PART - A

1 Q.i Define Micro Economics.

Ans. Micro economics studies the economic activities of individual units (like indiviual household, individual firm) In the words of Prof. Boulding "Microecomomics is the study of particular firm particular household individual price, wage income, indusing and particular commodity."

Q.ii If Price of petrol is increased, what will be the effect on the demand of a car?

Ans. If price of petrol is increased the demand for the car will be decreased.

Q.iii What is production?

Ans. Production is the transfomation of inputs into output. The relation between the physical input and physical output of commondity.

Q.iv What do you mean by total Revenue?

Ans. The revenue that a firm gets by selling a given quantiy of product is called total revenue. Suppose 100 bricks of ice - cream are sold @ Rs. 50 per brick the total revenue of the firm wil be

$$TR = Q \times P$$

Def:- Total revenue is the sum of all receipts or income of a firm.

Q.2 "How to Produce"? Explain this problem.

Ans. How to produce actually means how to organize production? This problem is concerned with the choice of technique of production. For example, production of cloth is possible either by handlooms or by modern machines. Many techniques of production can be adopted, like (a) Labour Intensive Technique wherein labour is used more than capital, or (b) Capital Intensive Technique wherein capital is used more than labour. An economy must decide as to which technique it is going to use in a given industry to that efficient production is obtained. Among different techniques of production, the most efficient technique is one the use of which requires the least amount of scarce resources to produce a given quantity of goods.

Q.3 What is meant by Consumer's Equilibrium? Write its assumptions.

Ans. Consumer's equilibrium refers to a situation wherein a consumer spends has limited income to get maximum satisfaction. According to Samuelson "The consumer is in equilibrium when he maximises satisfaction given by his income and the market prices." Consumer's equilibrium is determined by utility analysis.

Assumptions relating to consumer's equilibrium

(1) Rational Consumer : It is assumed that the consumer is a rational being. Rational consumer is one who desires maximum satisafaction out of his limited income.

(2) Cardinal Utility : Utility derived from each commodity can be measured in cardinal numbers, as 1,2,3,4, etc.

(3) Independent Utility : The utility that a consumer gets from a commodity depends upon the quatity of that very commodity. The utility derived from other commodities has no eddefct on it.

(4) Marginal Utility of Money is Constant : Money is considered to be the measure of utility. Just as the value of other measures remains constant so the utility derivated from each unit of money should also remain constant.

(5) Tastes are Constant : It is assumed that the taste of the consumer remains constant. The term taste has been used in a borad sense. It includes fashion, climate, nature, etc.

Q.4 Distinguish between fixed costs and variable costs.

Ans.

	Fixed costs	**Variable costs**
1.	Fixed costs do not change with change in quantity of output	Variable costs change with change in quantity of output
2.	Fixed costs remain the same whether output is zero or maximum	Variable costs are zero when output is zero. These costs increase when output increases and decrease when output decreases.
3.	Examples are (a) rent (b) wages of permanent staff (c) licence fee.	Examples are (a) cost of raw material (b) Wages of causal labour.
4.	It relates to fixed factor.	It relates to variable factor.
5.	It remains some even if production is stopped	It becomes zero if production is stopped

Q.5 Distinguish between fixed costs and variable costs.

Ans.

Unit of Production (Q)	**TP**	**AP**	**MP**
0	60	-	-
1	130	130	70
2	180	90	50
3	230	76.66	50
4.	290	72.5	60

Q.6 Find the Price Elasiticity of demand from the following table :

Price per unit Rs.	**Quantity per unit (kg.)**
8	**100**
10	**90**

Ans. Price elasticity $Ed = -\frac{P}{Q} \times \frac{\Delta Q}{\Delta P}$

Or $\frac{P}{Q} \times \frac{Q-Q}{P_1-P}$

$\Delta Q = Q - Q$ = 90 – 100 = –100

$\Delta P = P_1 - P$ = 10 – 8 = 2

$\frac{8}{100} \times \frac{-10}{2} = \frac{2}{5}\ Ed < 1$

Elasticity of demand to less than 1

Q.7 Explain the Law of Demand.

Ans. Def. According to Marshall "The amount demanded increases with the fall in prices and diminishes with size in price.

The law of demand states that, other things being equal, the demand for a good extends with a decrease in price and contracts with an increase in price. In other words, there is an inverse relationship between quantity demanded of a commodity and its price, other things being equal. The term 'other things being equal' implies that income of the consumer, his tastes and preference and prices of other related goods remain constant.

Assumptions of the Law of Demand

Law of demand holds good when "other things remain the same". It means factors influencing demand other than price are supposed to be constant. These refer to the assumptions of the law. It applies to normal goods and not to giffen goods.

The main assumptions of the law are as follows:

(i) Tastes and preferences of the consumers remain constant.

(ii) There is no change in the income of the consumer.

(iii) Prices of the related goods do not change.

(iv) Consumers do not expect any change in the price of the commodity in the near future.

Q.8 What is difference between decreasing return to factor and increasing return to factor.

Ans.

	Increasing return of factor	**Decreasing return of factor**
1.	Total output tends to increase at Increasing rate	Total output tends to increased at diminishing rate
2.	MP must be increasing	MP is diminishing
3.	MC diminishing	MS rises
4.	Fuller utilisation of fixed factor	Fixity of the factor
5.	Better co – ordination between the factors	Poor co – ordination between the factors

Q.9 Define perfect competition market. Explain its characteristics.

Ans. Perfect competition is a market wherein there are large number of buyers and sellers of homogeneous product and the price of the product is determined by the industry.

Def. In the words of Boulding "Perfect completion is a market situation in which there are large number of buyess and sellers. The sellers sell homogeneous product at a single uniform price. The price in determined not by the firm but by the undusting .

