PART-A

1. (i) Write the scarcity definition of Economics

Ans. Lord Robins has given scarcity definition "Economics is a science that studies human behaviour as a relationship behaviour ends and scarce means which have alternative uses.

(ii) Write one condition for consumer equilibrium

Ans. One condition for a consumer equilbrium is how much of a commodity consumer buys so that he maximises his satisfaction purchase of a commodity depends on three factors.

(i) Price of the commodity.

(ii) MU of the commodity.

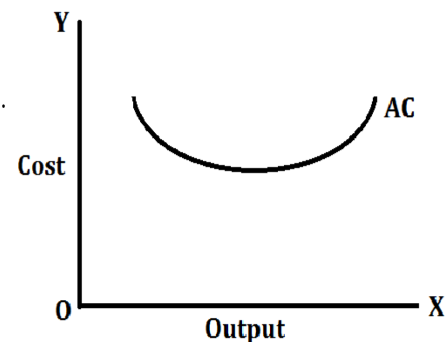
(iii) MU of the commodity.

(III) What is Average Cost ?

Ans. Average cost is the cost per unit of output produced.

It is also called unit cost of roduction.

$$AC = TC \div Q$$



(IV) Define monopoly market ?

Ans. According to Koutsoyiannis monopoly is a market situation in there is single seller , there are no close substitutes for commodity it produces. There are barriers to entry.

$[\mathbf{4} \times \mathbf{1} = \mathbf{4}]$

2. "For whom to produce" ? Explain this problem. **[2]**

Ans. The third branch of the problem of resource distribution is for whom to produce. While taking decision regarding 'what to produce' we cannot ignore another decision regarding 'for whom to produce'? Essentially it is a problem of distribution of final goods and services. To be brief, it is a problem of distribution of production. In an economy, value of production is equal to the value of income. Thus, problem of distribution of production implies problem of distribution of income. This problem has two aspects.

(a) The first aspect relates of persoanl distribution. It means how to distribute production among different individuals and houselholds.

(b) The second aspect of the problem of distribution relates to functional distribution. It is concerned with knowing as to how to distribute production among different factors of production, namely, land, labour, capital and entrepreneurships.

3. Write two assumptions of the Law of demad. [2]

Ans. Law of demand holds goods when other things remain the same The two assumptions of the law are

(i)Tastes and preferences of the consumer remains constant

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

4. What is production possibility curve ? Write its main characteristics. [3]

Ans. It is a curve showing alternative production possibilities of two goods with the given resources and teachnique of production. It is also called production possibility boundary or froniter because it shows the limit of what it is possible to produce with present resources. This curve is also called Transformation Line or Transformation Curve because it indicates that if more of good - X is to be produced then factors will have to be withdrawn from the production of good - Y and transferred to the production of good - X. In other words, good- Y is transformed into good X.

Definition

In the words of Samuelson, "Production possibility curve is that curve which represents the maximum amount of a pair of goods or services that can be produced with an economy's given resources and technique assuming that all resources are fully employed".

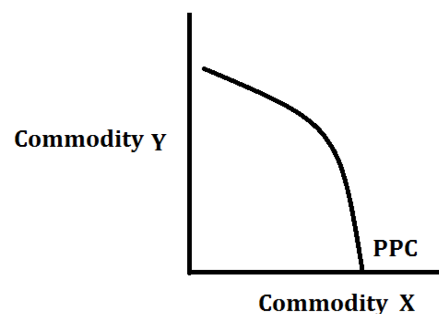
Characteristics

(i) It slopes downwards because if more of one good can be produced only by taking resources away from the production of another good.

(ii) Inverse relationship between change in quantity of one in commodity and change in another commodity.

(iii) It shifts from left to right

(iv) It is concave to the origin



5. Short run average cost curve is of U-shaped, why ? Explain it. [3]

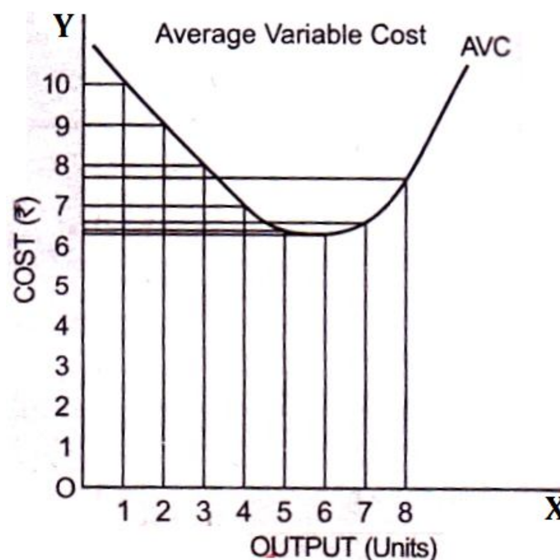
Ans. Short run average cost curve is U - shaped. It means that at first, this curve falls and after reaching the minimum point, it begins to rise.

U - shape of average cost curve can be explained in detail as under :

(1) Basis of Average Fixed Cost and Average Variable Cost :

Average cost (AC) is the sum total of average fixed cost (AFC) and average variable cost (AVC). As the production goes on invreasnig, average fixed cost goes on falling. Average variable cost (AVC) falls initially, as such average cost (AC) also falls initially. Having reached its minimum point, it begins to rise.

(2) Basis of Law of Variable Proprortions : In the beginning when with a fised factor variable factors are comnined, Then fixed factor is used more efficiently. As a result, average cost begins to fall. When fixed factor is used to its full capacity, then with me increasing use of variable factors, the proportion between fixed and variable factors become defective. As a result, average production of variable factor begins to diminish. Law of Diminishing Returns or Increasing Costs begins to operate. Consequently, average cost curve starts rising upward.



