Minimum Level of Learning
Class XII
Subject: Economics
(2018)

1: A consumer consumes only two goods. Explain consumer's equilibrium with the help of utility analysis.

Ans. In case of two goods, consumer's equilibrium is attained when he spends his income in such a way that marginal utilities of both the goods are same assuming that price of each good is the same. Thus,

$$MUx=MUy$$

Suppose, Vaani is a consumer with Rs 50. She wants to spend on eatables (x) and soft drinks (y). Price of one unit of each good is Rs.10. Her utility schedule of two goods is as under:

Rs. Spend	**MU of Eatable (x)**	**MU of Soft Drinks (y)**
10	100 (1)	90 (2)
20	80 (3)	60 (4)
30	60 (5)	40
40	40	20
50	20	10
	300	220

For equilibrium, Vaani will spend first Rs.10 on eatables, second Rs 10 on soft drinks, third Rs 10 on eatables, fourth Rs10 on soft drinks and last Rs 10 on eatables. In this way, Vaani gets the utility of 390. If Vaani spends her income in any other way, total utility will be less than 390.
If prices of two goods are different, the condition of consumer's equilibrium will be as under:

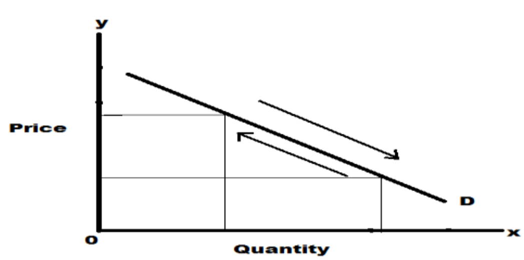
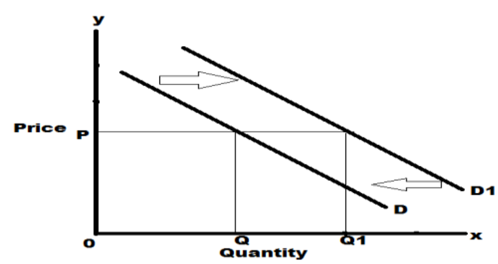
$$\frac{MU_x}{P_x} = \frac{MU_y}{P_y} \ or \ \frac{MU_x}{MU_y} = \frac{P_x}{P_y} = per\ rupee\ MU$$

2	***Consumer consumes only two goods X and Y and is in equilibrium. Show that when price of good Y falls demand for Y Rises. Answer this question with the help of utility analysis.*** ***Or*** ***A consumer consumes only two goods. Explain consumer's equilibrium with the help of utility analysis.*** ***Or*** ***What changes will take place if the condition of consumer equilibrium is not fulfilled. Use utility analysis.***
Ans.	A consumer is said to be rational and he will be in equilibrium when he maximizes his satisfaction his utility. In case of two commodities a consumer have to fulfill the following condition: $\frac{MUx}{Px} = \frac{MUy}{Py}$ But when the price of good Y falls it means that consumer will get more satisfaction from good Y. it also means that the condition of equilibrium is not satisfied because now the situation is as following: $\frac{MUx}{Px} < \frac{MUy}{Py}$ So he will buy more units of good Y. As per the law of diminishing marginal utility consumption of additional units of good Y will diminish its marginal utility. The consumer will continue to buy the good Y till its MU diminishes and becomes equal to MU of good X. It is hereby proved that when price of good be false its demand increases.

3: Distinguish between ‘decrease in demand’ and ‘decease in quantity demanded’.
Ans. Following are the points of distinction between decrease in demand and decrease in quantity demanded:

Decrease in demand	**Decrease in quantity demanded or contraction of demand**
Decrease in demand is caused by the factors other than the price of the commodity i.e. decrease in the income of the consumer, change in the taste of the consumer etc.	Decrease in quantity demanded is caused by increase in the price of the commodity.
Decrease in demand leads to leftward shift of the demand curve. It is shown on the new demand curve	Decrease in quantity demanded is upward movement along the same demand curve.

4. Difference between Change in Quantity Demanded and Change in Demand

Change in Quantity Demanded	**Change in Demand**
1. Other factors remain constant.	1. Price remains constant.
2.Two types : (1) Extension of demand (2) Contraction of Demand	2.Two types: (1) Increase in Demand (2) Decrease in Demand
3. It is represented on same demand curve.(movement along a curve)	3.It is represented by shifting of demand curve.
4.Reason : Change in price of a commodity	4.Reason : Change in other factors like income of consumer, price of other good etc.
5.Extension of demand : When price of a commodity decrease. Contraction of demand : When price of a commodity increase.	5.Increase in demand : When income of consumer increase than demand of normal good increases. Decrease in demand : When income of consumer decreases than demand of normal good decreases.
	

