

CBSE
Class XII Economics
Abroad Board Paper Set 2 – 2014

Time: 3 hrs

Max. Marks: 100

Note:

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

General Instructions:

- (i) **All** questions in both the sections are compulsory.
- (ii) Marks for questions are indicated against each question.
- (iii) Questions Nos. **1 – 5** and **17 – 21** are very short-answer questions carrying **1** mark each. They are required to be answered in one sentence each.
- (iv) Questions Nos. **6 – 10** and **22 – 26** are short answer questions carrying **3** marks each. Answers to them should normally not exceed **60** words each.
- (v) Questions Nos. **11 – 13** and **27 – 29** are also short answer questions carrying **4** marks each. Answers to them should normally not exceed **70** words each.
- (vi) Question Nos. **14 – 16** and **30 – 32** are long-answer questions carrying **6** marks each. Answers to them should normally not exceed **100** words each.
- (vii) Answers should be brief and to the point and the above word limits should be adhered to as far as possible.

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- | | |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|
| 1. What is meant by collusive oligopoly? | [1] |
| 2. Define production function. | [1] |
| 3. Define supply. | [1] |
| 4. Large number of technical training institutions have been started by the government. State its economic value in the context of production possibilities frontier. | [1] |
| 5. When is demand called perfectly inelastic? | [1] |

6. How does change in per unit tax influence the supply of a good by a firm? Explain.

OR

How does subsidy influence the supply of a good by a firm? Explain. [3]

7. Why is a production possibilities curve downward sloping? Explain. [3]

8. Price elasticity of demand of a good is (-) 1. Calculate the percentage change in price that will raise the demand from 20 units to 30 units. [3]

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

10. Under what market condition does Average Revenue always equal Marginal Revenue? Explain. [3]

11. State the different phases of change in total product according to the Law of Variable Proportions. Use diagram. [4]

OR

Explain the law of Variable Proportions.

12. Assuming that a consumer consumes only two goods, explain the conditions of consumer's equilibrium with the help of Utility Analysis. [4]

OR

A consumer consumes only two goods X and Y and is in equilibrium. Show that when price of good X falls, demand for good X rises. Use Utility Analysis.

13. Distinguish between demand by an individual consumer and market demand of a good. Also state the factors leading to fall in demand by an individual consumer. [4]

14. What is meant by 'excess supply' of a good in a market? Explain its chain of effects on the market of that good. Use diagram. [6]

15. State the conditions of consumer's equilibrium in the Indifference Curve Analysis and explain the rationale behind these conditions.

OR

Explain the three properties of the Indifference Curves. [6]

16. From the following information about a firm, find the firm's equilibrium output in terms of marginal cost and marginal revenue. Give reasons. Also find profit at this output. [6]

Output (units)	Total Revenue (Rs)	Total Cost (Rs)
1	8	10
2	16	18
3	24	23
4	32	31
5	40	41

17. Define aggregate supply. [1]

18. What is devaluation? [1]

19. What is a central bank? [1]

20. What is meant by 'excess demand' in macroeconomics? [1]

21. What is 'primary deficit'? [1]

22. Explain the 'standard of deferred payment' function of money. [3]

OR

Explain the 'store of value' function of money.

23. How is balance of payment 'deficit' measured? Explain. [3]

24. What is 'appreciation' of domestic currency? What is its likely effect on exports and how? [3]

25. What are non-monetary exchanges? Give an example. Explain their impact on use of gross domestic product as an index of welfare of the people. [3]

26. Giving reason, state whether the following is a revenue expenditure or a capital expenditure in a government budget: [3]

- i. Expenditure on scholarships
- ii. Expenditure of building a bridge.

27. Government has started spending more on providing free services like education and health to the poor. Explain the economic value it reflects. [4]

28. Explain the concept of money supply and its components. [4]

OR

Explain the 'currency authority' function of central bank.

29. Calculate 'Marginal Propensity to Consume' from the following data about an economy which is in equilibrium: [4]

National income = 800

Autonomous consumption expenditure = 100

Investment expenditure = 100

30. Explain national income determination through the two alternative approaches. Use diagram. [6]

OR

Outline the steps in deriving saving curve from the given consumption curve. Use diagram.