Features of Perfect Competition

(1) Large Number of Firms or sellers: the number of firms selling a particular commodity is so large that any increase or decrease in the supply of one particular firm makes no difference to the total market supply. Accordingly, no individual firm can influence price of the commodity. It is therefore said that a firm under perfect competition is a price taker. In other words, it has to sell its products at the prevailing market price.

(2) Large Number of Buyers: Not only is the number of sellers very large, also the number of buyers is very large. Accordingly, like an individual firm, an individual buyer is also not able to influence prive of the commodity. Any increase or decrease in individual demand will hardly make any difference to the total market demand. Accordingly, an individual buyer under perfect competition is also a price taker.

(3) Homogeneous Product : All sellers sell indentical units of a given product. It means that buyers will have no reason to prefer the product of one seller to the product of another seller. Thus, the price of the product throught out the market will be the same.

Selling homogeneous product at the given price rules out the possibility of advertisement expenses. So that there are no selling costs in perfectly competitive market.

(4) Perfect Knowledge : Buyers and sellers are fully aware of the price prevailing in the market. Buyers know it fully well at what price sellers are selling a given product. As such only one price prevails in the market.

(5) Free Entry and Exit of Firms : A firm can enter and leave any industry. There is no legal restriction on the entry or exit.

(6) Independent Decision - making and Freedom from Checks : Every seller takes his own decision regarding production, quantity and price as well as purchase and sale of any commodity.

(7) Perdect Mobility : Factors of prodction are perfectly mobile under perfect competition. Factors will move to that industry which pays the highest remuneration.

(8) No extra Transport Cost : No extra transport cost in incurred to send the goods to different areas of the market, under perfect competition. According, one price of the commodity prevails in the entire market. Firm can only determine the quantity of its product to be sold at the prevailing market price.

Q.10 How price elasticity of demand is measured with the help of "Point Method"? Explain it.

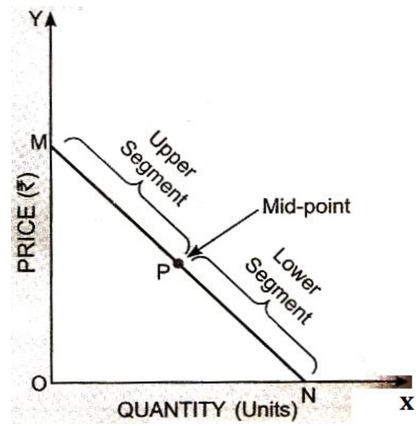
Ans. Geometric Method or Graphic Method or Point Method

Geometric method measures elasticity of demand, at a specific point on the demand curve. It is also called 'point method of measuring elasticity of demand'. This method is explained with the help of Fig.

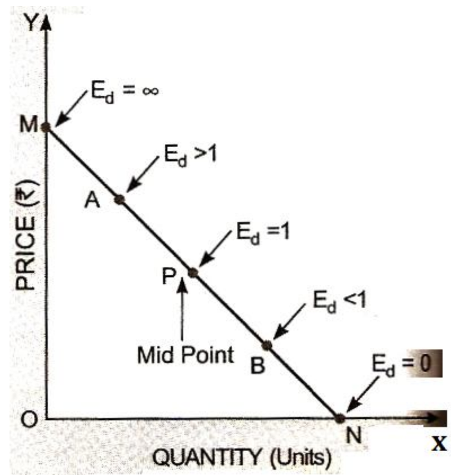
In figure, MN is a straight line demand curve. P is a specific point on the demand curve. The point P divides the demand curve into two segments, viz. lower segment PN and upper segment PM. Elasticity of demand at point P is the ratio between lower segment (PN) and upper segment (PM).

E_d (at point P) = $\frac{PN\ (Lower\ Segment\ from\ P)}{PM\ (Upper\ Segment\ from\ P)}$

Fig. shows elasticity of demand at different points on a linear (straight line) demand curse, by the above method.



(i) Unitary Elasticity of Demand : If point 'P' is the mid – point of linear demand curse, then $PN = PM$. Hence at point P elasticity of demand will be $\frac{PN}{PM}$ = 1 (Unitary).



(ii) More than unitary Elasticity of Demands : If point 'A' is above the point P, then the lower segment AN is bigger than the upper segment AM. Hence, at point 'A' elasticity of demand will be $\frac{AN}{AM}$ > 1 (Greater than Unitary).

(iii) Less than Unitary Elasticity of demand : If point 'B' is situated below the point P, then the lower segment BN is smaller than the upper segment BM. Hence, at point 'B' elasticity of demand will be $\frac{BN}{BM}$ < 1 (Less than Unitary).

(iv) $E_d = 0$: At point N (where demand curve touches X - axis) elasticity of demand will be $E_d = \frac{0}{NM} = 0$ (because lower segment =0).

(v) $E_d = \infty$: At point M (Where demand curve touches Y - axis) elasticity of demand will be $E_d = \frac{NM}{0} = \infty$ (because upper segment = 0)

(Note : - Any real number divided by zero tends towards infinity.)

In short, price elasticity of demand is unitary if a point is at the middle of a demand curve, it is greater than unitary if is above the mid - point and less than unitary if it is below the mid - point.

Q.11 Explain the Law of Supply with the help of a diagram.

Ans. **Law of supply :** Law of supply states that, other things remaing constant, there is the positive relationship between price of a commodity and its quantity supplied. Thus more is supplied at higher price and less at the lower price.

