# ISC Paper 2013
# ECONOMICS

10 YEARS QUESTION PAPER.COM

## Part—I

**Question 1.**

**Answer briefly each of the questions (i) to (xv) :** **[15×2]**

**(i)** *What does zero cross elasticity of demand between two goods imply ? Give an example to explain.*

**(ii)** *Why is the marginal cost curve U shaped ?*

**(iii)** *Diffrentiate between monopoly and monopsony. Give an example for each.*

**(iv)** *What is market period ? What is the shape of the supply curve in this period ?*

**(v)** *Give two assumptions of the law of Variable Proportions.*

**(vi)** *Explain the meaning of price ceiling with the help of a diagram.*

**(vii)** *Why is the central bank considered to be the lender of the last resort ?*

**(viii)** *What is Vote-on-account budget ?*

**(ix)** *Explain how taxation can be used to reduce inequality of income.*

**(x)** *What is meant by unlimited legal tender ?*

**(xi)** *Distinguish between CRR and SLR.*

**(xii)** *Calculate the value of multiplier if MPC is equal to MPS.*

**(xiii)** *Define GNP at factor cost. How is it different from national income ?*

**(xiv)** *Explain with the help of an example, how inflation affects the debtors.***

**(xv)** *How does an increase in the price of a commodity affect its quantity demanded ? Show it with the help of a diagram.*

***Answer :***

**(i)** Zero cross elasticity of demand between two goods implies that goods are not related to each other. Therefore, they are not influencing each other.

**For example :** Tea and T.V. Set.

Here, Cross Elasticity of Demand will be zero. A change in price of tea is not likely to influence the demand for T.V.

**(ii)** Marginal Cost Curve is U shaped because of the law of variable proportions. It is the negatively sloped in the initial stage of production due to increasing return to the variable factor and is positively sloped thereafter due to decreasing returns to the variable factor.

**(iii) Difference between Monopoly and Monopsony are as under :**

| Basis | Monopoly | Monopsony |
|---|---|---|
| (i) Number of Seller | There is only one seller. | There are many sellers. |
| (ii) Number of buyers | There are large number of buyers. | There is only one buyer. |

** *Answer has not given due to out of present syllabus.*

| | | |
|---|---|---|
| (iii) Example | Railway Trains are owned and run by the Government of India. | Govt. of India is a monopsonist in the market while purchasing variety of goods are defence requirements. |

**(iv)** Market period is very short period in which the supply is fixed. The maximum supply in the market period is the stock of goods which has already been produced. In market period, firms cannot adjust their output to any change in price.

Supply Curve in market period is vertical or parallel to $y$-axis (price).

**(v)** The assumptions of the law of variable proportions are as follows :

(1) The state of technology is given and remains unchanged.

(2) It is assumed that all the units of the variable factor are homogeneous and are equally efficient.

**(vi)** The price ceiling is the maximum legal price which the supplier can charge for a particular good or service. In simple words, the government fixes the maximum price in order to freeze the price of a particular commodity in order to protect the interest of the consumer.

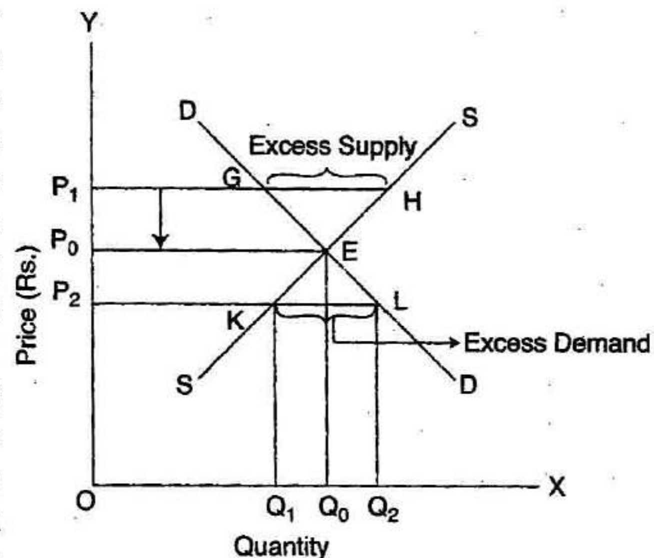


Fig. : Price Ceiling

**Implication of Price Ceiling Policy :** If the price ceiling is set above the equilibrium price (at $OP_1$) it has no effect on price and quantity. At a higher price $OP_1$, there will emerge excess supply (= GH). Which will pull down the price and quantity to the equilibrium level E. To be meaningful, the price ceiling must be below the equilibrium price, it will result in a situation of excess demand or shortage of the commodity. At $OP_2$ price, the quantity demanded is $OQ_2$ while the quantity supplied is only $OQ_1$. This shortage is equal to $OQ_2 - OQ_1 = Q_1Q_2 =$ (KL).

**(vii)** The central bank considered to be the lender of last resort because the central bank provides, directly or indirectly financial assistance to the institutions in order to help them at times of stress. So as to save the financial structure of the nation from collapse.