5: Distinguish between ‘increase in demand’ and ‘increase in quantity demanded’.

Increase in demand	**Increase in quantity demanded or expansion of demand**
Increase in demand is caused by the factors other than the price of the commodity i.e. increase in the income of the consumer, change in the taste of the consumer etc.	Increase in quantity demanded is caused by decrease in the price of the commodity.
Increase in demand leads to rightward shift of the demand curve. It is shown on the new demand curve	Increase in quantity demanded is downward movement along the same demand curve. It is shown on the same demand curve.

6: Explain the factors determining price elasticity of demand.
Ans. Following are the factors determining price elasticity of demand-

(i) Availability of substitutes- Larger the number of substitutes, more elastic will be the demand for the commodity. A commodity having no substitute will have inelastic demand.
(ii) Price level- Higher the price level, higher will be the elasticity of demand and vice-versa.
(iii) Time period- In short period, demand tends to be inelastic and vice-versa.

(iv) Number of uses of commodity- A commodity having more uses, will have elastic demand and vice-versa.

(v) Proportion of income spend on the commodity- If a consumer spends a large proportion of income on the commodity, demand will be elastic because any change in price will affect his budget considerably.

(vi) Habits- If a person is habitual of a product, the product will have inelastic demand. For example, for a opium addict, the demand for opium is inelastic whereas for other casual opium takers, the demand is likely to be elastic.

7: Explain any three properties of indifference curves.

Ans: following are the properties of indifference curves-

(i) An indifference curve slops downward from left to right- An indifference curve has a negative slope which shows that any increase in the amount of one commodity is accompanied by a reduction in amount of an other commodity.

(ii) An indifference curve is convex to the origin- An indifference curve is convex to the origin due to diminishing marginal rate of substitution.

(iii) Higher indifference curve represents a higher satisfaction- one indifference curve represents only one level of satisfaction. For different levels of satisfaction, there are different indifference curves. A higher indifference curve represents a higher level of satisfaction.

8. Producer's Equilibrium with the help of MC and MR schedule in perfect competition.

Producer is said to be in equilibrium when he is maximizing his profits.

The producer produces a level of output where his profits are maximum. This level of output is determined where the following conditions are fulfilled ;

1. Marginal Cost becomes equal to Marginal Revenue (MC = MR)
2. Marginal Cost is increasing after equating MR

Units	MC	MR
1	4	3
2	3	3
3	2	3
4	**3**	**3**
5	4	3

The producer is in equilibrium when he is producing 4 units. At 4th unit MC = MR and MC is rising after 4 the unit. He is not in equilibrium at 2nd unit as MC = MR but MC falls after 2nd unit. So producer is maximizing his profit at 4th unit as both the conditions are fulfilled.

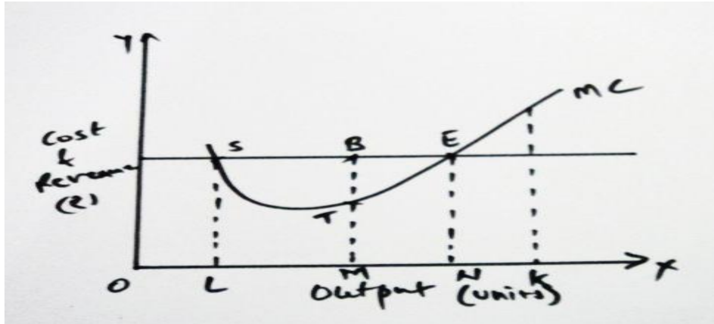
9. Producer's Equilibrium with the help of MC and MR Curve in perfect competition market

Producer is said to be in equilibrium when he is maximizing his profits.