Definition -

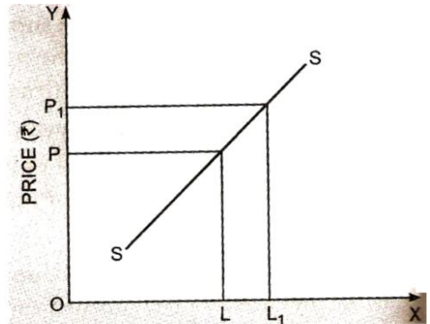
In the words of Dooley, "The law of supply states, that other things being equal, the higher the price, the greater the quantity supplied or the lower the price, the smaller the quatity supplied. " In other words, there is a positive relationship between the price of good and its supply.

Explain of the Law of Supply -

Law of supply may be explained with the help of Table and Fig.

Supply Schedule

Price (P_X) (₹)	Supply (S_X) (Units)
10	100
11	200
12	300



Supply schedule shows that when price rises from Rs. 10 to Rs. 11, supply extends from 100 units to 200 units. In Fig., upward sloping supply curve SS shows that with rise in price of the good its supply too increses. When price rises from OP to OP_1 supply extends from OL to OL_1.

Assumptions of the law of supply

Important assumptions of the law of supply are following:

(i) There is no change in the prices of the factors of production.

(ii) There is no change in the technique of production.

(iii) There is no change in the goal of the firm.

(iv) There is no change in the prices of related goods.

(v) Producers do not expect change in the price of the commodity in the near future.

Exceptions to the Law of Supply

Positice relationship between price and quantity suppliedof a good may not take place under the following conditions:

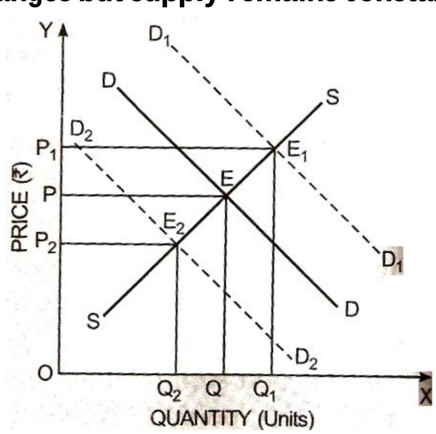
(i) This law may not hold firmly on agricultural products based on natural factors. If due to natural calamities, the production of wheat falls short, its supply cannot increase depite rise in its price.

(ii) Some goods having social distinction reamin limited in supply even when their price may rise high.

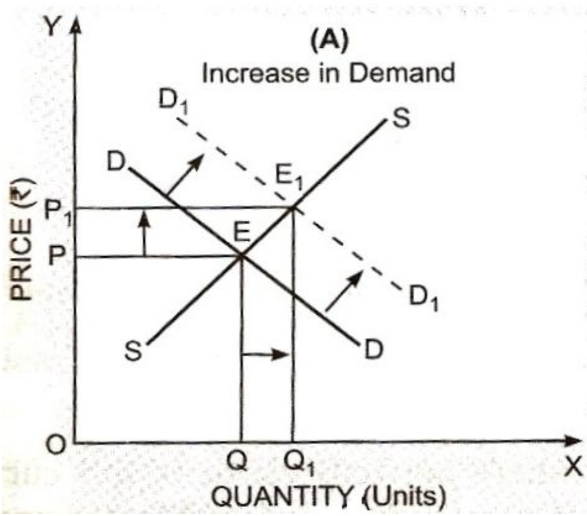
(iii) Sellers may be willing to sell more quantity of perishable goods although their price may be falling.

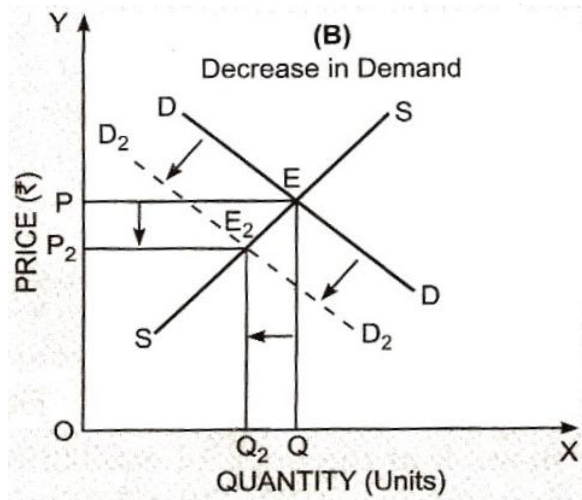
Q.12 What will be the effect on price equilibrium when demand changes but supply remains constant?

Ans. Effect of Change in Demand on Equilibrium Price -



If the supply of the commodity remains constant, then the price invreases with increase in demand and price decreases with decrease in demand. Fig. show that DD is the initial demand curve and SS is the initial supply curve, OP is the equilibrium price and OQ, the equilibrium demand and supply, i.e. equilibtium quantity. Suppose, due to the increase in demand, the demand curve shifts to the right from DD to D_1 D_1 . The new demand curve D_1 and D_1 intersects the supply curve SS at point E_1. Thus, E_1 will be the new equilibrium point and OQ_1 the new equilibrium quantity and OP_1 the new equilitium price. On the other hand, in case of decrease in demand, the demand curve shifts to the left from DD to D_2D_2. The new demand curve D_2D_2 intersects the supply curve at point E_2. Therefor, E_2 will be the new equilibrium point. At that point, OP_2 will be the new equilibtium price and OP_2, the new equilibrium quantity. In brief, we can conclude that when suply curve remains constant, equilibrium price invreases with increase in demand of the commodity and equilibrium quantity also increases. As against it, when demand decreases, equililbrium price will decrease and equilibrium quantity will also decrease. This situation is explained through Fig.





(i) Increase in Demand : Fig (A) show that, while supply remain unchanged, due to an increase in demand, the demand curve shifts upwards (rightwards) from DD to D_1D_1 intersects supply curve SS at point E_1. The new equilibrium point will be E_1. At this point E_1, equilibrium price will increase from OP to OP_1 and equilibrium quantity increases from OQ to OQ_1.