(3)Basis of Internal Economies and Diseconomies : When in the short period a firm increases it production, then due to indivisibilities of the fixed factors the firm enjoys various internal economies, e.g. economies of technology, economies related to sales, etc. As a result, average cost beings to fall and average cost curve moves downward. Howere, after a given level of production, the firms are faced with internal diseconomies like difficulties of management and technical difficulties etc. As a result, average cost begins to rise and average cost curve moves upward.

Q.6 Complete the following table : **[3]**

Units of Production (Q)	Total Revenue (Rs.) (TR)	Average Revenue (Rs.) (AR)	Marginal Revenue (Rs.) (MR)

1	**20**	**-**	**-**
2	**32**	**-**	**-**
3	**36**	**-**	**-**

Ans.

Units of Production Q	TR (Rs.)	AS (Rs.)	MR (Rs.)
1	20	20	20
2	32	16	12
3	36	12	4

Q.7 Find elasticity of demand: **[3]**

Price (Rs.)	**Demand (kg.)**
8	**40**
10	**10**

Ans. $E_d = \frac{P}{Q} \times \frac{\Delta Q}{\Delta P}$

$\Delta Q = Q_1 - Q$

$= 10 - 40$

$= -30$

$\Delta P = P_1 - P$

$= 10 - 8$

$= 2$

$\frac{8}{40} \times \frac{-30}{2}$

3

Q.8 Define monopolistic competition market. Explain its four characteristics. **[4]**

Ans. Concept of Monopolistic Competition

In real life, it is monopolistic competitive market that generally exists. It is that situation of the market wherein there are many seller of the product, byt the product of each seller is bit different form the products of other sellers. This product differenctiation shows itself in trade mark, name of the brand, quality differentiation or in different facilities and services offered to the consumers. There are many examples relating to this kind of market. Firms producing different brand of toothpast, as Pepsodent, Colgate, Close – up, etc. are operating under monopolistiv competition.

Definition – In the words of samuelson, " Monopolistic Competition is a form of the market in which there are many buyers and seller of a commodity. A produt (in the monopolistic competitive market) has a large number of close substitiutes and a producer generally exercises partial contol over price.

Features of monopolistic Competition

Main features of monopolistic competition are as follows :

(1) Learge Number of Firms and Buyers : As under pergect competition, there are large number of buyers and firms. Also, the size of each firm under monopolistic competititon is small. Each firm had a limited share of the market.

(2) Product Differentiation : the distinct feature of monopolistic competition is product differentiation. Though the number of firms is large byt their products differ from one another, in colour, shape brand name durability, etc. These products are clso substitutes.

(3) Freedom of Entry and Exit of Firms : Firms are free to enter into, or exit from the industry. But new firms have no absolute freedom of entry into industry. They may have to face several difficulties. Products of some firms may be legally patented. New firms cannot produce those products. No rival firm can produce and sell a patented item like Woodland shoes.

(4) Selling Cost : Each firm has to sped a lot on the advertisement of its product. In order to sell more units of the product, it gives wide publicity of its product in newspapers, cinemas, journals, radio, LED, etc. The expenses on advertisement and publicity are called selling costs.

Q.9 Explain the law of diminishing Return to a factor with diagram. [4]

Ans. Diminishing returns to a factor or Law of Diminishing Returns refer to a situation in which total putput tends to increase at the diminishing rate when more of the variable factor is combined with the fixed (s) of production. Such a situation marginal product of the variable factor must be diminishing.

Definition

According to Prof. Benham, "As the proportion of one factor in a of factors is increased, after a point, the marginal product of that factor will diminish."

LIlustration

Table and Fig. illustrate the operation of diminishing returns to a factor :

Units of Labour	Units of Land	Total Product	Marginal Product
1	1	5	5
2	1	8	3
3	1	10	2
4	1	11	1
5	1	10	0
6	1	10	– 1

Table shows that as more and more units of labour are combined with the fixed amount capital, total output invreases only at the decreasing rate, or if may even stop increasing all, or still further, start

diminishing. The marginal production of the cariable factor diminishing and beyond a point it becomes zero or even negative.

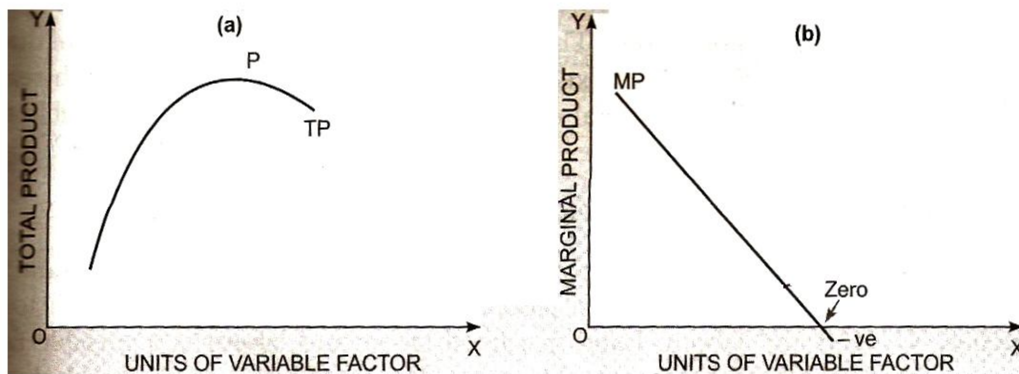


Fig. total product is increasing at the decreasing rate as indicated by the sope of TP. At point P, it becomes maximum and , beyond that, it starts declining. Fig, shows diminishing marginal product of the factor, indicated by downward sloping. Beyond a point it bexomes zero or even negative.