31. Calculate 'National Income' and 'Gross National Disposable Income' from the following: [6]

	(Rs in Arab)
i. Net imports	60
ii. Net current transfers to abroad	(-)10
iii Net domestic fixed capital formation	300
iv. Government final consumption expenditure	200
v. Private final consumption expenditure	700
vi. Consumption of fixed capital	70
vii. Net change in stocks	30
viii. Net factor income to abroad	20
ix. Net indirect tax	100

32. How should the following be treated while estimating national income? You must give reason in support of your answer. [6]

- Bonus paid to employees
- Addition to stocks during a year
- Purchase of taxi by a taxi driver.

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SECTION A

Answer 1

Collusive oligopoly is a form of market in which few firms mutually agree to avoid competition. They form a cartel and fix the output quotas and the market price. The leading firm in the market is accepted by the cartel as a price leader. All the firms in the cartel accept the price as fixed by the price leader.

Answer 2

Production function is the relationship between physical input such as labour, capital and physical output of a good. It is expressed in the following form: $q = f(x_1, x_2)$. It means by using x_1 amount of factor 1 and x_2 amount of factor 2, you will be able to produce q amount of good.

Answer 3

Supply is the quantity of a good which a firm offers for sale at a given price during a given period of time.

Answer 4

The government established technical training institutions to cope with advanced technology. This enabled human resources to improve their skills and to increase the level of output with low cost of production which leads to an increase in profit. Thus, the production possibility curve (PPC) will shift towards the right, and it reflects economic value with high production and skilled labour.

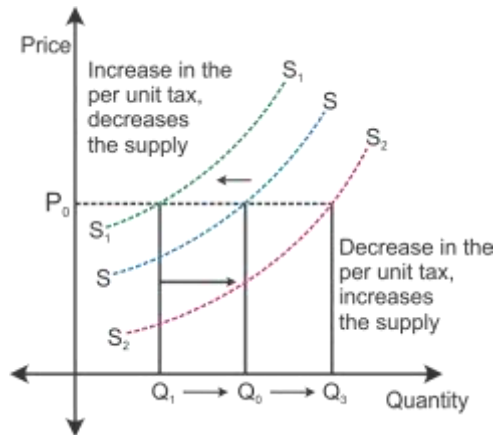
Answer 5

When the demand for a good does not change with the change in the price of that good, it is said to be perfectly inelastic, i.e. $E_d = 0$.

Answer 6

Changes in Tax

When there is a rise in taxes, there will be an increase in the cost of production which results in a decline in the profit margin and the supply of good. The supply curve S shifts leftwards from S to S_1 . It leads to a fall in the supply of good from OQ_0 to OQ_1 , where the price remains constant at OP .

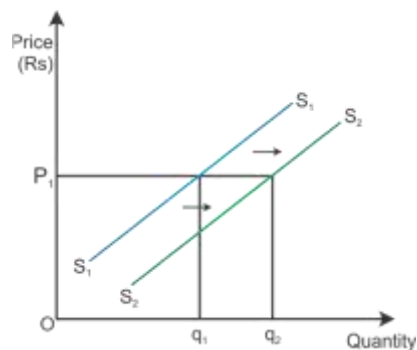


When there is a **decrease in taxes**, there will be a decrease in the cost of production which results in a rise in the profit margin and the supply of good. The supply curve S shifts leftwards from S to S_2 . It leads to an increase in the supply of good from OQ_0 to OQ_3 where the price remains constant at OP .

OR

Changes in subsidies

When the government provides a subsidy to the producer of goods, there will be an **increase in the supply of goods**. This is possible because the cost of production decreases and it leads to an increase in profit. The supply curve S shifts leftwards from S_1 to S_2 . It leads to an increase in the supply of good from OQ_1 to OQ_2 , where the price remains constant at OP_1 .



Answer 7

Production possibility curve (PPC) is a downward sloping curve because the law of increasing opportunity cost applies here. Let us consider the following example

Good X (Units)	Good Y (Units)	$MOC = \frac{\Delta Y}{\Delta X}$
0	20	-
1	18	$2/1 = 2$
2	14	$4/1 = 4$
3	8	$6/1 = 6$
4	0	$8/1 = 8$

The above schedule clearly states that the production of Good-X increases from Unit 1 to Unit 2, and correspondingly, the units of Good-Y forgone is 2. While the production of Good-X increases from Unit 2 to Unit 3, 4 units of Good Y are forgone. With each additional unit of production of Good-X, the amount of Good-Y to be forgone increases. So, because of increasing opportunity cost, the production possibility curve (PPC) is **concave to the origin and downward sloping curve.**