**(viii)** The sanction of Parliament for the withdrawl of money by the government from the Consolidated Fund of India to meet its expenses till the budget is finally approved is known as Vote on Account Budget. Vote on account is operational till the budget is passed in parliament.

10 YEARS QUESTION PAPER.COM

**(ix)** Taxation can be used to reduce inequality of income in following ways :

(1) By adopting progressive taxation policy where heavy direct taxes imposed on the rich person and the poor should be exempted from taxes.

(2) By leving heavy taxes on luxurious items which are demanded by rich section of the society whereas daily necessities goods should be exempted or subject to low taxes.

**(x)** Unlimited legal tender is the money which a person has to accept without any maximum limit. In our country currency notes of all denominations and coin of 50 paise and higher denominations are unlimited legal tender.

**(xi)** Cash Reserve Ratio (CRR) refers to that percentage of total deposits of commercial bank which it has to keep with the RBI in the form of Cash Reserves.

Statutory Liquidity Ratio (SLR) refers to that portion of the total deposit of a commercial bank which it has to keep with itself in the form of cash reserve, gold and government securities.

**(xii)** As we know, that

$$MPC + MPS = 1$$

Here, $$MPC = MPS = x$$

$$x + x = 1$$

$$2x = 1$$

$$x = 0{\cdot}5$$

Now, $$\text{Multiplier K} = \frac{1}{MPS} = \frac{1}{0{\cdot}5} = 2.$$ **Ans.**

**(xiii)** GNP at factor cost is the sum total of earnings received by various factors of production in terms of wages, rent, interest, etc. by normal residents of a country in a year.

GNP at factor cost is different from NNP at factor cost (National Income) to the extent of Depreciation.

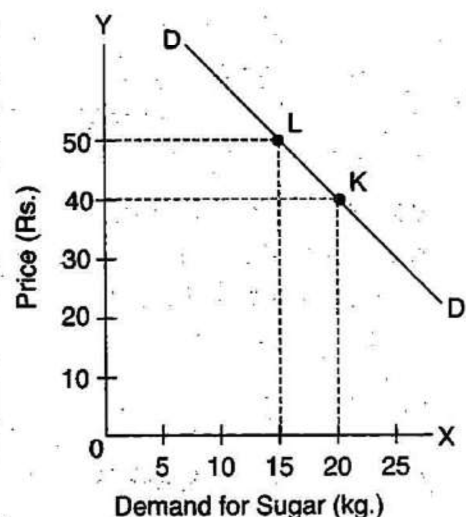
$$\boxed{NNP_{FC}\text{ (National Income)} = GNP_{FC} - \text{Depreciation}}$$

or $$GNP_{FC} = NNP_{FC} + \text{Depreciation}$$

**(xv)** An increase in the price of a commodity results in fall in quantity demanded. In simple words, the customers would buy lesser quantity of a commodity at increased prices.

**Demand Schedule**

| Price (₹) | Demand (Kg.) |
|---|---|
| 40 | 20 |
| 50 | 15 |




10 YEARS QUESTION PAPER.COM

## Part II

*(Answer any* **five** *questions.)*

**Question 2.**

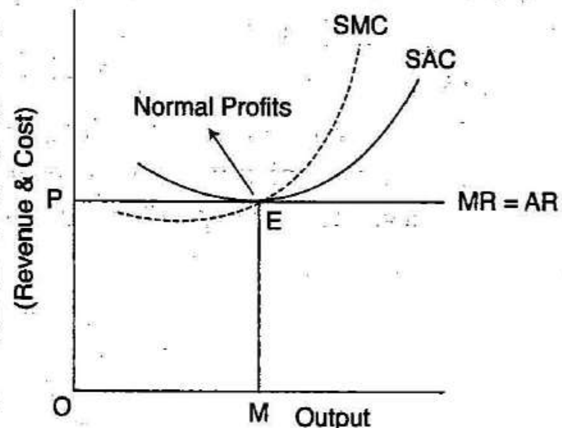
**(a)** *Explain with the help of a well labelled diagram how a perfectly competitive firm earns normal profit in short run equilibrium.* **[4]**

**(b)** *Why does the TC curve start from the Y axis and the TVC curve from the Origin ?* **[4]**

**(c)** *Discuss four features of Oligopoly.* **[6]**

**Answer :**

**(a) Perfectly competitive firm earn normal profit in short run equilibrium :** We know that average cost includes normal profit. In case Average Cost (AC) is equal to its Average Revenue (AR) *i.e.,* price at the equilibrium point, the firm earns normal profit. This situation has been explained through the alongside diagram.