Causes of Diminishing Returns to a Factor

Diminshing returns to a factor or the Law of diminishing returns may be explained in terms of the following factors :

(1) Fixity of the Factor : Fixity of the factor (s) is the principal cause that explains occurrence of the law of diminishing returns. More and more units of the variable factor continue to be combined with the fixed factor, the latter fets over – utilized. Hence the diminishing returns.

(2) Imperfect Factor Substituatability : Factors of production are imperfect substitutes of each other. More and more labour, for example, cannot be continuously used in place of additional capital . Accordingly, diminishing return to the variable factor becomes inevitable.

(3) Poor Coordination between the Factors : Continuous increasing application of the variable factor along with fixed factor (s) beyond a point crosses the limit of ideal factor ratio. This results in poor co-or-dination between the fized and variable factors.

Application of Law

Economists differ regarding the application of this law. Marshall has expressed this concept in these word, "While the part which nature plays in production shows a tendency to diminishing returns, the part which plays shows tendency to' increasing returns".

From the above – quoted statement of Marshall it can be concluded that nature's role is more dominant in agriculture than in industry. That is why the law of diminishing return applies in agriculture. On the other hand, man's role is more important in industry. Therefore, the law of increasing returnsoperates in industry. Accoring to modem economists, this concepts is note correct. Theuy hold that reson of the application of this law is that one of the factors is fixed factor cannot be only land, mines, fish – reaching or building but machines, raw material etc, also. Therefore, this law is applicable to all fields of production, that is, agriculture, minig, industry etc.

Q.10 What is meant by supply. Discuss the law of supply with diagram. [5]

Ans. **Meaning of supply –** Supply of a commodity refers to those quantities of the commodity that a seller is ready to sell at different possible prices at a given time.

Definition

In the words of Thomas, "The supply of goods is the quantity offered for sale in a given market at a given time at various prices".

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 -

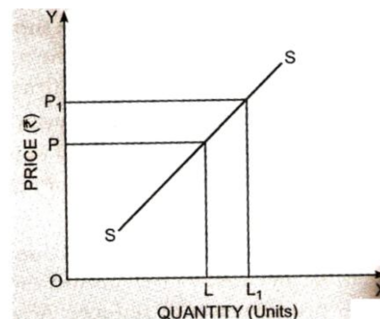
In the words of Dooley, "The law of supply states, that other things being equal, the higher the price, the greater the quantity supplied or the lower the price, the smaller the quatity supplied. " In other words, there is a positive relationship between the price of good and its supply.

Explanation 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

Positive 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 despite rise in its price.

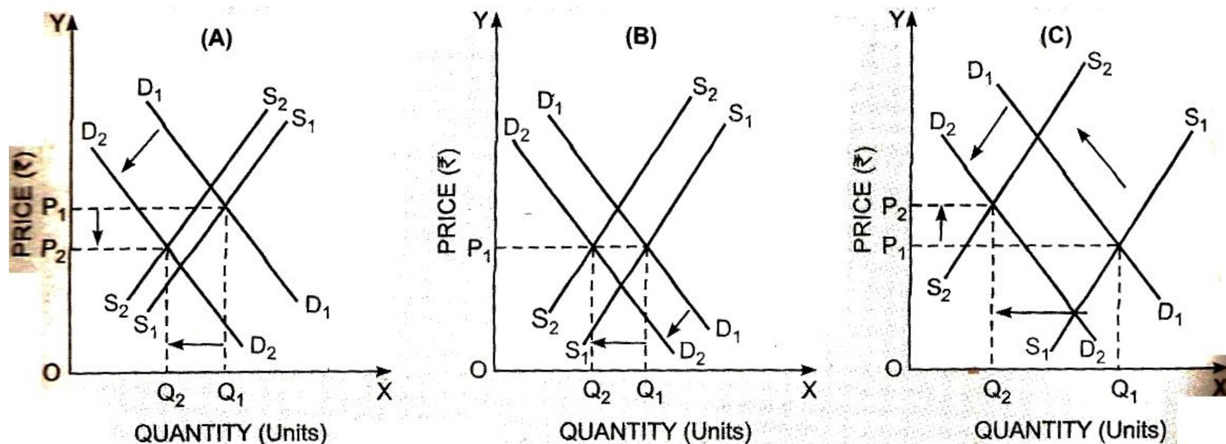
(ii) Some goods having social distinction remain limited in supply even when their price may rise high.

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

Q.11 What will be impact on equilibrium price, when both demand and supply decrease? [5]

Ans. There is simultaneous changes in demand and supply. With the help of the following diagrams, we can study the effect of simultaneous changes in demand and supply on equilibrium price.

Fig. Shows effect of simultaneous decrease in demand and supply on price and quantity.



(1) Fig (A) D_1D_1 is the intital demand curve and S_1S_1 intial supply curve. OP_1 in equilibrium price and OQ_1 is equilibtirum quantity. Due to decrease in demand, net demand curve take the shape of D_2D_2 and due to decrease in supply, new supply curve takes the shape of S_2S_2. In this situation, demand has decreased more than supply. Hence, price decreases to $OP_2$and quantity to OQ_2. Consequently, When demand decreases more than supply, price and quantity both fall.

(2) In Fig. (B) it is clear that decrease in demand and supply is equal. Hence, point remaind unchanged i.e. OP_1 but the equilibrium quantity decreases form OQ_1 to OQ_2. Thus, when demand supply decrease equally, no change in equilibrium price takes place but equilibrium quantity changes (decreases).

(3) In Fig. (C) decrease in supply in more than decrease in demand. Hence, price rises form OP_1 to OP_2 but the quantity decrease from OQ_1 to OQ_2. Thus, when supply decreases more than demand, price tends to rise but quantity decreases.

