac{\Delta Y}{\Delta X}$$

The opportunity cost can be understood with the help of the following schedule:

Good X (units)	***Good Y (units)***	***Opportunity Cost*** $\frac{\Delta Y}{\Delta X}$
0	10	-
1	8	2
2	5	3
3	1	4

Marginal opportunity cost is the slope of the production possibility curve. The marginal opportunity cost is rising which indicates that for the production of each additional unit of Good X, greater units of Good Y must be sacrificed.

Diagrammatically,

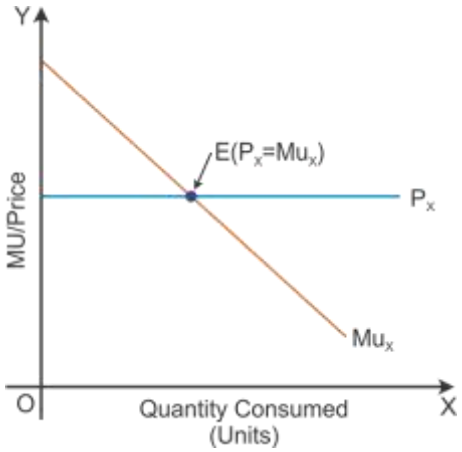


Answer 10

In case a consumer consumes only one commodity, he strikes equilibrium at the point where the rupee worth of satisfaction derived from the consumption of the commodity is equal to the marginal utility of money.

$$\frac{MU_x}{P_x} = MU_m$$

Diagrammatically,



In the diagram, MU_x is the marginal utility curve. P_x being constant is a horizontal straight line parallel to the x-axis. The consumer strikes equilibrium at Point E, where MU_x is equal to P_x.

This can be better understood with the help of the following example:

Suppose a consumer consumes one commodity X, priced at Rs 3 per unit. Also, the marginal utility of money is 5 utils. The marginal utility schedule of the commodity is as follows:

Units	Marginal Utility of X (utils)
1	20
2	15
3	7
4	1

The consumer would strike equilibrium at the point where

$$\frac{MU_x}{P_x} = MU_m$$

This is achievd at 2 units of the commodity

Here,

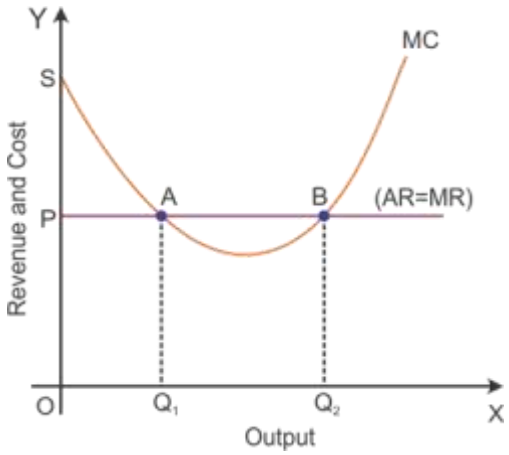
$$\frac{15}{3} = 5 = MU_m$$

Answer 11

According to the MR–MC approach, a consumer strikes equilibrium at the point where the following two conditions are met:

i. MR = MC
ii. MC is rising

This can be understood with the help of the following diagram:



In the diagram, AR (demand curve) is a horizontal straight line parallel to axis and is equal to MR. The MC curve is u-shaped. From the diagram, it can be seen that MR is equal to MC at two points—A and B. However, it is only at Point B that the second condition of equilibrium is met, that is MC is rising. Thus, Point B is the equilibrium point. This can be proved as follows:

At Point A:

Total Revenue = Area under MR curve = Area ($OPAQ_1$)

Total Variable Cost = Area under MC curve = Area ($OSAQ_1$)

As Area ($OSAQ_1$) > Area ($OPAQ_1$)

So,

TVC > TR

This implies a situation of loss.