In the diagram E is the equilibrium point and OM is the equilibrium output. Here,

$$SMC = MR = AR \text{ (Price)} = SAC \text{ (short run AC)}$$

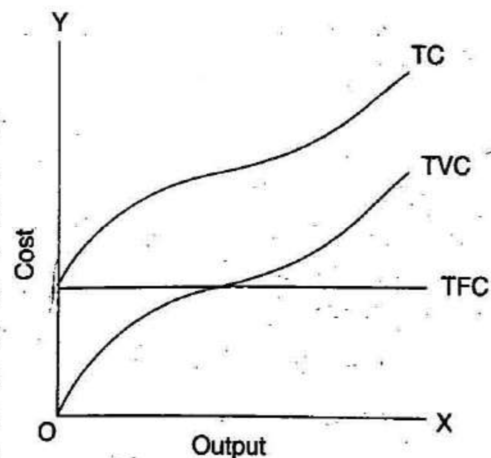
In this situation price is equal to both MC and AC.

**(b)** TVC curve starts from the origin which shows that when output is zero, the total variable cost is also zero. Whereas TC curve originates not from origin but from Y axis because at zero level of output total cost equals fixed cost since TVC is zero when output is zero.

Like, $TC_0 = FC_0 + VC_0$

$20{,}000 = 20{,}000 + 0$

Here, in above example, we understood that at zero level of production VC become zero, whereas TC never be zero rather it become equal to fixed cost at zero level of production.




Thus, the total variable cost curve starts from the origin, while the total cost curve starts at the point where the total fixed cost curve intersects the vertical axis. Vertical distance between TVC and TC curves equals the amount of total fixed cost and since the total fixed cost is constant, the vertical distance between the TVC curve and TC curve is same at all levels of output.

**(c) The four features of Oligopoly are as follows :**

**(i) Intense Competition :** There are only few firms, each firm produces a large share of the market. Each firm has significant market power to

10 YEARS QUESTION PAPER.COM

influence the market price. The number of the firms is so small that any action by one firm is likely to affect the rival firms. Therefore, every firm keeps a close watch on the activities of the rival firms. It is always busy in preparing an appropriate strategy to deal with the rival firms.

**(ii) Nature of the Product :** The firms under oligopoly may produce homogeneous product or differentiated product. Accordingly, we may have "oligopoly without product differentiation" and "oligopoly with product differentiation". In automobile industry, Maruti, Santro, Indica and in refrigeration industry, L.G., National and Godrej are the examples of differentiated oligopoly whereas cooking gas of Indane and Burshane are the examples of pure oligopoly.

**(iii) Importance of Selling Cost :** Under oligopoly as there is an intense competition, the firms compete each other through various sales promotion measures like price cutting, discounts, door to door campaign, advertisement etc. Therefore, there is a great importance of selling costs and advertisement under oligopoly.

**(iv) Barrier to Entry :** In the absence of the barriers to entry of new firms, the oligopoly may not retain its characteristic of few seller on the long run. Some major barriers to entry are economies of large scale production. Cost advantage of the old firms, price cutting etc.

**Question 3.**

**(a)** *Complete the following table and draw a supply curve for the firm A :* **[4]**

| *Price per unit* | *Supply by firm A* | *Supply by firm B* | *Market Supply* |
|---|---|---|---|
| 2 | 5 | 5 | ? |
| 3 | ? | 10 | 17 |
| 4 | 9 | ? | 24 |
| 5 | 11 | 20 | ? |

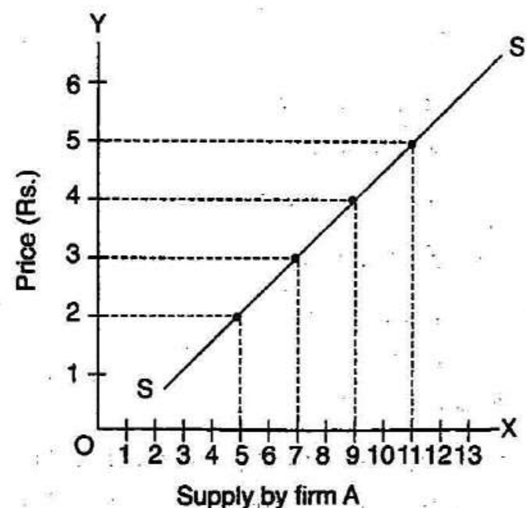
**(b)** *Explain what happens when the market price is less than the equilibrium price.* **[4]**

**(c)** *Explain the four determinants of supply of a commodity.* **[6]**

**Answer :**

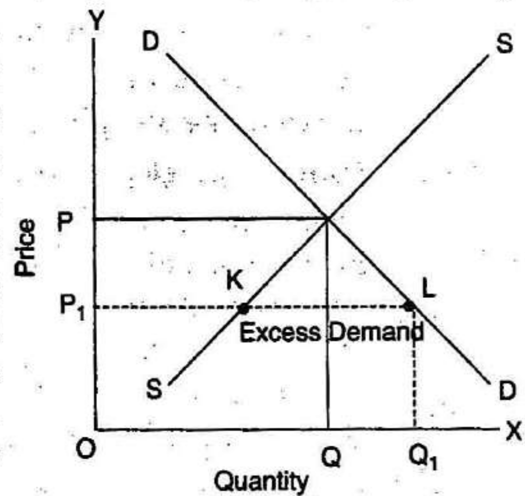
**(a)**

| *Price per unit* | *Supply by firm A* | *Supply by firm B* | *Market Supply* |
|---|---|---|---|
| 2 | 5 | 5 | **10** |
| 3 | **7** | 10 | 17 |
| 4 | 9 | **15** | 24 |
| 5 | 11 | 20 | **31** |