Q.12 Explain the 'Total Expenditure' method to measure the price eleasticity od demand with diagram. [5]

Ans. Marshall evolved Total expenditure Method to meaure elasticity of demand. Under this method, to measure elastivity of demand, one finds out how much and in what direction total expenditure changes as a result of change in the price of a commodity. We can consider there possible situations :

(i) If rise or fall in price of commodity makes no changes in its total expenditure, then elasticity of demand in unitary.

(ii) If with fallin price of commodity, total expenditure increasing and with rise in its price, total expenditure, decreases then demand for that commodity is greater then unitary elastic.

(iii) If with fall in price of commodity, total expenditure decreases and with rise in its price total expenditure increases then demand for that commodity is less than unitary elastic. In this case, total expenditure goes in the same direction as the price does.

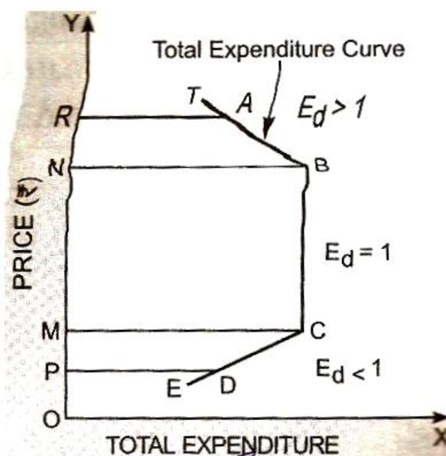
Elasticity of Demand	Price	Total Expenditure
Greater than Unity	Up ↑	Down ↓
	Down ↓	Up ↑
Unity	Up ↑	No Change
	Down ↓	No Change
Less than Unity	Up ↑	Up ↓
	Down ↓	Down ↓

Situation	Price of the Goods (₹)	Quantity (kg)	Total Expenditure (₹)	Effect on Total Expenditure	Elasticity of Demand
A	2 1 ↓	4 8	8 8 ↕	No change	Unitary $E_d = 1$
B	2 1 ↓	4 10	8 10 ↓	Increases	Greater than Unitary $E_d > 1$
C	2 1 ↓	3 4	6 4 ↓	Decreases	Less than Unitary $E_d < 1$

(i) Unitary Elastic Demand : Situtation A of Table 2 shows that when price of the commodity if Rs. 2, the total expenditure is Rs. 8. When price falls to Rs. 1, the total expenditure remains Rs. 8. Thus, change in price has no effect on total expenditure.

(ii) Greater than Unitary Elastic : Situation B of Table 2 shows that when the price of the commodity is Rs. 2, the total expenditure is Rs. 8, when the price of the commodity falls to Rs. 1, the total expenditure rises to Rs. 10. In this case, change in total expenditure is in the oppiste direction to change in price.

(iii) Less than Unitary Elastic : Situation C of Table shows that when price of the commodity is Rs. 2 the total expenditure is Rs. 6. When the price falls to Rs. 1 total expenditure also comes down to Rs. 4 In this case, chage in total expenditure in price. The total expenditure method of measuring elasticity of demand is expressed diagrammatically in Fig.



In Fig. price is shown on Y – axis and towal expenditure on X – axis. TE curve is total expenditure curve. BC part of TE curve represents unitary elastic demand. It shows that when price is OM, total expenditure is MC, as price rises to ON, total expenditure remains NB (= MC), i.e. same as before. TB part of TE curve represents freater than unitary elastic demand. It shows that when price rises from ON to OR, total expenditure falls fromNM to RA. EC par of TE curve represents less than unitary elastic demand. It shows that when price falls from OM to OP, total expenditure also falls from MC to PD.

OR

(i) Expain the relationship between Marginal Revenue and Average Revenue.

Ans. (i) $AR \times \frac{TR}{Q}$

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

(iii) Whe AR curve is slopping downward, MR curve should be below tha AR curve as in monopoly or monopolistic competition.

(iv) It AR is constant, MR is equal to AR. MR = AR in perfect competition. Both are represented by the same horibontal line parallel to X – asis.

(v) AR is always posititve. It cannot be zero or negative. But MR can be positive, zero or negative.

(ii) Explain the concept of producer's equilibrium.

Ans. A producer is in equilibrium when he is fully satisfied with the existing quantity of output. He has no tendency either to increase or decrease his output. In other words, the producer's equilibrium refer to the situation in which he maximizes his profit or minimizes his loss. It is with the objective of earning maximum profit that a producer selects inout and output. He tries to make as much difference between total revenuce and total cost as possible.

Definition

According to Hanson, "A producer will be in equilibrium whenit is of no advantage to increase or decrease his output.

Conditions of Producer's Exuilibrium

A producer is in equilibrium when he fulfils the following conditions:

(1) Maximum profits : A producer is in equilibrium when he is getting maximum profit. Profit is maximum when the difference between TR and TC is maximum.

Maximum Profit $(\pi) = TR - TC$ is maximum

In order to maximize his profit, a producer should produce that much quantity of a good which fulfils the following two conditions :

(i) Marfinal Revenue (MR) = Marginal Cost (MC).

(ii) Marginal Cost (MC) is rising , i.e., MC curve cuts MR curve from below.

To maximize economic profit a producer produces so much quantity of a good as equalises MR and MC i.e., MR = MC and at the equilibrium level of production marginal cost is increasing.

(2) Minimum Loss : In short period, a producer may also be in equilibrium in a situation when he suffers minimum loss. Situation of minimum loss occurs when the producer incurs loss of fixed costs or a part thereof. In situation of minimum loss the producer must recover his variable costs by the sale of his output.