On the other hand, at Point B,

Total Revenue = Area under MR curve = Area ($OPBQ_2$)

Total Variable Cost = Area under MC curve = Area ($OSBQ_2$)

As Area ($OPBQ_2$) > Area ($OSBQ_2$)

So,

TR > TVC

This implies a situation of profit.

Answer 12

Perfect Competition	***Monopoly***
There are a large number of buyers and sellers.	There is a single seller against a large number of buyers.
The entry of new firms in the market is not restricted.	There is restriction to the entry of new firms.
Firms have perfect knowledge with respect to market conditions.	The monopolist has imperfect knowledge of market conditions.
A firm under perfect competition faces a perfectly elastic demand curve.	The demand curve faced by the firm is relatively less elastic.
A single firm has no control over the price.	The monopolist has complete control over the price.
The average revenue of a firm is equal to its marginal revenue.	The average revenue is more than the marginal revenue.

SECTION B

Answer 13

One of the measures to reduce revenue deficit is to reduce unnecessary and unproductive expenditure of the government.

Answer 14

The correct answer is (d). Revenue receipts refer to receipts of the government as a result of which there is neither any creation of liability nor any reduction in assets of the government.

Answer 15

Involuntary unemployment refers to a situation where a person who is willing to work and capable to work at the prevailing wage rate does not get work.

Answer 16

When aggregate demand is greater than aggregate supply, then a situation corresponding to full employment equilibrium will lead to inflationary gap. On the other hand, a situation corresponding to underemployment equilibrium will not lead to inflationary gap.

Answer 17

Money is demanded for the following reasons:

i. ***Transaction motive***: Money is required for various transactions which need to be conducted daily. Cash is required to be held by the people as there is a gap between the receipt of income and expenditure. According to Keynes, there is a direct positive relation between the transaction demand for money and the level of income of the

individual. As the income increases, the transaction demand for money increases and *vice versa*.

ii. ***Precautionary motive***: People hold cash for certain unforeseen contingencies. The demand for money for precautionary motive is positively related to the level of income of the individual. With the rise in income, the demand for money for precautionary motive increases and *vice versa*.

iii. ***Speculative motive***: It refers to the demand for money for speculative purposes. Besides cash balances, people can hold money in the form of bonds. The decision whether to hold cash or bonds depends on the expected rate of interest. With a rise in the interest rate, the value of bonds falls, so, the demand for money for speculative purposes falls and *vice versa*.

Answer 18

The Central Bank functions in the same way with commercial banks as a commercial bank functions with the public. As the banker's bank, the Central Bank performs the following functions:

i. **Holding cash reserves:** Commercial banks are mandatorily required to maintain a minimum portion (as defined) of the deposits with the Central Bank.

ii. **Lender of last resort:** The Central Bank comes to the rescue of commercial banks when they cannot meet their financial requirements from any other source. In such a scenario, the Central Bank provides loans to commercial banks by discounting securities and bills of exchange. **Clearing house function:** The Central Bank acts as a clearing house for commercial banks; in other words, it settles interbank claims by commercial banks.

Answer 19

At equilibrium

$Y = C + I$

$Y = 400 + 0.75Y + 2000$

$Y = 9,600$

Putting the value of Y in consumption function

$C = 400 + 0.75Y$

$C = 400 + 0.75 \times 9600$

$C = 7,600$

Answer 20

Consumption of fixed capital = GDP at market price + NFIA − (Indirect taxes − Subsidies) − NNP at factor cost