10 YEARS QUESTION PAPER.COM

**(b)** If market price falls and become lesser than equilibrium price, the quantity demanded will increase. Many consumers, who were not able to afford this commodity at the higher price, would start purchasing this commodity at the lower price. The amount supplied, would fall at lower price. Result emerges in excess demand. This excess demand will push the price towards the equilibrium price. The excess demand means that many consumers will not be able to get the commodity at higher prices. In an attempt to get this commodity, they are prepared to offer a higher price. Therefore, as a result of competition among buyers, price starts rising and eventually it becomes equal to equilibrium price.




**(c) The four determinants of supply of a commodity are as follows :**

(i) **Change in Technology :** If the change in technology or new discoveries bring reduction in costs and increase in production, this will increase the level of supply also.

(ii) **Taxation Policy :** The production of the commodity is discouraged, if heavy duty on its production is imposed. In the same way tax concessions encourage producers to increase supply.

(iii) **Input Prices :** If the producers have to pay higher prices to secure the factors of production needed for producing the commodity, its cost of production will be high. Given the price of the commodity, a higher cost of production reduces the profit margin. This will lead to a lower amount of output that firms will produce and offer for sale at a given price level.

(iv) **Nature of the Commodity :** The supply of a commodity also depends on whether the industry is monopolised or competitive. In case of monopoly, one firm produces the entire commodity. A monopolist firm will like to restrict the output so as to raise the market price. But if there is a competition among firms, there will be no tendency to restrict the output. Thus, the competitive are likely to produce and sell more as compared to monopolised industry.

**Question 4.**

**(a)** *Explain the nature of the AR and MR curve under perfect and imperfect competition.* **[4]**

**(b)** *Explain any one internal and any one external economy of scale.* **[4]**

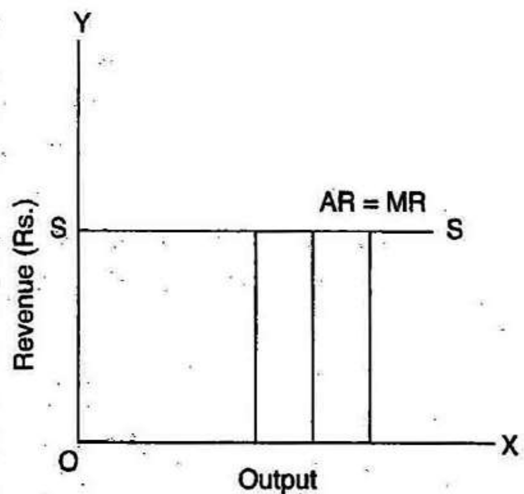
**(c)** *How does a producer attain equilibrium under perfect competition through the MR and MC approach ?* **[6]**

**Answer :**

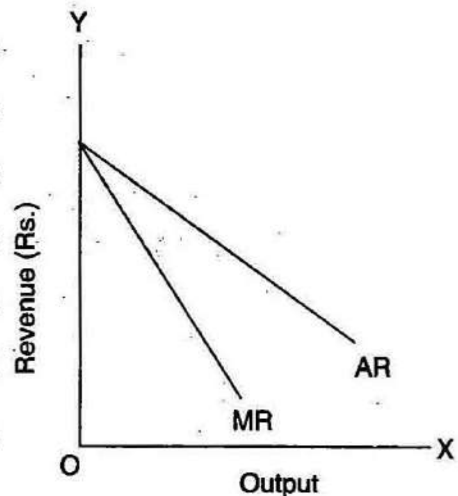
**(a)** **Nature of the AR and MR curves under Perfect Competition :** Under perfect competition market, a firm is only a price-taker. No firm under perfect

10 YEARS QUESTION PAPER.COM

competition can charge a price higher than the prevailing market price. Nor can it afford to change a price less than the prevailing market price. This is why, the production of a firm constitute a very small fraction of the total production of the industry. A firm under perfect competition sells each unit of its output at the same price. Hence, its marginal revenue is equal to its average revenue (price). Therefore, AR and MR curve represents horizontal straight line, parallel to X-axis.




**Nature of AR and MR curve under Imperfect Competition :** If a firm under imperfect competition raises the price, the proportionate fall in its demand will be more. It is so because in an imperfect competition market goods have their substitutes and buyers are equally attracted towards them. If one firm raises the price of its products, the buyers will shift their demand to the substitute product, whose price remains unchanged.




**(b) The internal Economy of Scale is as follows :**

**Managerial Economies :** Managerial economies arise due to better and more elaborate management which a large-sized firm is able to provide. A large firm is able to enjoy the benefit of division of labour in the management of its concern. The management can be divided into different departments. The firm can engage qualified persons to look after different departments. This functional specialisation in management increases efficiency at all levels.