Answer 8

Given that

$$Q_1 = 20$$

$$Q_2 = 30$$

$$E_d = -1$$

$$\Delta Q = Q_2 - Q_1 = 30 - 20 = 10$$

We know that

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

$$-1 = \frac{\frac{\Delta Q}{Q_1} \times 100}{\% \text{ change in price}} = \frac{\frac{10}{20} \times 100}{\% \text{ change in price}}$$

$$-1 = \frac{50}{\% \text{ change in price}}$$

$$\% \text{ change in price} = -50$$

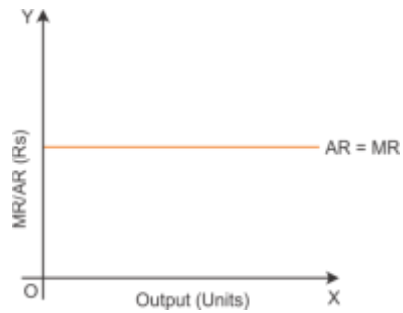
Thus 50% fall in price will increase the demand from 20 units to 30 units.

Answer 9

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

Answer 10

Under the perfect competition market, AR is equal to MR **at all levels of output.** Individual buyers cannot influence the market price of a good by varying their demands, and an individual buyer is a price taker and not a price maker. Hence, AR = MR and price will remain the same. The MR curve is a straight horizontal line which is parallel to the X-axis and coincides with the AR curve.



Answer 11

Law of variable proportion in terms of TP:

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

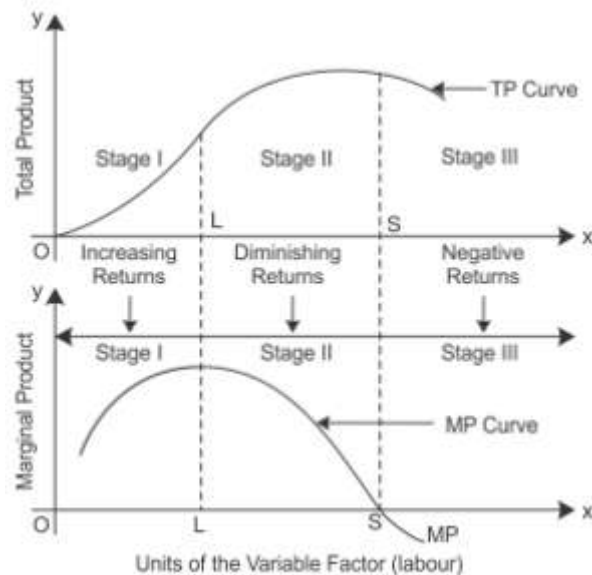
Units of Fixed Factor	Units of Variable Factor	TP	Stages
1	1	4	TP increases at an increasing rate (Increasing returns to a factor)
1	2	12	
1	3	24	
1	4	32	TP Increasing at a decreasing rate TP (Increasing at a diminishing returns to a factor)
1	5	34	
1	6	34	
1	7	30	TP starts falling (Negative returns to a factor)
1	8	21	
1	9	10	

In the above table,

Stage I: As more units of factor input are used, MP tends to rise till 3 units of factor input are used. Here, the total product increases at an increasing rate till 5 units of factor input are used which is called increasing returns to the factor input.

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

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



OR

Law of variable proportion:

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

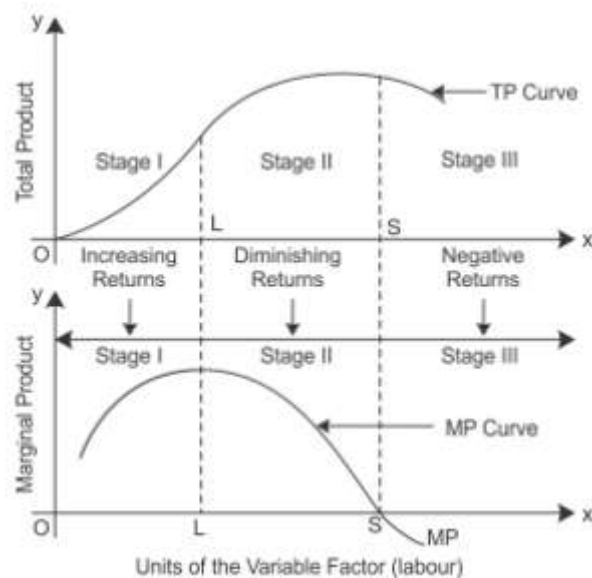
Units of Fixed Factor	Units of Variable Factor	TP	MP	Stages
1	1	4	4	Increasing MP (Increasing returns to a factor)
1	2	12	8	
1	3	24	12	
1	4	32	8	Diminishing MP (Diminishing returns to a factor)
1	5	34	2	
1	6	34	0	
1	7	30	-4	Negative MP (Negative returns to a factor)
1	8	21	-9	
1	9	10	-11	