(II) Decrease in Demand : Fig. (B) shows that, while supply remains unchanged, due to decrease in demand, the demand curve will shift downwards (leftwards) to D_2D_2. This new demand curve D_2D_2 intersects supply curve SS at point E_2.

This E_2 will be new point of equilibrium. At point E_2, the equilibrium price will fall from OP to O2 and equilibrium quantty falls from OQ to OQ_2.

OR

(i) Write difference between Internal Economices and External Economies.

Ans.

	Internal	**External**
1.	They are firm specific	They occur based or larger changes
2.	Caused internally	caused outside the firm

(ii) Explain the relationship between total revenue and marginal revenue.

Ans. (i) $TR = AR \times Q$ or $\sum MR$.

(ii) $MR_n = TR_n - TR_{n-1}$

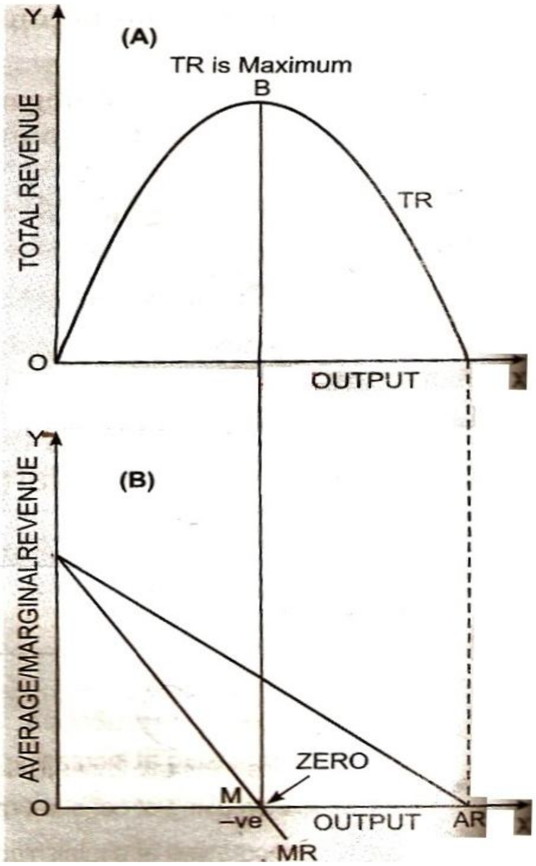
(iii) When TR is increasing at increasing rate, MR is also increasing.

(iv) When TR is increaing at constant rate, MR should be constant.

(v) When TR is increasing at diminishing rate, MR should be diministing.

(vi) When TR is maximum, MR is zero.

(vii) When TR is diminishing, MR is negative.



PART - B

13. Q.i What do you mean by Macro Exonomics?

Ans. Macro economics studies economic problem at aggragate level i.e. at the level of entire economy. Aggregate consumption aggregete employment, nateonal income etc are studies in this branch. According to shapies Macroeconomics deals with the functioning of the economy as whole.

Q.ii What is Revenue Deficit?

Ans. A revenue deffcit occurs when the net income generatel revenues less expenditures falls short of the projected net income. This happens When the actual amount of revenue received or the actual amount of expenditures not correspond with bridgeted revenue and expenditure.

Q.iii Define Bank Rate.

Ans. Bank rate is the minium rate at which the central bank of a country as a lender of last resort is prepared to five evedit to the commercial banks. The increase in bank rate increases the rate of interest and credit becomes dear.

Q.iv What is meant by Exchange Rate?

Ans. Exchange rate refers to the price of one currency in relation to other currency in the international money market. Example if Rs. 50 are to be part to paid to buy one VS $ rate between the two currencies = 50 : 1.

Q.14 Write difference between Domestic and National Income.

Ans. Main differences between domestic factor invome and national income are as under :

(i) Domestic factor invome is the sum total of factor invome earned in one accounting year within the domestic territory of a country ; that is,

Domestic Factor income = Wages + Rent + Interest +Profit + income of Self - emplolyed within the DomesticTerritory

On the other hand, national income is the sum total of factor invome within the domestic terriory and net factor income from abroad; that is

National Income = Domestic Factor Income + Net Factor Income from Abroad

(ii) Domestic factor income is earned in the domestic territory of the counrty by all producers, normal residents as well as non - residents. On the countrary, national income is earned by the normal residents. They earn it within the domestic territory of the country as well as rest of the world. National invome may be more or less then domestiv factor income. It depends whether net factor invome from abroad is positive or negative.

Q.15 Explain the two primary functions of money.

Ans. Money was introduced into the economy as a mdeium of exchange two primary fundctions of money.

(i) Medium of exchange - It mwans that money axts as an intermediary that can be used in exchange for goods and resvices in an exchanfe transaction. As a medium of exchnave money has removed the main difficulty of baeter system. Exchange has become convenient and simple. It is generally acceptable by the people.

(ii) Measure of Value - Measure of value is the other primary function money serves as a measure of value in terms of unity of acount which means that the value of each good or service is measure in the monetary unit. After measuring the value of each good, money determines the prices of different goods and their mutual exchange values.

Q.16 If MPC = 0.6 find the value of multiplier (K).

Ans. $MPC = 0.6$

Multiplier = $\frac{1}{1-MPC}$

$= \frac{1}{1-0.6} = \frac{1}{.4} = 2.5$

Q.17 Distinguish between Progressive Tax and Regressive Tax.

Ans. **Difference between progressive and regessive tax.**

	Basis	**Progressive**	**Regressive**
(i)	Rate	rate increases with increase in income	rate decreases with increase in income
(ii)	Example	A man has an income of Rs. 5,000 per year paying 10% tax if income	If a person with Rs. 1,00,000 monthly

		increases to Rs. 10,000 the rate of tax may be 15%	income pays 10% tax he still has balance of Rs. 90,000 p.m.
(iii)	Burden	Burden is more on rich and less on poor	Burden falls heartily or poor people.