**External Economy is as follows :**

**Technological Economies :** When an industry expands, it may provide motivation to the discovery of improved and better techniques of production. New methods of production and better machines are discovered. Production function improves. Productivity increases and per unit cost decreases.

**(c) Producer's Equilibrium Under Perfect Competition Through the MR and MC Approach :** Profit is maximised (or a producer strikes his equilibrium) when two conditions are satisfied :

(i) MR = MC, (ii) MC is rising.

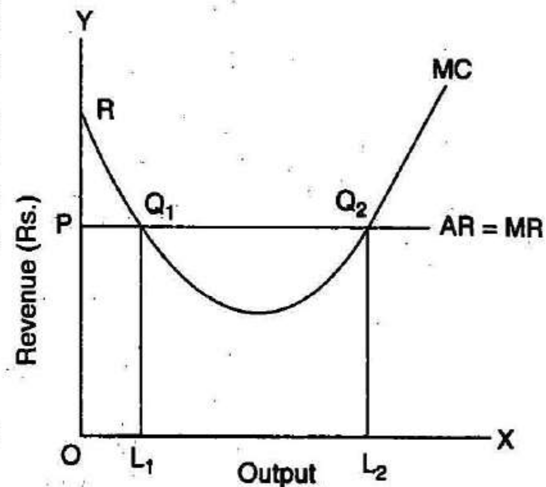
10 YEARS QUESTION PAPER.COM

**Diagrammatic Illustration :** In fig. AR = MR = OP and is assumed to be constant as under perfect competition. Accordingly, AR (& MR) line is drawn as a horizontal straight line parallel to X-axis. MC curve is shown to be U-shaped, as usual. MR is equal to MC under 2 situations :

(i) at point $Q_1$ when output = $OL_1$ and

(ii) at point $Q_2$ when output = $OL_2$.

In situation 1, MC is falling but in situation 2, MC is rising.




We know,

TR = area under MR corresponding to a given level of output.

This is equal to $OL_1\,Q_1\,P$ in situation 1.

TVC = area under MC corresponding to a given level of output.

This is equal to $OL_1\,Q_1\,R$ in situation 1.

Evidently, area $OL_1Q_1R$ > area $OL_1Q_1$ P.

Implying that in situation 1, the firm is not covering even its variable costs. This is not a viable situation for a firm to undertake production.

Corresponding to situation 2, when MC is rising, at point $Q_2$, we find that :

$$TR = OL_2Q_2P \text{ and}$$

$$TVC = IL_2Q_2R$$

$$TR > TVC$$

**Question 5.**

**(a)** *Explain how the income effect and the substitution effect are the reasons for the downward slope of the demand curve.* **[4]**

**(b)** *Price elasticity of demand for a product is unity. A household buys 50 units of this product when its price is ₹ 10 per unit. If its price rises to ₹ 12 per unit, how much quantity of the product will be bought by the household ?* **[4]**

**(c)** *A marginal utility schedule of a person is given below. Discuss the law underlying the given schedule :* **[6]**

| Pen (units) | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| MU (units) | 25 | 20 | 15 | 10 | 5 |

**Answer :**

**(a)** The downward slope of demand curve represents that with the fall in price, demand expands for the commodity. **Income effect and substitution effect** are the reasons for the downward slope in the following ways :

**Income Effect :** Income effect refers to change in quantity demanded when real income of the buyer changes owing to change in price of commodity with a fall in price, real income increases. Accordingly, demand for the commodity expands results into downward slope of demand curve.

10 YEARS QUESTION PAPER.COM

**Substitution Effect :** Substitution effect refers to substitution of one commodity for the other when it becomes relatively cheaper. Thus, when own price of commodity falls, it become cheaper than substitute product and customers of substitute product start switching towards our commodity.

**(b)**

| Price | Demand |
|---|---|
| 10 | 50 |
| 12 | ? |

$e_p = 1$ Here, $e_p$ stands for elasticity of demand

$$e_p = \frac{\Delta q}{\Delta p} \times \frac{P}{Q}$$

$\Delta q$ = Change in quantity demanded

$\Delta p$ = Change in price

P = Initial price

Q = Initial Quantity demanded.

$$1 = \frac{\Delta q}{2} \times \frac{10}{50}$$

$$1 = \frac{\Delta q}{10}$$

$$\Delta q = 10$$

Demand at the price of ₹ 12 = 50 – 10

= 40 units

**(c)** The law underlying the given Schedule in **Law of Diminishing Marginal Utility :** Here, the given schedule represents that with each successive unit of pen gives lesser satisfaction than previous one.

**Law of Diminishing Marginal Utility :** Law of Diminishing Marginal Utility states that as more and more units of a commodity are consumed, marginal utility derived from every additional unit must decline. In other words, the additional benefit a person derives from a given increase in his stock of a thing diminishes with every increase in the stock that he already has".

**Assumptions of Law of Diminishing Marginal Utility :**

(1) All the units of commodity must be same in all respects in size, colour, design, quality, etc.