PART-B

Q.13 (i) What is closed Economy?

Ans. A closed economy is the one that has bo export and import.

(ii) What is Direct Tax?

Ans. A direct tax is a tax which is levied on the income or profit of the person who pays it, rather than on goods or services. e.g. Income tax.

(iii) What do you mean by forward market?

Ans. Forward market for foreign exchange is the market which handles such transactions as are meant for future delivery. Such transaction are signed today but are to materliase on some future date.

(iv) Define Excessive Demand.

Ans. Excessive demand is a situation in which the market demand for a commodity is greater than market supply, thus causing its market price to rise. $[4 \times 1 = 4]$

Q.14 Explain circular flow of income in the two sector economy. [2]

Ans. (1) Two Sector Model of the Circular Flow of Income

Under this model circular flow of income between two sectors of the economy i.e.

(i) Household sector and (ii) Produciing sector (Firms) is studied.

Assumptions

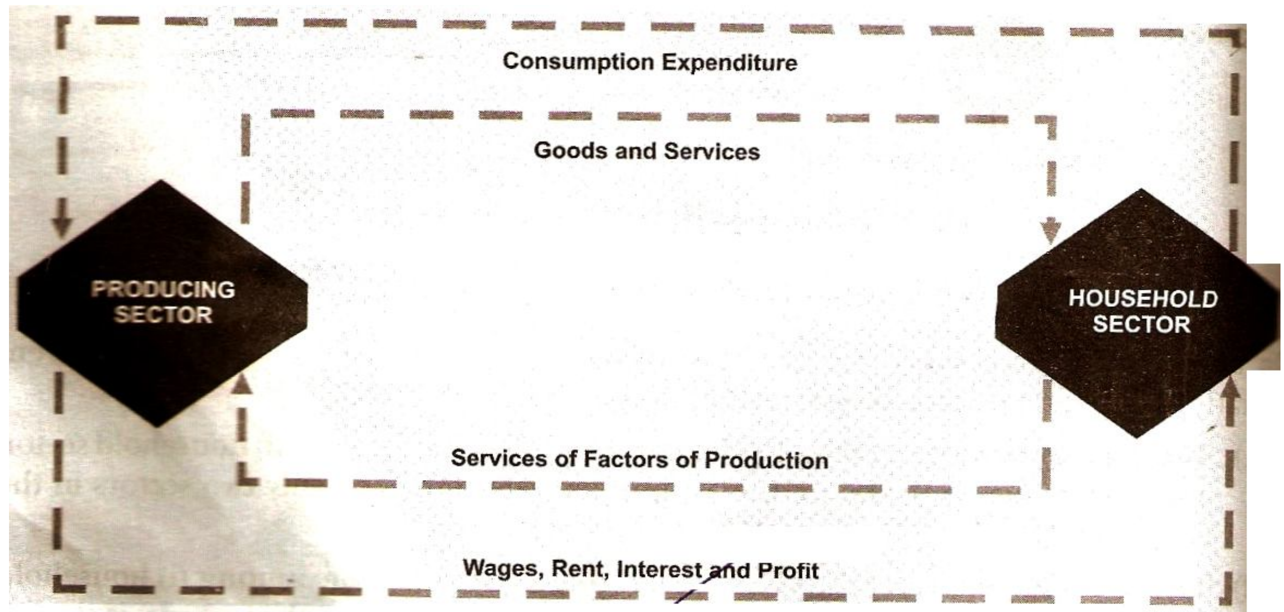
(i) It is assumed that there are only two sectors in the economy: (a) Producing Sector : It produces the final foods and services by making use of the factors services, Viz., labour, capital, land etc. (b) Household Secotr : It provides factor services to produving sector and consumes final goods and services produced by it.

(ii) Government had bno influence over the economic activities.

(iii) It is a closed economy, meaning thereby that no export or import activity is undertaken by the producing sector and househjold sector depends on domestic production.

(iv) Household sector spends all its income on goods and services. In order words, no saving is done.

On the basis of the above assumptions, cirular flow of income is explained with the help of



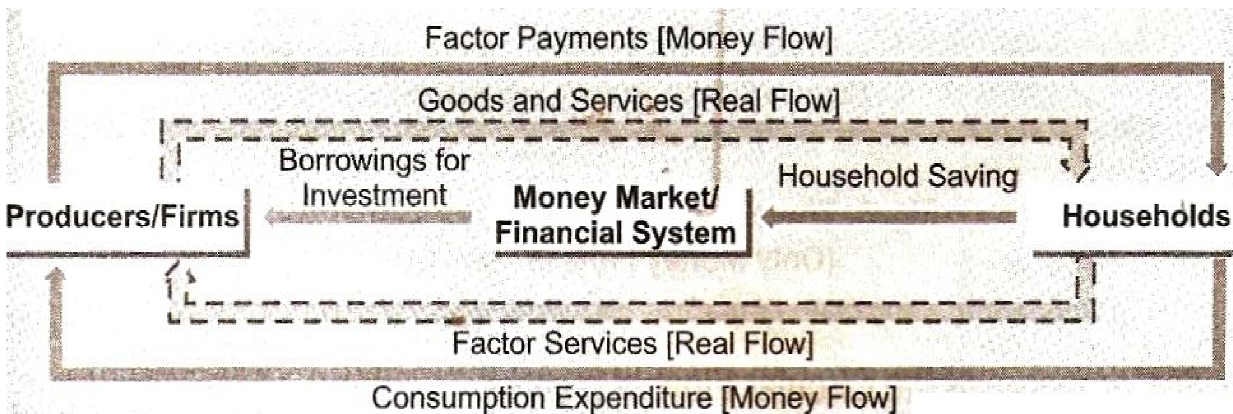
The outer circle represents real flow and the inner circle represents monetary flow. Real flow indicates that services of the factors flow from household sector to prodcing sector and goods and services flow from producing sector and goods and services flow from producing sector to household sector. Monetary flow expresses that rent , wages, interest and profit in terms of money flow from producing sector to household sector. On the other hand, the expenditure on consumption of goods and services in terms of money flows from household sector to producing secot (or firms).