In the above table,

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

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

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



Answer 12

Conditions of consumer's equilibrium using marginal utility analysis:

When a consumer buys both Goods X and Y, the consumer's equilibrium condition is expressed through the equation:

$$\frac{MU_x}{P_x} = \frac{MU_y}{P_y} = \frac{MU_m}{P_n} = MU_m$$

Consider the following numerical example to understand the consumer's equilibrium using marginal utility. A consumer Marginal Utility of Money (MU_m) is 16 utils and two Goods X and Y whose prices are Rs 1 (P_x) and Rs 1 (P_y) per unit, respectively. Consider the following schedule to analyse marginal utility of good x (MU_x) and good y (MU_y).

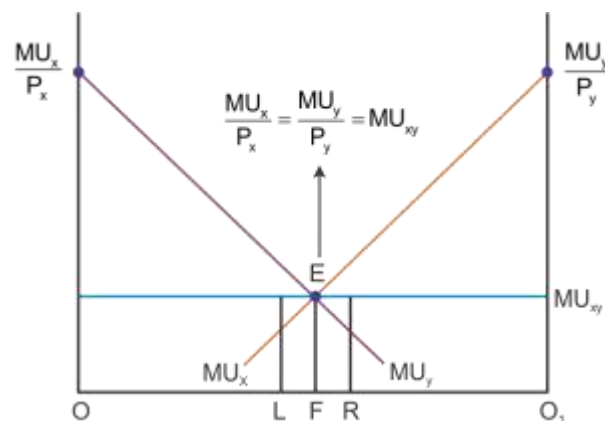
Units of x	MU x (Utils)	MU y3 (Utils)
1	28	32
2	24	29
3	21	27
4	20	23
5	16	20
6	13	18
7	9	17
8	5	16
9	3	12
10	1	9

Based on the given schedule, the consumer is in equilibrium at the consumption of 5 units of commodity x and 8 units of commodity y. At such a consumption combination, the marginal utility of a rupee spent on the commodity x $\left(\frac{MU_x}{P_x}\right)$ is equal to the marginal utility of a rupee spent on the commodity y $\left(\frac{MU_y}{P_y}\right)$ and also equal to the marginal utility of money (MU_m).

Marginal utility of a rupee spent on commodity x = marginal utility of a rupee spent on commodity y = Marginal utility of money

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

$$\frac{MU_x}{P_x} = \frac{MU_y}{P_y} = \frac{16}{1} = 16 = MU_m$$



In the diagram, OO_1 is the total income of a consumer. MU_x and MU_y are the marginal utility curves of commodity x and commodity y, respectively.

The consumer does not attain equilibrium at Point L because the point at L is

$$\frac{MU_x}{P_x} > \frac{MU_y}{P_y}$$

The consumer does not attain equilibrium at Point R because the point at R is

$$\frac{MU_x}{P_x} < \frac{MU_y}{P_y}$$

So, when OF amount of income is spent on commodity x and FO₁ amount is spent on commodity y, the consumer is in equilibrium at Point E. Hence, at this point

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

OR

Utility Analysis:

The consumer reaches equilibrium only if the following condition is satisfied

$$\frac{MU_x}{P_x} = \frac{MU_y}{P_y}$$

Give that the utility received from each additional unit of the money spent on both the goods should be equal. Marginal utility of the amount spent on good A is equal to the marginal utility of the amount spent on good B and also equal to marginal utility of money.

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

If the price of good B falls in relation to good A, the consumer will buy more of good B.

$$\frac{MU_y}{P_y} > \frac{MU_x}{P_x} = MU_m$$

The consumption of good B will tend to increase till the equality is established between the marginal utilities of both the goods become equal to the marginal utility of money.

Answer 13

Individual demand: The demand curve represents the maximum quantities per unit of time which consumers will consume at various prices.

Market Demand: Market demand curve is the horizontal summation of the individual demand curves. It indicates various quantities of a good which all consumers in the market are willing to buy at different possible prices of a good at a point of time.