The producer produces a level of output where his profits are maximum. This level of output is determined where the following conditions are fulfilled ;

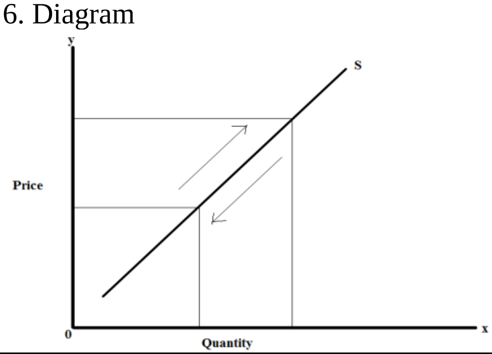
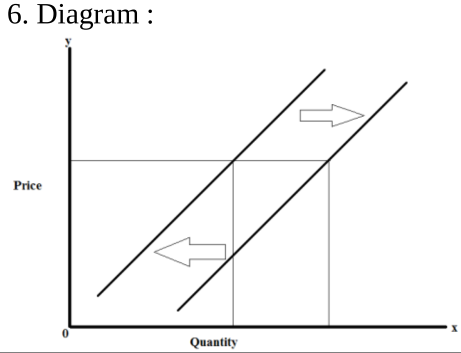
1. Marginal Cost becomes equal to Marginal Revenue (MC = MR)
2. Marginal Cost is increasing after equating MR

The producer is in equilibrium at ON level of output. Here MC=MR and MC rises after intersecting MR. the producer is earning profits equal to area STE. If the producer decides to produce OM level of output he would lose some profit. His profits would be equal to area SBT.

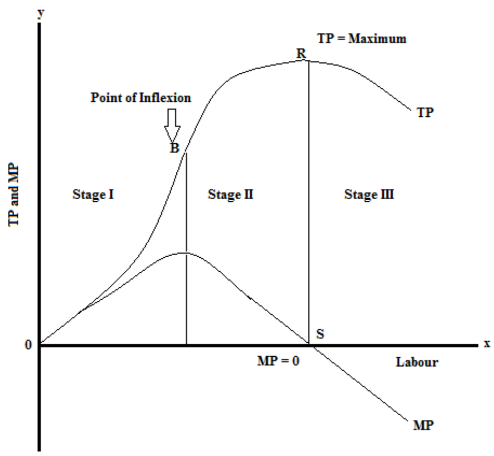


So he is not in equilibrium at OM because Area SBT < Area STE
If he decides to produce more than ON, at OK he would add more to cost and less to revenue. So he must not be maximizing his profits at OK level.
At OL level of output MC = MR but afterward MC falls. This gives an incentive to producer to produce more so that he can increase his profits.
Therefore the producer is in equilibrium when MC = MR and MC is rising.
Hence producer is in equilibrium at ON level of output.

10. Differentiate between Change in Quantity Supplied and Change in Supply

Change in Quantity Supplied	Change in Supply
1. Other factors remain constant.	1. Price remains constant.
2.Two types : (1)Extension of Supply (2)Contraction of Supply	2.Two types: (1)Increase in Supply (2) Decrease in Supply
3. It is represented on same Supply curve.(movement along a curve)	3.It is represented by shifting of Supply curve.
4.Reason : Change in price of a commodity	4.Reason : Change in other factors like input price, technological improvement, Govt. policy etc.
5.Extension of Supply : When price of a commodity increases. Contraction of Supply : When price of a commodity decreases.	5.Increase in Supply : When input price reduces supplier increase the supply of commodity. Decrease in Supply : When input price rises supplier decreases the supply of commodity.
6. Diagram 	6. Diagram : 

11	***Differentiate between short run and long run production function .***	
Ans.	Short run production function	Long run production function
	At least one factor of production is kept constant and others are variable.	All factors of production are variable.
	Factor ratio changes.	Factor ratio remains constant.
	Generates law of variable proportion.	Generates returns to scale.

12	***What are the different phases in the law of variable proportion in terms of marginal product? Give reason behind each phase.*** ***OR*** ***What are the different phases in the law of variable proportion in terms of total product? Give reason behind each phase.*** ***OR*** ***State the different phases of changes in total and marginal product in the law of variable proportions. Use diagram.***
Ans.	The law of variable proportion states that other factors of production remain constant, as more and more units of variable factor is employed in the beginning total product (TP) increases at increasing rate, then increases at a decreasing rate and ultimately decline. In short, the effect on total production/ marginal production in short run when variable factor is increased is called the law of variable proportion.  **I phase**: MP increases, due to which TP increases at increasing rate. AP also increases. The stage lasts where the MP is maximum. **Reasons**: a.better utilization of the fixed input with increase in variable input, b.Benefits of division and specialization of the variable input used, say, labour, c.indivisibility of fixed input. **II phase:** MP decreases, due to which TP increases but at decreasing rate. AP also reaches at maximum and start decreasing. The stage lasts where the TP is maximum and MP is zero. **Reasons**: a.Optimum combination between fixed and variable inputs is disturbed with increasing use of the variable input b.After a certain level of employment of the variable input, the benefits from the division of labour will diminish leading to diminishing return. c.Imperfect substitutes between fixed input and variable input **III phase:** MP becomes negative, due to which TP fall. **Reasons:** Over utilization of fixed factors