Since the households spend their entire income, the total monetary receipts of producing sector will be equal to the income and consumption expenditure of the household sector. Monetary receipts of the producers = Income of the households = Consumption expenditure of the households. In this way, the total demand of the economy will be equal to total supply. This position is called position of equilibrium where in the circular flow of income continues to operate regularly.

(2) Two Sector Model with Saving - Investment / Financial System

So far our dicussion proceeded on the assumptions that households speds the entire income on the purchase of goods and services. As a matter of fact, households tend to save a part of their income. Emergence of savings implies the emergence of a fincial system . It refers to the existence of a money market (and capital market) in the economy including a variety of finacial intermediaries such as commercial banks and insurance companies. These financial intermediaries serve as al link between savers and investors. Those who save, deposit their savings with the financial intermedires and those

who invest, borrow funds from these financial intermediaries. The activity of 'saving and borrowing for investment' is reflected in the circular flow model as under



Q.15 Write difference between intermediate and final goods. [2]

Ans.

Basis	Intermediate	Final goods
1. Produce	It is a product used to produce final good	It is the last and final production
2. Sold	They are sold between industries for resale or production	They are sold to the consumers for final consumption
3. Example	Salt	Bicycle

Q.16 If MPS is = 0.10 then find out the value of MPC. [2]

Ans. MPS = 0.10

MPC

$K = \frac{1}{1-MPC} = \frac{1}{MPS}$

$K = \frac{1}{MPS} = \frac{1}{\frac{10}{100}}$

$= \frac{1}{10} \times 100 = 10$

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

$10 = \frac{1}{1-MPC}$

$10 - 10MPC = 1$

$10 - 1 = 10\ MPC$

$\frac{9}{10} = MPC$

$0.9 = MPC$

Q.17 Write difference between excess demand and deficient demand. [3]

Ans.

	Basis	Excess Demand	Deficient Demand
1.	Meaning	It refers to a situation when aggregate demand is in excess of aggregate supply corresponding to full employment in the economy i.e., AD> AS.	It refers to a situation when aggregate demand is short of aggregate supply corresponding to full employment in the economy i.e., AD < AS.
2.	Employment level	It represents over full employment situation	It represessents an under - employment situation.
3.	Generation of gap	It generated an inflatinary gap in the economy.	It generates a deflationary gap in the economy.
4.	Effect on output, empoyment and prices	It leads to no change in the level of output and employment, only prices tend to rise.	The level of output, employment and prices tend to fall.
5.	Causes	Excess demand arises due to increase in money supply.	Deficient demand arises due to decrease in money supply.
6.	Diagrammatic presentation		

Q.18 Write three quantitative instruments of monetary policy. [3]

Ans. Excess demand results in price rise or inflation in the economy.

Following fiscal measures are recommended to corect the inflationary situation :

(1) Increase in Taxes : Tax rates shoudl be increased to reduce purchading power of the people.

(2) Decrease in Government Expenditure : Government expenditure should be reduced on (i) health and eduction, (ii) public works programmers, (iii) maintencanceof law and order, and defence of country, and (iv) the subsidies.

(3) Reduction in Deficit Financing : Deficit financing should be restricted. Because the printing of more notes would only increase the rate of inflation.

(4) Increase in Public Debt or Borrowing : Public borrowing should be incresed, so that people are left with lesser purchasing power.

Thus, during periods of excess demand, the government sould adopt the policy of surplus budget, increasing its revenue and decreasing its expenditure as much as possible.

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.

Following are the noteble measures of monetary policy :

Quantitative instruments of monetary policy aim at controlling the overall flow of money supply/ credit supply in the economy. Following is a brieft discussion of some important quantitative instruments.

(i) Bank Rate : The bank rate is the minimum rate at which the central bank of a country is prepared to give loans or credit to the commercial banks. The increase in bank rate increases the rate of interest and credit becomes dear / expensive. Accordingly, the demand for credit is reduced. On the other hand, decrease in the bank rate lowers the rate of interest and credit becomes cheap. Accordingly, the demand for credit expands.

(ii) Open Market Operations : Open market operations refer to the purchase and sale of securities in the open market by the central bank. By selling the securities, the central bank reduces purchasing power in the economy. According, flow of credit is reduced. And, by buying the securities, the central bank increases purchasing power in the economy. It increases the flow of credit.

(iii) Change in Minimum Reserve Ration: Minimum cash reserve ratio refers to the minimum percentagte of a bank's total deposits which is required to be kept with the central bank. All the banks have to keep with the central bank a certain percentage of thier deposits in the form of minimum cash reserve ratio. For example, if the minimum cash reserve ratio is 10 [er cent and total deposits of a certain bank is Rs. 100 crore, it will have to keep Rs. 10 crore with the central bank. If the minimum reserve ratio is raised to 20 per cent, the bank will have to keep Rs. 20 crore with the central bank. When the cash flow or credit is to be increased, minimum cash reserve ratio is reduced, and when the cash flow or creidt is to be reduced, minimum cash reserve ratio is increased.