= 300 + 10 − (20 − 5) − 250

= Rs 45 crore

Answer 21

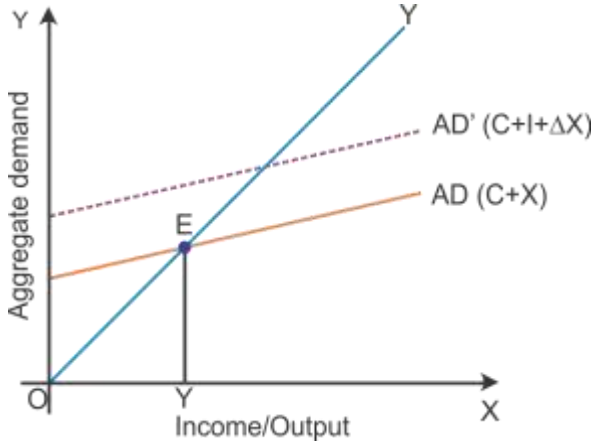
a. Purchase of stationery by an employer for office use is an expenditure on intermediate product as it is not used for final consumption by the employer but rather for further office work.

b. Bread purchased by a household is an expenditure on the final good as it is used for final consumption by the household.

Answer 22

Excess demand refers to a situation wherein at the full employment level of output, the aggregate demand is greater than the aggregate supply.

Excess demand is represented by the following diagram:



According to the diagram, AD is the aggregate demand curve. On the other hand, AS is represented by the 45 degree line. Point E is the point of equilibrium, where the AD and AS curves intersect each other. OY is the full employment level of output. If due to rise in investment expenditure, AD rises to AD′, then it will be called the situation of excess demand.

Bank rate can be used to correct the situation of excess demand. Bank rate refers to the rate at which the Central Bank lends to commercial banks. In a situation of excess demand, the Central Bank raises the bank rate. A rise in the bank rate implies that the cost of borrowings for commercial banks rises. Commercial banks, in turn, raise their lending rates. This discourages loans and credit in the economy which helps in correcting the situation of excess demand.

Answer 23

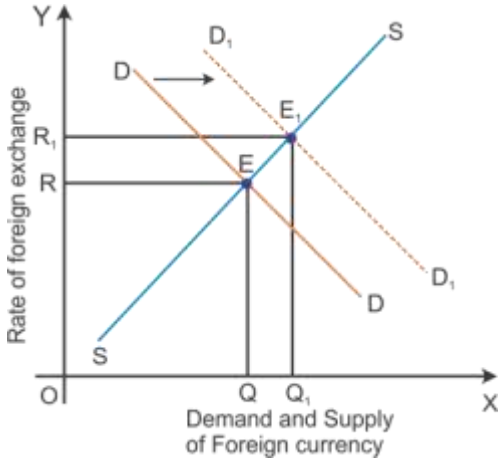
a.

Fixed Exchange Rate System	***Flexible Exchange Rate System***
The exchange rate is determined by the government.	The exchange rate is determined by the market forces of demand and supply.
It is also known as the pegged exchange rate system.	It is also known as the floating exchange rate system.
There is complete control of the government.	There is no control of the government.

The exchange rate remains stable.	The exchange rate keeps changing.

b. A rise in the demand for foreign exchange implies that there is a rise in the demand for the foreign exchange rate to make payments for imports. With the supply of foreign exchange remaining the same, this would lead to a rise in the foreign exchange rate (currency depreciation).

This can be understood with the help of the following diagram:



In the diagram, DD and SS are the initial demand curve and the initial supply curve, respectively. Initial equilibrium is determined at Point E, and therefore, OQ is the initial equilibrium quantity and OR is the initial equilibrium exchange rate.

With the rise in demand for foreign exchange, the initial demand curve shifts outwards to the right to D_1D_1. With the supply curve remaining the same, the new equilibrium is determined at Point E1. Accordingly OQ1 is the new equilibrium quantity and OR1 is the new equilibrium exchange rate.

Answer 24

Gross national disposable income = National income + Consumption of fixed capital + Indirect tax − Subsidies − Net current transfers to abroad

= Private final consumption expenditure + Government final consumption expenditure + Net domestic fixed capital formation + Change in stock − Net imports − Net factor income to abroad − Indirect taxes + Subsidies

= 300 + 60 + 40 + (−20) − (−10) − 20 − 50 + 30 = 350

= 350 + 20 + 50 − 30 − 4 = Rs 386 crore