13	***Define collusive and non-collusive oligopoly. Explain the features of oligopoly.***

Ans.	***Collusive oligopoly*** is one in which the firms cooperate with each other in deciding price and output. ***Non collusive oligopoly*** is one in which firms compete with each other. **Features of oligopoly** 1. **Few firms -** Few firms mean either only a few firms in number or a **few big firms** producing most of the output of the industry. The exact number of firms is not defined. The word 'few' signifies that the number of firms is manageable enough to make a guess of the likely reactions of rival by a firm. 2. **Firms are interdependent in taking price and output decisions -**When there are only a limited number of firms, it is likely that rivals have some knowledge as to how these firms operate. It one firm does something about the price and quantity of the product it produces, the rivals are likely to take quick note of it and react by changing their own price and output plans- It makes each firm dependent on other firms in the industry. 3. **Barriers to the entry of firms-** The main reason why the number of firms is small is that there are barriers which prevent entry of firms into industry. Patents, large capital, control over the crucial raw materials etc. prevent new firms from entering into industry. Only those who are able to cross these barriers are able to enter. 4. **Non-price competition-** Firms try to avoid price competition for the fear of price war. They use other methods like advertising, better services to customers, etc. to compete with each other.

14: Market of a commodity is in equilibrium. Demand for the commodity 'increases'. Explain the chain of effects of this change till the market again reaches equilibrium. Use diagram.

Ans. When market of a commodity is in equilibrium, it implies that demand for the commodity is equal to its supply. When demand for the commodity increases, there will be a situation of excess demand. There will be following changes in the market for the commodity-

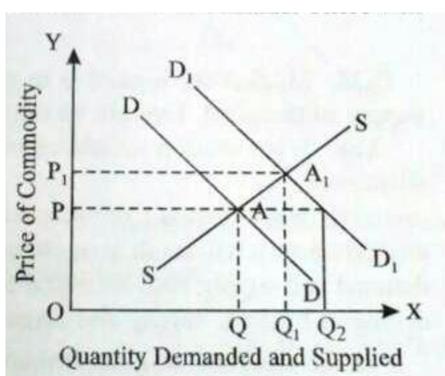
(i) Since demand is more than the supply, all buyers will not be able to buy the quantity they want to buy. As a result of this, price will tend to rise.

(ii) When price of the commodity starts rising, suppliers of the commodity will be motivated to supply more.

(iii) Rise in the price of the commodity will lead to decline in demand till demand is equal to supply.

As a result of above changes, excess demand will be corrected and prevailing market price will be equal to equilibrium price.

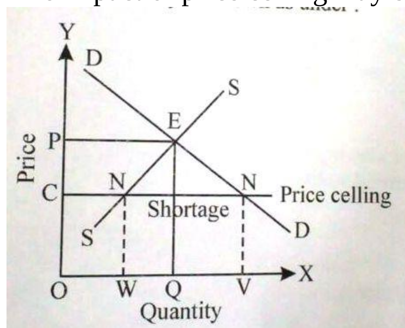
It may be shown under:



DD is original demand curve and SS is supply curve. The equilibrium price is OP and equilibrium quantity is OQ. When demand increases from DD to D_1D_1, equilibrium price increases from OP to OP_1. There is an excess demand at given price OP equal QQ_2. However, rise in price leads to fall in demand. These changes will continue till the market reaches at new equilibrium price OP_1 with quantity OQ_1.

15: Explain the impact of price ceiling with the help of a diagram.

Ans: Price ceiling is a system under which a ceiling is imposed on the price of a commodity as a result of which sellers cannot charge price higher than the price fixed by the government. Price fixed by the government is lower than the equilibrium price. Price ceiling is a method of government's intervention in the free operation of market forces. Such a step is taken to protect the interests of the poor people who cannot afford the equilibrium price. The impact of price ceiling may be shown as under:



In the diagram OP is equilibrium price. The government fixes ceiling at OC. As a result of price ceiling, prices is reduced from OP to OC. At this price demand increases to CN i.e. OV. But the sellers offer only CM i.e. OU quantity of commodity. As a result, there is a shortage of commodity equal to MN to UV. To avoid the problem of shortage, the government adopts the system of Rationing.