Q.19 Find Gross National Disposable Income from following data : [3]

Items	Crore
(i) National Income	2500
(ii) Indirect Taxes	80
(iii) Economic Subsidy	35
(iv) Net current transfer from the rest of world	600

Q.20 Write difference between Central Bank and Commercial Bank. [4]

Ans. Central bank of a countary differs from the commercial banks in following respects:

(i) Public welfare is the main motive of the central bank while commercial bank operate to earn profit. De Kock was of the opinion that the guiding principle of the central bank should be to work for public interest and the well - being of the entire country and its main aim should not be profit.

(ii) Central bank has bo direct dealing with the people as aginst the commercial banks who deal directly with the people.

(iii) Central bank is a state - owned insitution where commercial banks may be private or state owned.

(iv) Central bank has the monopoly of note - issue but commercial banks cannot issue notes.

(v) Central bank does not compete with commercial banks rather it functions as banker to the banks and as a lender of the last resort.

(vi) Central bank controls the banking system of the country. Commercial banks function under the control and supervision of the central bank.

(vii) Central bank is the custodian of foreign exchange of the country. Commercial banks depend on the approval of the central bank in matter of foreign exvhange business.

(viii) Central bank is the banker of the government . All banking activies of the government are dne by it. Commercial bank may function as representatives of the central bank for government works.

(ix) Central bank is a banker of the commercial banks. Commercial banks are supposed to keep a certain percentage of their total deposits with the central bank as cash reserve.

(x) Central bank controls credit and also functions as Clearing House of other banks. Other banks may perform this funtiona as representatives of the central bank.

Q.21 What is mean by the concept of deficit financing? What are its advantages? [4]

Ans. The term deficit financing is used to denote the direct addition to gross national expenditure through budget deficits whether the deficits are on revenue or capital account. In the words of Dr. V.K. R.V. Rao. "Deficit Financing is the financing of deliberately created gap between public revenue and public expenditure or a budgetary deficit, the method of financing being og a type that results in an increase in the quantity of money in a country".

Merits of Deficit Financing

(i) The government gets enough financial resources through deficit financing. By procuring money through deficit financing the government provides employment to unemployed resources. Comsequently, output increases and the rate of economic growth rises.

(ii) Natural resources are found in abundance in underdeveloped countries. But they are not profitably exploited in the absence of adequate financial resources. Government monetary resources are increased as a result of deficit financing.

(iii) Increase in infrastructure that is , railways, roads, canals, power projects, school, hospital, etc. is made possible by produring funds through deficit financing. Its development accelerates the rate of economic growth of the country.

(iv) The finance for economic planning can be arraged easily through deficit financing. Thus, deficit financing becomes necessary to implement economic plans.

(v) The agricultura and industrial development as well as development of infrastucutre are necessary for accelerating the rate of gwoth. Money in adequate quantity can possibly be procured for their development through deficit financing.

Q.22 Explain the "Income Method" to measure the National Income. [5]

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.

Estimation of Factor Income

Income paid out by each producing enterprise can be measured by multiplying the number of units of each input employed and the income paid to each unit. The resultant will be the income fenerated by the enterprise. Income generated by all the enterprises in a particular industrial sector can be found out by adding the income paid out by each enterprise. By adding the incomes paid out by all the industrial secotrs we get net domestic income. We can find out other concepts of national product by making appropriate changes in the concept.

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.

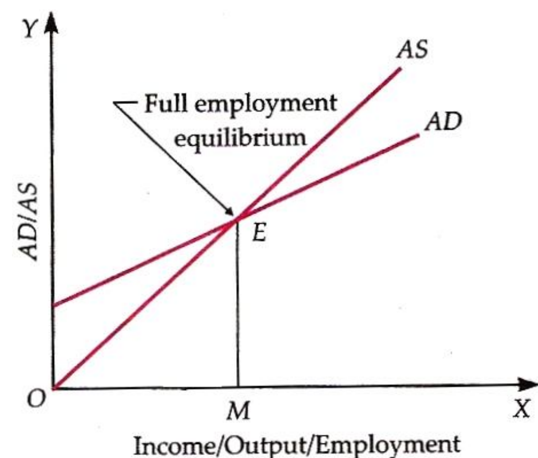
(5) Windfall gains, like lotteries and capital gains should not be included.

Q.23 Distinguish between the full employment and under employment equilibrium. [5]

Ans. Full Employment Equilibrium

Full employment equilibrium refers to a situation when the aggregate demand is equal to the aggregate supply at full employment level , i.e., all those who are willing to work at the prevailing wage rate are able to ding employment. So full employment means there is no involuntary unemployment.

Observations.



(1) AD and AS curves intersect at point E, which is full employment equilibrium because aggregate demand EM corresponds to full employment level of output OM.

(2) At OM level of output, economy is at full employment equilibrium because all those who are willing to work at the prevailing wage rate have got employment.

(3) Here, actual level of aggragate demand (EM) is equal to required level of aggregate demand (EM) to maintain full employment EM = EM. Hence full employment.

Under Employment Equilibrium

Under Employment Equilibrium refer to a situation when the aggregate demand is equal to the aggregate supply correspindig to under - employment of resources. It occurs prior to the full employment level.

Obervations

(1) Planned level of equilibrium is at point E,

where planned AD is equal to planned AS.