Q.18 What is difference between stock and flow?

Ans.

Stock	Flow
1. Stock relates to a point of time, e.g., your savings as on January 1, 2016 are Rs. 10,000.	1. Flow relates to the period of time, e.g. your pocket expenses of Rs. 20 per day.
2. Stock is not time dimensional	2. Flow is time dimensional as per hour, per month, per year.
3. Stock influences the flow. Greater the stock of capital, greater is the flow of goods and services.	3. Flow influence the stock. For examples, monthly increases in the supply of money leads to an increase in the quantity of money.
4. Some concepts in economics do not have their stock aspect such as imports and exports.	4. Imports and exports are used only as flow concepts.
5. There are certain stock variables which have the flow aspect as well. For example, capital at a point of time is a stock but addition to the stock of capital, i.e., capital formation during a year is a flow.	

Q.19 Find net domestic product at factor cost from the folloiwng data :

	Items	**Crore Rs.**
(i)	**Gross National Product at market price**	**1500**
(ii)	**Indirect taxes**	**50**
(iii)	**Economic subsidy**	**30**
(iv)	**Net factor income from abroad.**	**15**

Ans. Net domestiv product at factor cost = NDP_{MP} Indirect taxes + subsidies

NDP_{Fc} = GNP_{MP} - NFIA - [Indirect tax - subsides]

= 1500 - 15 - [50-30]

= 1465

Q.20 Explain the causes of excess demand.

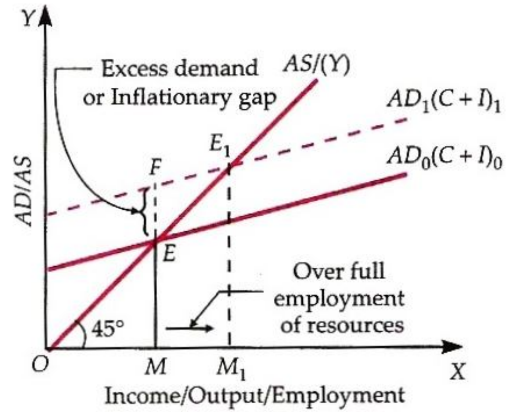
Ans. Excess demand refers to the situation when aggregate is in excess of aggregate supply corresponding to full employment in the economy i.e., AD > AS.

OR

When actual level of aggregate demand is more than required / planned level of aggregate demand to maintain full employment.

Inflationary gap regers to the situation of excess demand. It is equal to the difference between AD beyond full employment and employment and AD at full employment equilibrium.

Observations



1. In the digram Fig. at point E, AD= AD and there is full employment in the economy.
2. If aggregate demand rises to AD_1, then there is excess demand in the economy as AD > AS.
3. The difference between AD_1 and AD_0 is the inflationary gap i.e.,

   Inflationary gap / Excess demand (measured at full employment output)

   = Actual AD - Required AD =FM-EM=EF
4. Point E is a point of equilibrium corresponding to full employment od resources.

   Point E_1 is also a point of equilibrium but, corresponding to over full employment of resources.
5. In Fig. AD_0 is the desired aggregate demand curve corresponding to full emploment level to resources (OM).
6. AD_1 is the actual aggregate demand at beyond full employment level of resources (OM_1) when equilibrium is at 'E_1' implyment over full employment of resources equal to MM_1.

Causes of Excess Demand

Cause of excess demand is, increase in money supply in the economy which is due to

1. Increase in consumption expenditure (Household sector)
2. Increase in investment expenditure (Producer sector)
3. Increase in Government expenditure (Government sector)
4. Increase in exports (Row secotr)

Impact of Exess Demand

Impact of excess demand is as follows:

1. Impact on employment - As there is full utilisation of the resources available in the economy, thus there is full employment. Hence, excess demand does not lead to any increase in the level of employment.
2. Impact on output - Since the resources have already been utilised to the full, thus excess demand does not lead to any increase in the output.
3. Impact on prices - As output and employment can not change, so ultimate pressure is on price. Prices tend to rise as competition among buyers will push the price up.

Q.21 Explain the concept old deficit Buget. Write its merits and demerits.

Ans. Budget deficit refer to a situation when budget expenditures of the government are greater than the budget receipts. Or, it is the excess of total expenditure (revenue expenditure and capital expenditure) over and above the total receipts (revenue receipts and capital receipts) of the government.

Thus,

BD = BE or TE (RE + CE) BR or TR (RR + CR)

When TE > TR

(Here, BD = Budget deficit; BE= Budget expenditure ; BR = Budge receipts, RE = Revenue expenditure, RR = Revenue receipts; CE = Capital expenditure; CR = Capital receipts; TE = Total expenditure; TR = Total receipts)

Types and Meaurement

With reference to the budget of the Government of India, there are three important types of budget deficit. These are:

(1) Revenue Deficit

(2) Fiscal Deficit, and

(3) Primary Deficit.

(1) Revenue Deficit - Revenue deficit is related to revenue expenditure and revenue receipts of the government. This does not include items of capital receipts and capital expenditure. Thus, revenue deficit is the excess of revenue expenditure over revenue receipts.

RD = RE - RR, when RE > RR

(2) Fiscal Deficit - Fiscal deficit is estimated, accounting for both the revenue as well capital receipts adn expenditures of the government. Fiscal deficit is the excess of total expenditure (revenue + capital) over total receipts (revenue + capital other than borrowing). It is estimated as under.

Significance

Fiscal deficit is etimated to know about the extent of borrowings by the government. Greater fiscal deficit signifies greater borrowings by the government.