(2) The unit of good must be standard e.g., a cup of water, a bottle of cold drink.

(3) There should be no change in taste during the process of consumption.

(4) There must be continuity in consumption.

(5) There should be no change in the prices of substitute goods.

(6) The utility is measurable.

**Question 6.**

**(a)** *Calculate MPC, MPS and APC from the following data :* **[4]**

| *Income (Y)* | *Consumption* |
|---|---|
| 100 | 95 |
| 110 | 104 |

**(b)** *Discuss the fiscal measures used to solve the situation of deficient demand.* **[4]**

**(c)** *Explain how the equilibrium level of income can be determined by aggregate demand and aggregate supply.* **[6]**

10 YEARS QUESTION PAPER.COM

**Answer :**

**(a)** (i)

$$\text{MPC} = \frac{\Delta C}{\Delta Y} = \frac{9}{10}$$

$$= 0{\cdot}9$$ **Ans.**

(ii)

$$\text{MPS} = 1 - \text{MPC}$$

$$= 1 - 0{\cdot}9 = 0{\cdot}1$$ **Ans.**

(iii)

$$\text{APC} = \frac{C}{Y}$$

$$\text{Ist} = \frac{95}{100} = 0{\cdot}95$$ **Ans.**

$$\text{IInd} = \frac{104}{110} = 0{\cdot}94.$$ **Ans.**

| Income (Y) | Consumption (C) | MPC | MPS | APC |
|---|---|---|---|---|
| 100 | 95 | — | — | 0·95 |
| 110 | 104 | 0·9 | 0·1 | 0·94 |

**(b) Fiscal Measures to Correct Deficient Demand :**

**(i) Deficit Budget or Deficit Financing :** It is a situation, wherein estimated expenditures exceed anticipated revenue. The government, in order to meet the shortage of funds adopts deficit financing measures. The measures are :

(a) Borrowings within the country.

(b) External borrowings,

(c) Borrowings from Reserve Bank of India.

The above measures are used by the government to obtain funds and supply in the economy. It reduces deficient demand.

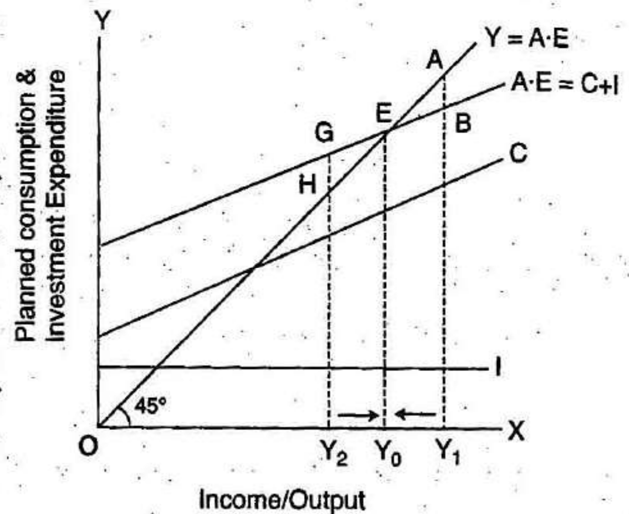
**(ii) Reduction of Taxes :** The government reduces rates of tax and taxation in certain areas is dropped. It leaves sufficient funds in the economy and aggregate demand is increased.

**(iii) Increase in Public Expenditures and Investment :** It will pump more resources in the economy and the pressure of deficient demand on the economy will be reduced.

**(c) Determination of Equilibrium level of income by aggregate Demand and Aggregate Supply :** In terms of aggregate demand aggregate supply approach, equilibrium level of income and output in the economy is the one where the aggregate demand for goods and services is equal to the aggregate supply. The aggregate demand refers to the total expenditures (spending) of the community. Total expenditure comprises planned expenditures on consumer goods by the households and the planned investment expenditure on capital goods by the business firms.

Aggregate supply refers to the aggregate value of total output of goods and services in an economy. In other words, it is equal to the value of national product *i.e.,* national income.

10 YEARS QUESTION PAPER.COM




In fig. income is measured along the X-axis and consumption and investment (I) are shown on the $y$-axis. The equilibrium level of income is at point E corresponding to the point of intersection of the aggregate demand curve (C +I) with the 45° line, which is $y_0$ because at this level of income aggregate demand equals aggregate supply. At this level of income aggregate desired spending is equal to national output. Purchasers can fulfill their spending plans and the firms are able to sell whatever they desire to produce. There is no incentive for the firms to change their output. Therefore output and income are at equilibrium.

**Question 7.**

**(a)** *Explain the following functions of money :*

(i) *Medium of exchange.*

(ii) *Store of value.* **[4]**

**(b)** *Explain how bank rate and open market operations can be used by the central bank of control credit.* **[4]**

**(c)** *How do commercial banks create credit ? Explain with the help of an example.* **[6]**

**Answer :**

**(a) Functions of Money are as follows :**

**(i) Medium of Exchange :** It means that money acts as a medium for the sale and purchase of goods and services. In the absence of money, goods were exchanged for goods. This required double coincidence of wants. Accordingly, exchange was difficult and therefore limited. Introduction of money has separated the acts of sale and purchase.