Factors affecting demand for a good by an individual:

- i. Own price of good:** Assume that other things remaining constant, an increase in the price of a good will decrease the demand for a good, and a decrease in the price of a good will increase the demand for the good. There is an inverse relationship between the price of a good and the demand for a good.
- ii. Price of other goods:** Demand for a commodity is influenced by change in price of other goods. When the price of one good falls, it becomes cheaper in relation to another good.

If there is an increase in the price of the substitute good coffee, then the demand curve for tea shifts to the right. On the other hand, if there is a decrease in the price of the substitute good coffee, the demand curve for tea shifts to the left even when its price is constant.

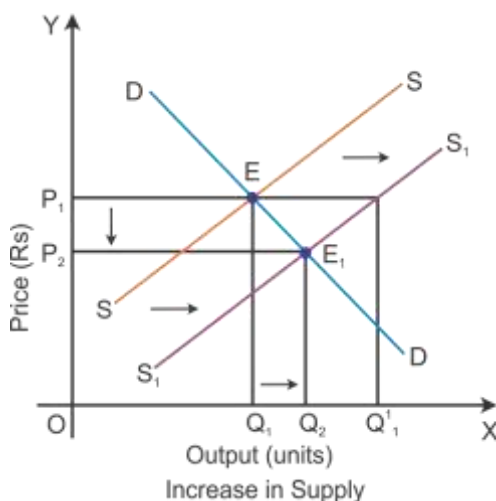
If there is an increase in the price of a good, then the demand for another good will decline. So, the demand curve shifts parallel to the left. On the other hand, if there is a decrease in the price of a good, then the demand for another good will increase and so the demand curve shifts parallel to the right.
- iii. Income of consumers:** A change in income causes a change in the demand for a good based on the variety of goods available in the market. There will be an increase in the demand for normal goods with a rise in income level. On the other hand, the demand for inferior goods will decrease with an increase in income.
- iv. Consumers' tastes and preferences:** Assume that other things remaining constant, if consumers have more preference for a good than other goods, then the demand for those goods will increase. On the other hand, if consumers have no preference for a good than other goods, then the demand for those goods will decrease.
- v. Population size:** An increase or decrease in population size will influence the demand for goods in the market. There is a positive relationship between the size of population and the demand for a good.

Answer 14

Excess supply is a situation where the market demand is less than the market supply at a particular price.

Consider DD to be the initial demand curve and SS to be the supply curve of the market. Market equilibrium is achieved at Point E, where the demand and supply curves intersect each other. Therefore, the equilibrium price is OP, and the equilibrium quantity demanded is OQ.

When there is change in other factors than price, there will be rise in the supply of goods. There will be a shift in the supply curve towards the right to SS_1 with an increase in the supply, and the demand curve DD will remain the same. This implies that there will be a situation of excess supply at the equilibrium point.



In the above diagram, there is an excess supply of OQ_1 to OQ'_1 units of output at the initial price OP_1 . Thereby the producers will tend to reduce the price of the output to increase the sale in the market. Profit margin of the firm will come down and slowly some of the firms will tend to quit the market. Because of this, the market supply will decline to OQ_2 level of output and the price of the output also gets reduce to the point OP_2 . Now, the new market equilibrium will be at Point E_1 , where the new supply curve SS_1 intersects the demand curve DD .

Answer 15

Conditions of consumer's equilibrium using indifference curve analysis:

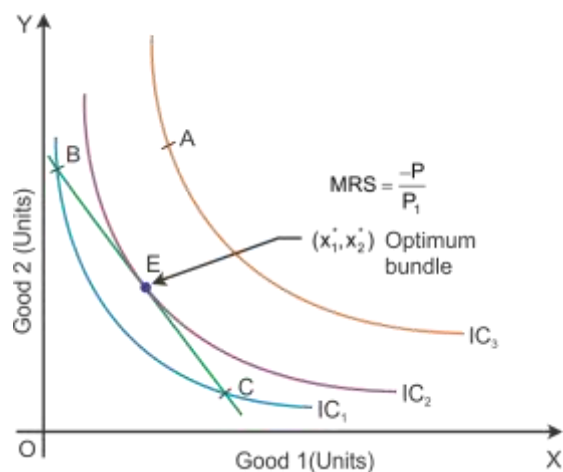
A consumer will strike his equilibrium at the point where the budget line is tangent to an indifference curve.