Significance of fiscal deficit is as follows:

(i) Causes Inflation : An important component of government borrowings includes borrowing from the Reserve Bank of India. This invariably means deficit financing or meeting the deficit of the fovernment by way of printing more notes. This is a dangerous practive, though very convenient for the government. It in creases ciculation of money and causes inflation.

(ii) Increase in Foreign Dependence - Government also borrows from rest of the world. It increases our dependence on other countries. Foreign borrowing is often associated with economic and polilitical interference by the lender countires. It increases our economic slavery.

(iii) Financial Burden for Future Generation : Borrowing implies accumulation of financial burdens for the future generations. It is for the future generations to repay loans as well as the mounting interest thereon. Accordingly, greater the borrowings, greater are the bult - in checks for future growth and development.

(3) Primary Deficit - Primary deficit is the difference between fiscak deficit and interest payment. It is estimated as under:

Parimary Deficit = Fiscal Deficit - Interest Payment

PD = FD - IP

(Here, PD = Primary deficit; FD = Fiscal deficit; IP = Interest payment)

Merits and Demerits of Deficit Dudget

Merits : Keynes recommends deficit budget as a key instrument to remedy depression. According to him, depression is that phase of economic activity when the level of investment is low owing to the low level of AD. Consequently, planned output is much lower than the full employment level of output. Unemployment becomes a national problem. Deficit budget raises the level of AD in two ways:

(i) Directly by wat of high government expenditure, and

(ii) Indirectly by inducing greater (investment and consumption) expenditure by the people.

Demerits : Deficit budget is not desired during periods of inflation. It is a period when the AD exceeds AS of full employment level. Deficit budget in such situations would further increase the gulf between AD and AS. Consequently, inflationary gap would rise and wage - price spiral (When wages increase with prices and prices increase with wages) may set in.

Q.22 Explain the main function of the Central Bank.

Ans. Central Bank is the apex bank responsible for controlling the entrie bodning system of a country. It is instrunantal in the process of growth in India RBI is the central bank. It occupies the cantral pivotal position in the monetary and bonding strucutre of India.

Def : According to samuelson "Every Central Bank has one function. It operates to control economy, supply of money and credit.

Functions of Central Bank

(1) Issuing of Note : In modern times, central bank alone has the exclusive right to issue notes in every country of the world. The notes issued by the central bank are unlimited legal tender throughout the county. According to De Kock, " Almost everywhere the privilege of not issue is associated with the origin and development of central banking. " Actually, till the beginning of 20th century, these banks were known as Bank of Issue.

(2) Banker to the Government : Central bank acts as a banker, agent and financial advisor to the government. As a banker to the government, it keeps the accounts of all government banks and manages government treasuries. It performs the same functions for the government as the commercial banks do for their customers. The loans are given to the government without any interest for short term. It also transfers government funds. It also buys and sells securities, treasury bills on behalf of the government. Being the apex bank of the country, it advises the government from time to time on economic, financial and monetary matters.

(3) Banker's Bank : It performs the functions of a banker to all other banks as a commercial bank has with its customers. Central bank keeps part of the cash balances of all commercial banks as deposit with a view to meeting liabilities of these banks in times of crises. These cash balances are kept by the commercial bank in two ways: (i) part of the cash balances with themselves, and (ii) another part with the central bank as deposit.

(4) Supervision of the Banks : As a banker's bank, the central bank also supervises the commercial banks. The supervision of commercial bank relates to : (i) licensing of the commercial banks, (ii) expansion of the commercial banks in terms of their branches across different parts of the country and abroad, (iii) merger of different banks, and (iv) liquidation of the banks.

(5) Lender of the Last Resort : The central bank also acts as lender of the last resort for the other banks of the country. It means that if a commercial bank fails to get financial accomodation from anywhere, it approaches the central bank as a last resort. Central bank advances loan to such a bank against approved securities. As a lender of the last resort, central bank exercises control over the entire banking system of the country.

(6) Custodian of the Nation's Reserves of Foreign Exchange : Central bank also functions as the custodian of nation's foreign exchange reserves. It is the responsibility of the central bank to keep the external value of country's currency stable. In order to discharge this function successfully, central bank maintains reserves of foreign currencies. Besides, central bank maintains foreign exchange reserves in order to promote international trade and stabilise exchange rate.

(7) Clearing House Functions: Central Bank also performs the function of a clearing house. Every bank keeps cash reserves with the central bank. The claims of banks against one another can be easily and conveniently settled by simple transfers from and to their account. Supposing, Bank A recives a cheque of Rs. 10,000 drawn on Bank B, and Bank B receives a cheque of Rs. 15,000 drawn on Bank A. The most convenient method of settling or clearing their mutual claims is that Bank A should issue a cheque amounting to Rs. 5,000 in favour of Bank B, drawn on central bank. As a result of this transference, a sum of Rs. 5,000 will be debited to the account of Bank A and credited to the account of Bank B. There is no need of cash transactions between the banks concerned. This system, while it facilitates cash transactions across the entire banking system, it also reduces withdrawl of cash by the commercial banks and thus enables then to create credit on a large - scale.

(8) Control of Credit : The most important function of the central bank is to control the credit activities of the commercial banks. Credit control refers to the increase or decrease in the volume of credit money in accordance with the monetary requirement of the country. More expansion of credit money than necessary leads to the situation of inflation. Greater contraction of credit money, on the other hand, might create a situation of deflation. Central bank seeks to contain credit creation within reasonable limits. With central bank keeping credit under proper control, stability in general price level and increase in output and employment can be achieved in the country.

Q.23 Determine income and employment level of equilibrium in the economy with the help of aggregate demand and aggregate demand and aggregate supply approach.