**(ii) Store of Value :** Store of value implies store of wealth. Storing wealth has become considerably easy with the introduction of money. Wealth can be stored just in terms of paper titles. It was not convenient to store value in the barter system because goods tends to wear-out or perish. Store wealth is a source of future investment and investment is a source of growth and prosperity.

**(b)** The bank rate and open market operations can be used by the central bank to control credit in following manner :

**(i) Bank Rate Policy :** The rate at which the Reserve Bank of India lends money to its scheduled banks is termed as 'Bank rate'. Scheduled banks lends money to the public at the rate more than the bank rate. For increasing money supply in the economy, the RBI will fix up lesser bank rate, causing the scheduled bank to supply money to public at cheaper

10 YEARS QUESTION PAPER.COM

rates. People will be induced to borrow because the loan is available at cheaper rates. In order to reduce the money in the economy the RBI increases bank rate which enables bank also the advance loan at higher rates. It discourages borrowing.

(ii) **Open Market Operations :** Open market operations means public selling and borrowing of Government promissory notes. RBI increases the supply of money in the economy through buying Government papers as the payment for these purchases will increase money supply. In the same way, in order to decrease the money supply in the economy the bank sells Government bonds, certificates and papers and these bonds are purchased by the individuals. Payment by individuals reduces money supply in the economy.

(c) **Credit Creation by Commercial Banks :** Money deposited by the people is given to other people in the form of loan. People, who take loan from the banks do not spend whole money, they also deposit excess money in their bank A/c. The process continues. In this way money multiplies and banks make a system of credit creation.

Commercial Banks are able to extend loans and advances by an amount which is many times more than the cash they get in the form of primary deposits. Banks have learnt from their experience that all depositors do not withdraw their money at the same time. They are able to meet the day-to-day cash requirements by keeping a small fraction of deposits as cash reserves and using the surplus amount or the excess reserves in advancing loans. This fraction of reserve called the Cash Reserve Ratio. If bank keep 100 percent cash against deposits, they would not be able to create credit loans given by banks create deposits. It is in the sense that credit is created by commercial banks.

**Example :** When the customer of Bank of Baroda deposit ₹ 1,000/- in it, the initial balance sheet of the bank is shown in Table 1.

**Table 1 : Initial Balance Sheet of Bank of Baroda**

| *Liabilities* | *Amount* | *Assets* | *Amount* |
|---|---|---|---|
| | (₹) | | (₹) |
| Deposit | 1,000 | Cash Reserve | 1,000 |
| | 1,000 | | 1,000 |

Bank of Baroda keeps a Cash Reserve of ₹ 200 (20% of 1,000) and advances a loan of ₹ 800 to Shyam & Co. Shyam & Co. uses this loan of ₹ 800 in purchasing goods from Bandhu Bros. by issuing cheque for ₹ 800 drawn on Bank of Baroda. Suppose Bandhu Bros. has its account in Canara Bank. As a result of this, ₹ 800 in cash will be transferred from Bank of Baroda to Canara Bank. The final balance sheet of Bank of Baroda is shown in Table 2.

10 YEARS QUESTION PAPER.COM

**Table 2 : Final Balance Sheet of Bank of Baroda**

| *Liabilities* | *Amount* | *Assets* | *Amount* |
|---|---|---|---|
| | (₹) | | (₹) |
| Deposit | 1,000 | Cash Reserve | 200 |
| | | Loans | 800 |
| | 1,000 | | 1,000 |

Now, Canara Bank has got a deposit of ₹ 800. Its initial balance sheet due to this deposit of 800 will look as shown in Table 3.

**Table 3 : Initial Balance Sheet of Canara Bank**

| *Liabilities* | *Amount* | *Assets* | *Amount* |
|---|---|---|---|
| | (₹) | | (₹) |
| Deposit | 800 | Cash Reserve | 800 |
| | 800 | | 800 |

Canara Bank also obliged to keep a minimum cash reserve of 20% or ₹ 160 (20% on ₹ 800). Therefore, it lends this surplus amount of ₹ 640 to Siyaram & Sons. Siyaram & Sons uses this loan in making purchases of ₹ 640 from other businessman. If that businessman has his A/c in Syndicate Bank, then Canara Bank lose ₹ 640 to Syndicate Bank. The Final Balance Sheet of Canara Bank is shown in Table 4.

**Table 4 : Final Balance Sheet of Canara Bank**

| *Liabilities* | *Amount* | *Assets* | *Amount* |
|---|---|---|---|
| | (₹) | | (₹) |
| Deposit | 800 | Cash Reserve | 160 |
| | | Loans | 640 |
| | 800 | | 800 |

In the same way, the process of creating credit goes on.