Slope of IC = Slope of price line

$$\left| \frac{-dy}{dx} \right| = |MRS| = \left| \frac{-P_1}{P_2} \right|$$

Equality of marginal rate of substitution and ratio of prices: When the budget lines is tangent to an indifference curve at a point, the absolute value of the slope of the indifference curve and of the budget line are equal at that point, i.e. MRS is equal to the price ratio. The slope of the budget line is the rate at which the consumer can substitute one good for the other in the market. At the optimum, the two rates should be the same. Thus, a point at which the MRS is greater, the price ratio cannot be optimum, and when the MRS is less than the price, the ratio cannot be optimum.

The equilibrium can be represented as follows:



In the diagram, Point E shows the consumer's equilibrium where the budget line is tangent to the indifference curve. Consumers' desire to purchase correspond to the consumer originally purchase, i.e. x_1^* , x_2^* shows the optimum bundle.

Consumer does not reach equilibrium condition at the following points:

At point B: $MRS > -\frac{P_1}{P_2}$

At Point A: $MRS > -\frac{P_1}{P_2}$

OR

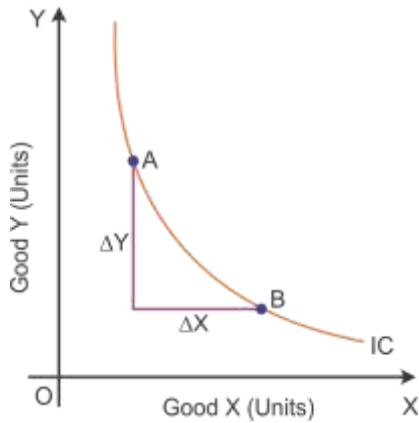
Properties of indifference curves (ICs)

i. Indifference curves slope downwards or negative slope:

The indifference curves slope downwards, left to right, because an increase in the amount of Good X along the indifference curve is associated with a decrease in the amount of Good Y, as the preferences are monotonic.

ii. Slope of indifference curves represents marginal rate of substitution:

Marginal rate of substitution (MRS) is the rate at which a consumer is willing to substitute one commodity for another commodity.

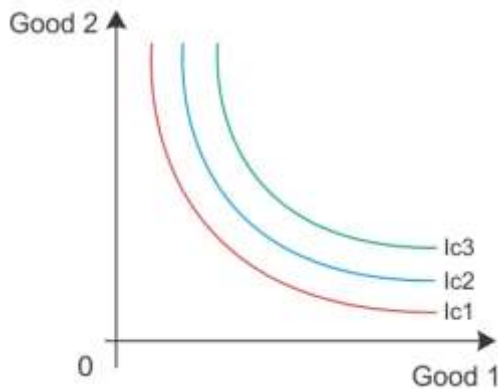


Slope of indifference curve between A and B = $\frac{\Delta Y}{\Delta X} = \text{MRS}$

MRS is the rate at which the output of Good Y is sacrificed for every additional unit of Good X.

iii. In an indifference map, higher IC represents higher level of satisfaction:

An indifference map refers to a set of indifference curves. An indifference curve which is to the right and above another shows a higher level of satisfaction to the consumer. Here, IC₃ shows higher level of satisfaction than IC₂. Thus, the indifference curve relates to a higher level of income of the consumer.



Answer 16

Output (units)	Total Revenue (Rs)	Total Cost (Rs)	Marginal Revenue (Rs)	Marginal Cost (Rs)	Profit (TR - TC)
1	8	10	-	-	-2
2	16	18	8	8	-2
3	24	23	8	5	1
4	32	31	8	8	1
5	40	41	8	10	-1

According to the MR–MC approach, the firm reaches equilibrium only when the following conditions are satisfied:

- i. $MR = MC$
- ii. MC must be rising after the equilibrium level of output

The firm is in equilibrium at the output level of 4 units, and MC increases after the 4th unit of output. Thus, the firm's equilibrium level of output to maximise output is $MR = MC$ and MC should be rising at the point of intersection with MR. If there is a decline in the level of output, then the price will exceed the marginal cost. Hence, the firm should increase output to earn high profit. The firm reaches equilibrium only when it produces 4 units of output.

Answer 17

Aggregate supply means the total production of goods and services in the country at a given level of employment during the year.

Answer 18

Devaluation is the rise in the price of domestic currency in terms of foreign currencies under a fixed rate system.

Answer 19

The Central Bank is an apex bank which regulates all the activities of commercial banks and other financial institutions of an economy.

Answer 20

In macroeconomics, excess demand is a situation where the aggregate demand for output is more than the full employment level of output.

Answer 21

Primary deficit is the difference between the fiscal deficit and interest payment. It determines the amount of borrowing which is necessary for the government to pay for the expenses other than interest payments.