<table>
<tr><td>16</td><td colspan="2">Distinguish between nominal GNP and real GNP.</td></tr>
<tr><td>Ans.</td><td>Nominal GNP is measured at current prices. Since this aggregate measures the value of goods and services at current year prices, GNP will change when volume of product changes or price changes or when both changes.</td><td>Real GNP is computed at the constant prices. Under real GNP, value is expressed in terms of prices prevailing in the base year. This measure takes only quantity changes. Real GNP is the indicator of real income level in the economy.</td></tr>
<tr><td>17</td><td colspan="2">Explain the main steps involved in measuring national income through product method.</td></tr>
<tr><td>Ans.</td><td colspan="2">a. Identification and classification of producing units into different sectors like primary, secondary and tertiary sectors.
b. Estimate value of output by adding sales + change in stock (sales = quantity sold x price)
Value of output = sales + change in stock
c. Estimate gross value added by value of output – intermediate consumption
Gross Value Added = Value of output - intermediate consumption
Gross Value Added is also termed as GDP_{MP}
d. Add net factor income from abroad and deduct depreciation and net indirect tax to GDP_{MP} to obtain NNP_{FC} which is national income.
$NNP_{FC} = GDP_{MP}$ – Depreciation – NFIFA – NIT</td></tr>
<tr><td>18</td><td colspan="2">Explain the steps involved in calculation of national income through income method.</td></tr>
<tr><td>Ans.</td><td colspan="2">a. Classify the producing enterprises into different sectors like primary, secondary and tertiary.
b. Estimate the factor income paid by the producing units in each sector i.e.
*Compensation of employees
*Operating surplus
*Mixed income of self employed
c. Add the factor income by all the sectors to arrive at the NDP_{Fc}(Which is called domestic income)
NDP_{FC} = Compensation of employees + Operating surplus + Mixed income of self employed
d. Add net factor income from abroad to the net domestic product at factor cost to arrive at the net national product at factor cost (National Income).
$NNP_{FC} = NDP_{FC}$ + NFIFA</td></tr>
<tr><td>19</td><td colspan="2">Explain the main steps involved in measuring national income through expenditure method.</td></tr>
<tr><td>Ans.</td><td colspan="2">a. Classify the economic units incurring final expenditure into distant groups like households, government, firms, rest of the world.
b. Estimate the following final expenditure by all economic units:
1. Private final consumption expenditure (C)
2. Government final consumption expenditure (G)
3. Gross domestic capital formation (I)
4. Net export (X-M)</td></tr>
</table>

	c. Sum total of above gives GDP_{MP} **GDP_{MP} = C + I + G + (X - M)** d. Deduct depreciation, net indirect taxes to get NDP $_{FC}$ e. Add net factor income from abroad and deduct depreciation and net indirect tax to GDP_{MP} to obtain NNP_{FC} which is national income. **NNP_{FC} = GDP_{MP} – Depreciation + NFIFA – NIT**

20: Can the size of economic welfare be identified with the size of GDP/ GNP? Give reasons.
Ans. GNP/ GGDP provides a satisfactory measure of aggregate output and serves as an indicator of overall economic performance of a country.

Following are some of the limitations of using GDP as an index of welfare of a country-

(i) Distribution of GDP- GDP ignores distribution of income. There will be no change in economic welfare if the distribution of GDP is not equitable.

(ii) Non-monetary exchanges- Many activities in an economy are not evaluated in monetary terms. A number of transactions are not counted in the GDP of a developing country, and there is under estimation of GDP. Hence, GDP is not a good indicator of economic welfare.

(iii) Externalities- Externalities refer to those benefits or harms accruing to another for which they are not paid or penalized. Externalities may be positive or negative. If increase in GDP has been brought about my making workers work in bad working conditions increase GDP will not raise the level of economic welfare.

(iv) Composition of GDP- The composition of GDP affects the economic welfare of a country. If the GDP of a country consists of a larger quantity of investment goods and/ or war materials, economic welfare may be very low.

(v) Rate of population growth- Economic welfare depends on the per capita availability of goods and services. If the rate of population growth is higher than the rate of growth of GDP, economic welfare will be less.