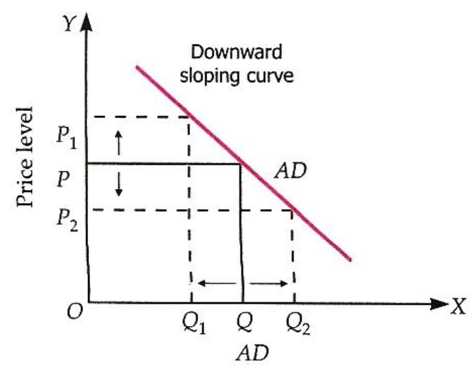
Ans. Meaning and components of Aggregate demand (AD) / Aggregate Expenditure

(i) Aggregate demand refers to sum total od demand for all goods and services in an economy during the period of an accountaing year.

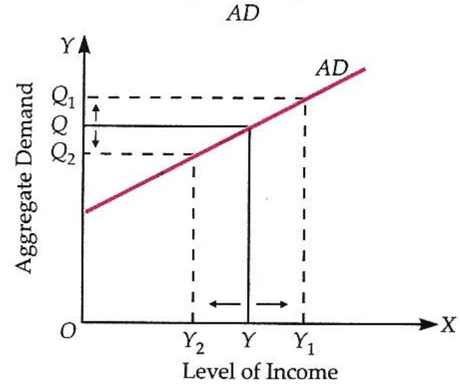
(ii) It is aggregate or total expenditure on final goods and services in the economy.

(iii) If people tend to s pend more than what they were spending on goods and services earlier, it means rise in aggregate demand and vice versa.

(iv) AD can be related with price level and income level.



There is a positve relation between them i.e., aggregate demand increases with rise in income level. The curve has positive slope.



(i) The curve shows positive relation between income and AD.

(ii) As income rises from OY to OY_1 , AD rises from OQ to OQ_1 and vice versa.

Meaning and Components of Aggregate Supply(AS)

It is the total flow of goods and services in an economy during a period of one year. Components of aggregate supply are C + S.

Since AS is value of invome generated,

Y = C + S or AS + C + S

Where C is consumption expenditure ; S is saving , (Y - C)

Components of Aggregate Supply

(i) Consumption (C). It is always positive even when income is zero. When income invrease consumption increase and vice - versa.

$$C = f(Y)$$

(ii) Savings $(S) \rightarrow S = Y - C$. Saving increase with increase in income and vice - versa

$$S = f(Y)$$

There is positive relationship between savings and income.

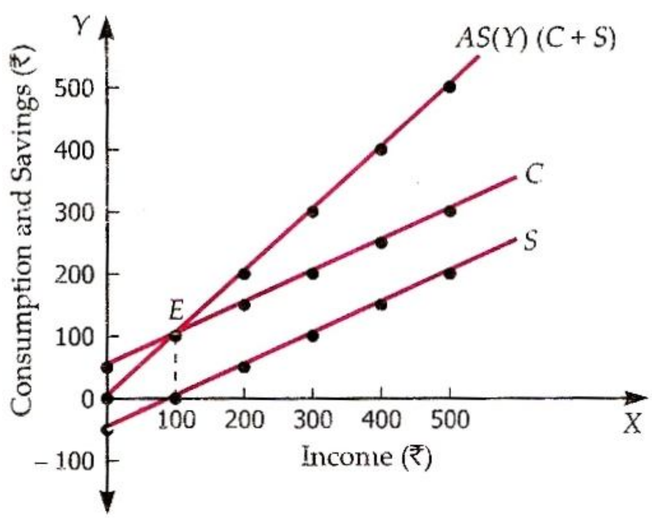
(i) Savings may be negative when the level of income is low, i.e., when C > Y.

(ii) Savings are zero when consumption is equal to income, i.e., when C = Y.

(iii) Savings are positive when consumption is less than income, i.e., when C < Y

The following table is based one assumption : C = 50 + 0.5Y

Level of Income Y (Rs.)	Consumption C(Rs.)	Savings S = (Y - C) (Rs.)	Aggregate Supply AS (Rs.) C + S
0	50	-50	0
50	75	-25	50
100	100	0	100
200	150	50	200
300	200	100	300
400	250	150	400
500	300	200	500



Observations

1. C is a positive function of income as income increases, consumption increases and vice - versa.
2. S is a positive function of income as income increases, saving increases and vice - versa.
3. As is same as income. AS = C + S. It forms an angle of 45^0 at origin which means that AS = C + S.

Q.24 What do you mean by disequilibrium in balance of payment? Explain its causes.

Ans. **Disequilibrium -** It is a state of either deficit BoP Status or surplus BoP status. Equilibrium in BoP is achieved when the net balance of all receipts and payments is zero. When the net balance is positive (+), it is a disequilibrium with surplus balance. On the other hand, when the net balance is negative (-), it is a disequilibrium with deficit balance.

Causes Disequilibrium

Disequilibrium in BoP is caused by a number of factors, broadly categorised as (i) economic factors, (ii) political factors, and (iii) social factors. Following are their details:

(i) Economic Factors

(a) Huge development expenditure by the government owing to which there are large scle inports. It may cause a deficit BoP disequilibrium.

(b) Business cycles in terms of recession, depression, recovery and boom. A period of boom may witness large scale exports of a country. Accordingly, a 'surplus BoP disequilibrium' may occur.

(c) High rate of inflation in the domestic market, compelling large scale imports of essential goods. This drives the economy towards 'deficit BoP disequilibrium'.

(d) Development of import substitutes because of which imports are reduced and deficity BoP disequilibrium is narrowed.

(e) Change in the cost structure of trading partners occurring due to technological and managerial innovations.