Primary deficit = Fiscal deficit – Interest payment

Answer 22

Standard of deferred payment: Deferred payments refer to those payments which are made in the future. Money has made deferred payments easier. When money is borrowed, the principal and interest amounts have to be returned to the lender. However, these transactions are not possible in terms of goods and services. Money performs this function more effectively.

OR

Store of Value: People keep their wealth in the form of money because money is the most liquid form of wealth. Savings in the form of money is maintained for purchasing

commodities in the future. In this case, the values of commodities are being stored. Hence, money acts as a store of value.

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

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

Answer 23

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

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

Answer 24

Currency appreciation means the value of domestic currency becomes costlier in terms of foreign currency. For example, if the exchange rate for \$1 = Rs 50 decreases to \$1 = Rs 45, then the export of goods to foreign countries will become costlier. This implies that the rupee value is appreciated against the dollar. So, the goods worth Rs 48 for \$1 only get exported, and hence, there is a decrease in the demand for exports.

Answer 25

Non-monetary exchanges are the transactions of purchase and sale of goods and services which occur without money. This refers to all those services rendered by family members to each other. When money is not involved in these transactions, it is not accounted in GDP calculation, because GDP calculates the goods and services produced in an economy during a period of time in terms of money. These non-monetary exchanges are not accounted during GDP calculation which results in the underestimation of GDP. Anyhow, this exchange has a positive effect on the welfare of the people.

Answer 26

- i. Expenditure incurred on scholarships is considered as revenue expenditure because this expenditure does not create any asset and does not reduce any liability of the government.
- ii. Expenditure incurred on building a bridge is considered a capital expenditure because this expenditure creates an asset and reduces the liabilities of the government.

Answer 27

When there is an increase in government expenditure in providing free services such as education and health to the poor, it improves the welfare of the nation. This has an effect on the economic value of the nation. The government can reallocate resources so that social and economic objectives can be met in the following ways:

- i. The government ensures productive expenditure to maximise the welfare of the nation with minimum level of profit.
- ii. The government regularises the activities of the private sector to provide social benefit to the poor.

Hence, it helps to bridge the gap between the rich and poor sections of society.

Answer 28

Money supply refers to the total stock of money in the form of currency notes and coins held by the people of an economy at a particular point in time.

The following are the components of money supply:

- i. **Currency component** - It includes currency notes and coins (collectively called the currency component of money supply) that are issued by the monetary authority of a country. In India, the RBI issues currency notes of various denominations such as Rs 2, Rs 5, Rs 100, Rs 500 and Rs 1000 and the Government of India issues currency coins and notes of denominations less than and equal to Re 1.
- ii. **Deposit component** - It includes the savings or the current account deposits held by the public in various commercial banks of a country. Deposits held by the public can be classified into two major categories- Term Deposits and Demand Deposits.

OR

The central bank of a country has the exclusive authority to issue the currency (notes + coins). The currency issued by the central bank is known as 'legal tender money' i.e. the value of such currency is backed by the central bank. However, the currency issued by the central bank is its monetary liability. In other words, the central bank is obliged to back the currency issued by it by assets of equal value such as gold coins and foreign exchange. In addition to issuing currency to the general public, the central bank also issues currency to the central government of the country. That is, the central government if required, can sell its securities to the central bank and in return gets the required cash currency.