21	***Define money supply. What are the components of money supply?***
Ans.	The stock of money in form of coins, currency notes and demand deposits with commercial banks at a particular point of time is called money supply. Main components of money supply are: a. Currency held by the public which includes notes and coins, b. Demand deposits with commercial banks which include current account deposits and saving account deposits.

22	***Explain how does a central bank control money supply by changing:*** ***a. Repo rate*** ***b. Reverse repo rate***
Ans.	**(a)**: The rate of interest at which central bank advances short term loans to commercial banks is called repo rate. Repo rate is increased if central bank wants to reduce the money supply. The borrowings for commercial banks become costlier so they will increases the interest rate on loans demanded by the public. This will result in the decrease in the demand for loans and hence the decrease in money supply. **(b):** The rate of interest at which central bank borrows from commercial banks is called reverse repo rate. Increase in reverse repo rate will attract commercial banks to deposit their excess funds with central bank which means less availability of money to be granted as loans. Repo Rate is one percent greater than Reverse Repo rate decided by RBI.

23	***Explain the roll of following to reduce money supply in the economy:*** ***a. statutory liquid ratio*** ***b. cash reserve ratio***

Ans.	a. **Statutory liquidity ratio** is the percentage of total deposit of the commercial banks which they have to invest in government securities. To reduce the money supply central bank will increase the SLR. This results in the decrease in loaning capacity of commercial banks which means less availability of credit to the public. b. **Cash reserve ratio** is the percentage of total cash deposit of the commercial banks which they have to keep with the central bank in form of cash. To reduce the money supply central bank will increase the CRR. This results in the decrease in loaning capacity of commercial banks which means less availability of credit to the public.

24	***Can commercial banks create money? Explain with an example.***
	The deposits held by banks are used for giving loans. However banks cannot use the whole of deposits for lending. It is legally compulsory for the banks to keep a certain minimum fraction of their deposits as resources. The friction is called legal reserve ratio (LRR) is fixed by the central bank. Example: suppose initial deposits in the bank are rupees 1000 and LRR is 20% It means, banks are required to keeps only Rs. 200 as cash reserves and free to lend Rs. 800. This 800 will again come in the bank as deposit. With new deposit of Rs.800, banks keep 20% as reserves and lend the balance Rs. 640 to other person, and so on…….

	Deposits (in Rs.)	Loans (in Rs.)	Cash Reserves (20%)
Initial deposit	1000	800	200
Round I	800	640	160
Round II	640	512	128
…………..	…………..	……………	…………..
………....	……………	…………..	…………...
…………..	5000	4000	1000

Money Multiplier = 1/LRR= 1/0.2=5
Total Deposit = Initial Deposit X Money Multiplier
= 1000X5 = 5000Rs.

25. Briefly explain the various functions of The Central Bank.

Ans. MEANING: An apex body that controls, operates, regulates and directs the entire banking and monetary structure of the country.

FUNCTIONSOFCENTRAL BANK:

i) ***Currency authority or bank of issue***: Central bank is a sole authority to issue currency in the country. Central Bank is obliged to back the currency with assets of equal value (usually gold coins, gold bullions, foreign securities etc.,)
Advantages of sole authority of note issue:
(a)Uniformity in note circulation (b) Better supervision and control (c) It is easy to control credit
(d)Ensures public faith (e)Stabilization of internal and external value of currency

ii) ***Banker to the Government***: As a banker it carries out all banking business of the Government and maintains current account for keeping cash balances of the government. Accepts receipts and makes payments for the government. It also gives loans and Advances to the government.

iii) ***Banker‘s bank and supervisor***: Acts as a banker to other banks in the country—
a) *Custodian of cash reserves*:- Commercial banks must keep a certain proportion of cash reserves with the central bank (CRR)
b) *Lender of last resort*:- When commercial banks fail to need their financial requirements from other sources, they approach Central Bank which gives loans and advances.
c) *Clearing house*:-Since the Central Bank holds the cash reserves of commercial bank sit is easier and more convenient to act as clearing house of commercial banks.