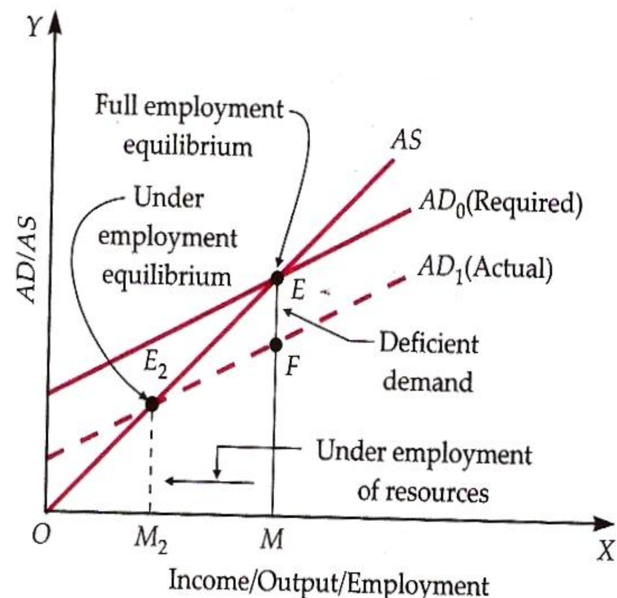
(2) Accordingly, OM is full employ- ment level of output.

(3) Actual level of AD (AD_1) is lesser then the required level of AD (AD_0).

(4) Actual equilibrium is determined at point E_2 which corresponds to under employment of resources (OM_2).

(5) Actual AD = FM, required AD = EM. Hence there is deficient demand = EM - FM = EF.

(6) Accordingly, OM_2 is less than OM which implies under - employment of resources by MM_2.



Difference between Full Employment Equilirbium and Underemployment Equilibrium

Full Employment Equilibtium	Underemployment Equilibrium
1. Full employment equilibrium refers to the situation where aggregate demand = aggregate supply and all those who are able to work and willing to work (at the existing wage rate) get work	1. Underemployment equilibrium refers to the situation where AD = AS but all those who are able to work and willing to work (at the existing wage rate) do not get work.
2. Full employment equilibrium is a stable equilibrium and real output reaches its maximum point.	2. Underemployment equilibrium is not a stable equilibrium and real output does not reach its maximum.
3. Attempt to increase production beyond full employment equilibrium causes inflationary gap.	3. Attempt to increase production beyond underemployment equilibrium does not cause inflationary gap.

Q.24 Define balance of payment and explain the measures to correct the diseequilibrium in balance of payment. [5]

Ans. Definition - In the words of Kindleberger, "The balance of payment of a country is a systematic record of all economic transactions between its residents and residents of foreign countries".

Meaures to correct Adverse Balance of Payments

Following are the meaures to correct adverse balance of payments:

(1) Discouraging Imports : In order to correct an advarse 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 not only imports become dearere 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 food is fixed by the goverment. By restriciting imports in this way balance of payment is corrected.

(iii) Encouraging Import Subsitutaion : When subsitutes of imported goods 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 faciliteies. In order to increase the demand for domestic products in foreign countries, intensive publicity and advertisement should be undertaken. Country's products should be displayed in specially organied exhibitions and trade fairs abroad. Thus, production and export capacity of the export industry will increase and balance of paymens 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. Central bank of the country, contracts the volme of credit in the economy by raising the bank rate, open market iperation and other quantitative and qualitative methods of credit control. All these measures bring down the prices and monetary income of the people.

OR

Write note on the following :

(i) Balanced and Unbalanced Buget.

Ans. (1) Balanced Budget

A balanced budget is that buget in which government receipts are equla to government expenditure.

Balanced Budget :

Government Receipts = Government Expenditure

Merits of a Balanced Budget

(i) The government does not indulge in wasteful expenditure.

(ii) A balanced budget ensures financial stability.

However, during the depression of 30's , the policy of balanced budget was severely criticised. It was then that the following shortcomings of a balanced budget were highlighted.

Shortcomings or Demerits of Balanced Budget

(i) Balanced budget does not offer any solution to the problem of unemployment during depression in development countries.

(ii) Balanced budget is not conducive to the growth and development programmes of the less developed countries. These countries often need more and more investment by the government even when it causes some inflation in the economy.

(2) Unbalanced Budget

An unbalanced buget is that budget in which receipts and expenditures of the government are note equal . This may be

(i) Surplus Budget : This is a budget in which government receipts are greater than government expenditures. 0

Surplus Budget :

Estimated Government Receipts > Estimated Government Expenditures

(ii) Deficit Budget : This is a buget in which government expenditures are greater than government receipts.

(ii) Fixed and flexible Exchange Rates.

Ans. Fixed rate of exchange refers to rate of exchange as fixed by the government. Under this system, rate of exchange is determined on the basis of quantity of gold contained in one unit of the currency. Different currencies are compared on the basis of quantity of gold contained in one unit of these currencies. It has two different type as under:

(i) Gold Standard System of Exchange Rate,and

(ii) Bretton Woods System of Exchange Rate

Merits

Fixed exchange rate system had the following merits or advantages :

(i) Stability : It ensures stability, in the international money market / exchange market. Day - to day fluctuations are avoided. It helps formulation of long - term economic policies, particularly relating to exports and imports.

(ii) Encourages International Trade : Fixed exchange rate system implies low risk and low uncertaintly of future payments. It encourages international trade.

(iii) Coordinationa of Macroeconomic Policies : Fixed exchange rate helps coordination of marcroeconomic policies across different countries of the world. Long - term economic policies can be drawn in the area of international trade and bilateral trade agreements.

Flexible Exchange Rate System

Flexible rate of exchange is that rate which is determined by the demand for and supply of the currencies concerned in the foreign exchange market. In other words, it is determined by the market forces, like the price of any other commodity. The market where foreign currencies are demanded and supplied is called foreign exchange market. It can therefore, be said that

$$R = f(D, S)$$

(Here, R: Exchange rate; D: Demand for different currencies in the international market; S : Supply of different currencies in the international market.)

The exchange rate at which demand for foreign currency is equal to its supply is called Per Rate of Exchange and it constitutes the Noraml Rate or Equilibrium Rate. It is a flexible rate because it tends to change in accordance with changes in the supply of and demand for different currencies in the foreign exchange market.