Answer 29

Given that

National Income (Y) = 800

Autonomous consumption expenditure (\bar{C}) = 100

Investment expenditure (I) = 100

As we know that

$$Y = C + I$$

$$C = \bar{C} + cY$$

$$Y = \bar{C} + cY + I$$

$$800 = 100 + C(800) + 100$$

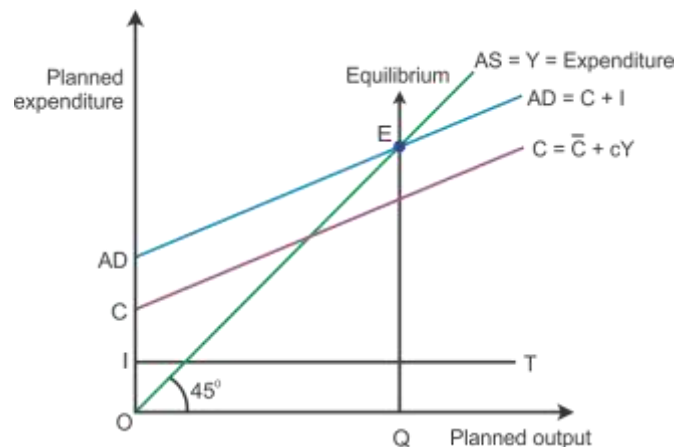
$$600 = 800C$$

$$C = 0.75$$

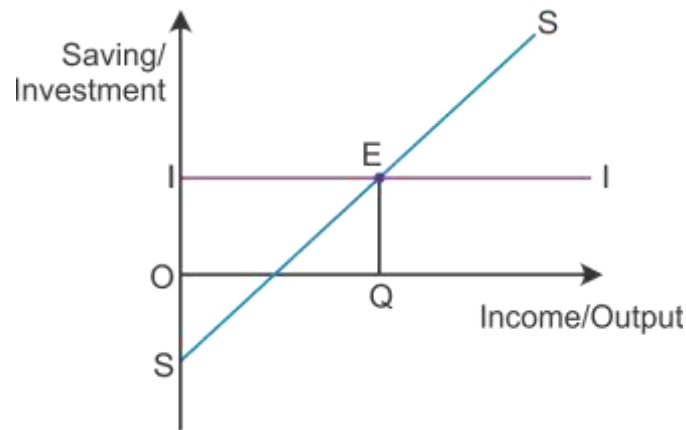
Therefore, Marginal Propensity to Consume (MPC) is 0.75

Answer 30**Aggregate demand and aggregate supply approach**

The equilibrium level of income is attained only when the aggregate demand is equal to the aggregate supply. It is the level of output where producers plan to produce an amount of good which is equal to consumers' plans to purchase the amount of good. Thus, equilibrium is struck where the planned output (AS) is equal to the planned expenditure (AD) during a period of time.

**Saving and Investment Approach**

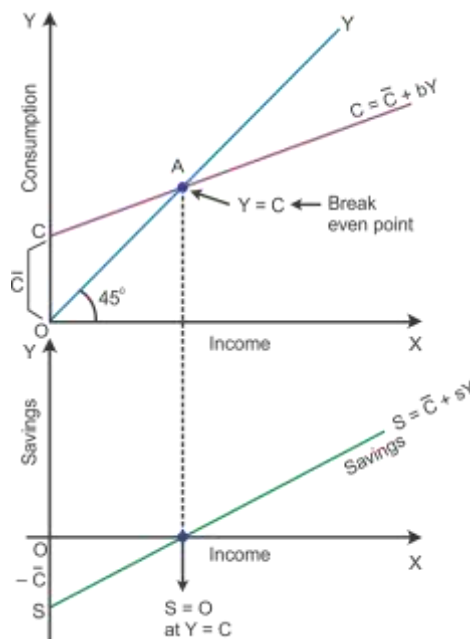
The equilibrium is determined at a point where the saving and investment are equal to each other, i.e. leakages = injections.



In the diagram, SS shows the saving curve and II shows the investment curve, and the investment curve shows autonomous investment. Savings is equal to investment at Point E, where the saving curve SS and the investment curve intersect each other.

OR

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



Derivation of saving function from consumption function:

— \bar{C} is the saving function where negative savings are equal to autonomous consumption at $Y = 0$. This is shown on the negative axis in the lower panel at Point S. Here, all the

income is spent on consumption expenditure. Hence, there is no saving which is shown as the breakeven point. After this point, S and Y are joined to have a straight line sloping curve.

Answer 31

$$\begin{aligned}\text{NNP}_{\text{FC}} &= \text{Private final consumption expenditure} + \text{Government final consumption expenditure} + \text{Net domestic fixed capital formation} + \\ &\quad \text{Net change in stocks} - \text{Net imports} - \text{Net indirect tax} - \text{Net factor income to abroad} \\ &= 700 + 200 + 300 + 30 - 60 - 100 - 20 \\ &= 1050 \text{ arab}\end{aligned}$$

$$\begin{aligned}\text{Net National Disposable Income (NNDI)} &= \text{NNP}_{\text{FC}} + \text{NIT} - \text{Net current transfers to abroad} \\ &= 1050 + 100 - (-10) \\ &= 1160 \text{ arab}\end{aligned}$$

Answer 32

- i. Bonus paid to employees **will be included in the estimation of national income** because it is a part of compensation paid to employees.
- ii. Addition to stocks during a year **will be included in the estimation of national income** because it forms a part of gross domestic capital formation and is included in the capital stock.
- iii. Purchase of a taxi by a taxi driver **will be included in the estimation of national income** because the purchase of new taxis is considered an investment by the driver.