Measures to Correct Adverse Balance of Payments

(1) Discouraging Imports : In order to correct an adverse balance of payments imports are reduced by adopting the following measures:

(i) Import Duties : In order to discourage imports, their value is raised by levying new import duties or raising the rate of existing import duties. On account of these duties or raising the rate of existing import duties. On account of these duties not only imports become dearer but their demand also goes down. Fall in the volume of imports corrects adverse balance of payments.

(ii) Import Quotas : Imports are reduced by fixing import quotas. Under import quota system, either the maximum quantity or the value of the imported goods is fized by the government. By restricting imports in this way balance of payments is corrected.

(iii) Encouraging Import Substitution : When substitutes of imported good are produced within the country, it is called import substitution. It brings down the demand for foreign imports and thus an adverse balance of payments is removed to a large extent.

(2) Export Promotion: The best method to correct an adverse balance of payments is to increase the volume of exports. All duties or restrictions on exports should be withdrawn and export industries be given special concessions and facilities. In order to increase the demand for domestic products in foreign countries, intensive publicity and advertisements should be undertaken. Country's products should be displayed in specially organised exhibitions and trade fairs abroad. Thus, production and export capacity of the export industry will increase and balance of payments position improve.

(3) Deflation : Deflation refers to that monetary policy under which the volume of currency in the country is reduced, so that prices and monetary income of the people are brought down. Cenral bank of the country, contracts the volume of credit in the economy by raising the bank rate, open market operation and other quantitative and qualitative methods of credit contraol. All these measures brings down the prices and monetary income of the people.

OR

(i) Write the precautions of 'Income Method' used to measure the National Income.

Ans. Definition

Income method is that method which measures national income in terms of payments made in the form of wages, rent, interest and profit to the primary factors of production, i.e., labour, land, capital and enterprise respectively for their productive services in an accounting year.

Precautions Regarding Income Method

The following precautions are to be taken while estimating factor incomes:

(1) Transfer earnings like old age pensions, unemployment allowances, scholarships, pocket expenses etc. should not be included in natinal income. However, it should be remembered that retirement pension is included in national income, as these are part of compensaton of employees.

(2) Income from illegal activities like smuggling, theft, gambling, etc. should not be included in national income. Income generated in terms of black money is also not accounted.

(3) Sale proceeds of second hand goods like second hand Car, second hand house, second hand house, second hand TV sets are not included in national income. But the commission paid on thier sales in included in the national income.

(4) The sale proceeds of shares and bonds are not included in national income. BBecause such transactions are not related to the flow of goods and services.

(5) Windfall gains, like lotteries and capital gains should not be included.

(ii) What is monetary policy? Who regulates it in India?

Ans. Monetary Policy

Monetary policy is that policy by which the government of a country and the central bank try to control (i) the supply of money (ii) the availability of credit and (iii) the cost of credit (rate of interest) in the economy, with a view to achieving economic stability.

Definition

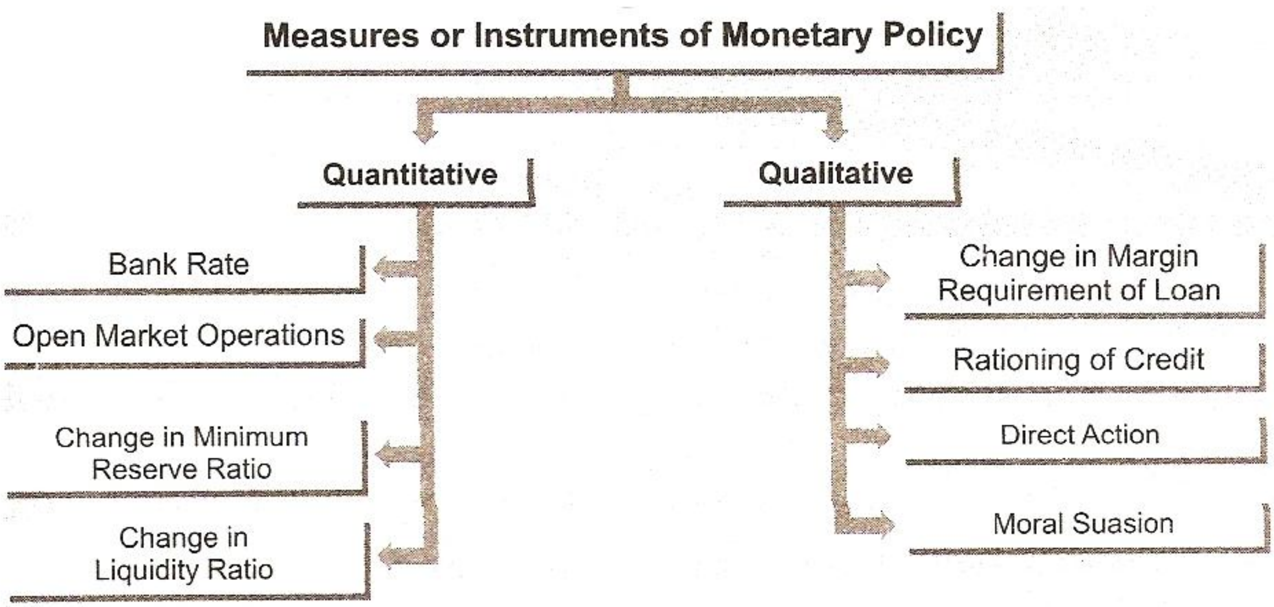
According to D.C. Aston, "Monetary policy involves the influence on the level and composition of aggaregate demand by the manipulation of interest rate and availability of credit.

Measures / Intruments of Monetary Policy

(i) Quantitative Measures/ Instruments or Quantitative Credit Control, and

(ii) Qualitative Measures/Instruments or Selective Credit Control.

The following flow chart is a summary statement of the various measures of monetary policy, quantitative as well as qualitative:



The government and the Central Bank against it.