The amount of credit creation by the banking system as a whole can be worked out by the following formula :

$$\text{New Deposits} = \frac{1}{RR} \times \Delta D$$

Here, RR = Required Reserve Ratio

$\Delta D$ = Initial change in the volume of deposits

**Question 8.**

**(a)** *Explain any two objectives of the fiscal policy in a developing economy.* **[4]**

**(b)** *What is primary deficit and fiscal deficit in a government budget ? What is the implication of the primary deficit on the economy ?* **[4]**

**(c)** *Explain cost-push inflation with the help of a diagram.*** **[6]**

** *Answer has not given due to out of present syllabus.*

10 YEARS QUESTION PAPER.COM

**Answer :**

**(a)** Two objectives of the fiscal policy in a developing economy :

**(i)** **Economic Growth :** One of the most important objective of fiscal policy in developing countries is to attain high rate of economic growth. Economic growth is traditionally defined as the process whereby the real per capita income of a country increases over a long period of time. Economic growth enables the economy to produce more goods and services and thereby raise the standard of living of the people. High rate of economic growth reduce the problem of poverty and unemployment.

**(ii)** **Price Stability :** Another objective of fiscal policy in a developing economy is to achieve price stability. There is a tendency of prices to rise in these countries because of the large development expenditure without a corresponding increase in production during the early phase of economic development. Therefore, there is need for controlling price rise.

**(b)** **Fiscal Deficit :** Fiscal Deficit is the difference between the total expenditure and the sum of revenue and capital receipts excluding borrowings.

Thus,

Fiscal Deficit = Total Budgetary Expenditure
(–) Revenue Receipts
(–) Capital Receipts
(–) Capital Receipts (Excluding Borrowings)

Fiscal Deficit, therefore, is the measure of excess expenditure over what may be termed as government's own income (revenue receipts and recovery of loans and other receipts under capital receipts).

**Primary Deficit :** Primary Deficit refers to the difference between fiscal deficit and interest payments.

Thus,

Primary Deficit = Fiscal Deficit – Interest Payments.

**Implications of Primary Deficit :** Implication of Primary Deficit are similar to those of fiscal debt, except the fact that interest payments highlight the extent to which we are already under debt. Primary deficit indicates our borrowing requirement related to current year expenditures and current year receipts of the government.

**Question 9.**

**(a)** *Classify the following as final or intermediate goods. Give reasons for your answer.* ** **[4]**

(i) *A car purchased by a company for business purposes.*

(ii) *Pen or paper purchased by a consumer.*

**(b)** *Discuss two reasons why the per capita real income is considered to be a better index of economic welfare than gross domestic product.* **[4]**

**(c)** *Calculate national income and $GDP_{mp}$ by the income method using the following information :* **[6]**

| | *Items* | *₹ in crores* |
|---|---|---|
| (i) | *Private final consumption expenditure* | *1,300* |
| (ii) | *Net factor income earned from abroad* | *50* |

*Answer has not given due to out of present syllabus.*

10 YEARS QUESTION PAPER.COM

| | | |
|---|---|---|
| (iii) | *Mixed income of self employed* | *500* |
| (iv) | *Subsidies* | *100* |
| (v) | *Indirect tax* | *200* |
| (vi) | *Consumption of fixed capital* | *1,000* |
| (vii) | *Operating surplus* | *5,000* |
| (viii) | *Compensation of employees* | *1,500* |

**Answer :**

**(b)** The per capita real income is considered to be a better index of economic welfare than gross domestic product due to following reasons :

**(i)** From the point of view of economic welfare, what is important is the availability of goods and services on average and this is indicated by per capita income rather than total income. Higher total income, such as GDP, need not result in increased availability of goods and services on average if the increase in GDP is accompanied by still higher increase in population. In fact, as a result of higher growth rate of population, per capita availability of goods and services in the country will fall. This will result in a fall in the standard of living of the people and thereby a fall in economic welfare.

**(ii)** While taking national income as an indicator of economic welfare, national income should be taken in real terms and not in nominal terms. An increase in money national income may be partly due to increase in prices and partly due to increase in the quantity of goods and services.

**(c) (i) National Income by Income Method**

| | | ₹ in Crores |
|---|---|---|
| | Compensation of Employees | 1,500 |
| (+) | Operating Surplus | 5,000 |
| (+) | Mixed Income of Self Employed | 500 |
| | $NDP_{FC}$ | 7,000 |
| (+) | Net factor income from Abroad (NHA) | 50 |
| | National Income ($NNP_{FC}$) | 7,050 |

**(ii) Calculation of $GDP_{mp}$**

| | | |
|---|---|---|
| | $NNP_{FC}$ | 7,050 |
| (+) | Consumption of fixed capital (Depreciation) | 1,000 |
| | $GNP_{FC}$ | 8,050 |
| (–) | NFIA | (50) |
| | $GDP_{FC}$ | 8,000 |
| (+) | Net Indirect Taxes (Ind. Taxes – Subsidies) | 100 |
| | $GDP_{mp}$ | 8,100 |

●●

10 YEARS QUESTION PAPER.COM