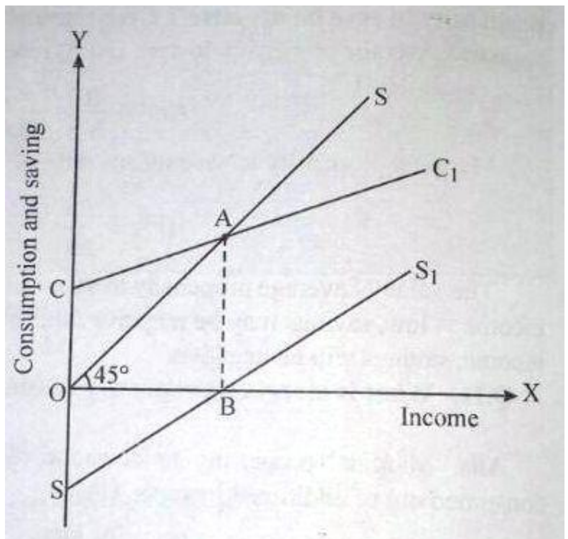
iv)***Controller of money supply and credit***:- Central Bank or RBI plays an important role during the times of economic fluctuations. It influences the money supply through quantitative and qualitative instruments. Former refers to the volume of credit and the latter refers to regulate the direction of credit.

v) ***Custodian of foreign exchange reserves***.

Another important function of Central Bank is the custodian of foreign exchange reserves. Central Bank acts as custodian of country's stock of gold and foreign exchange reserves. It helps in stabilizing the external value of money and maintaining favorable balance of payments in the economy.

26: Outline the steps taken in deriving consumption curve from the saving curve. Use diagram.

Ans. Following diagram shows the manner of deriving consumption curve from saving curve.



Following are the steps taken in deriving consumption curve CC_1 from the given saving curve SS_1-

(i) SS_1 is the given saving curve which shows that there is negative saving equal to OS at point O. It implies that there will be some consumption even there is no income.

(ii) We shave draw a 45° line from point of origin. This is income line.

(iii) SS_1 curve intersects x-axis at B. We shall draw a perpendicular from point B upward which cuts income line at point A.

(iv) Now we shall locate the origin point of consumption curve CC_1. C will be point of origin of consumption curve because OS=OC.

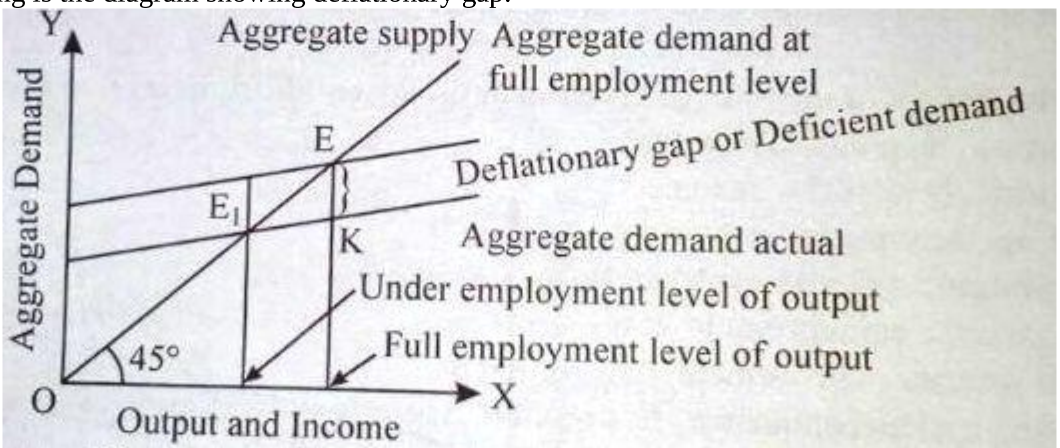
(v) We shall join C and A by a straight line and extend it to C_1.

(vi) CC_1 is the desired saving curve.

27	***Define Aggregate demand. State its components.***
Ans.	Aggregate demand is the total demand for goods and services in the economy. Aggregate demand in fact represents the total expenditure of goods and services in an economy. There are four components of aggregate demand (AD): (i)Consumption (ii) investment (ii) government expenditure (iv)net export (X-M) AD=C+I+G+(X-M)
28	***What is meant by investment multiplier? Explain the relation between MPC and investment multiplier?***
Ans.	Investment multiplier is defined as the ratio of change in income due to change in investment ***Multiplier (k)*** $=\Delta Y/\Delta I$ *and* $K = \frac{1}{1-MPC}$ Relationship between multiplier and MPC: the value of the multiplier varies directly with MPC

	Higher the MPC, the higher will be the multiplier and vice versa. FOR example, if ***MPC =. 5 , K= 2.*** ***If MPC= .8, K=5***

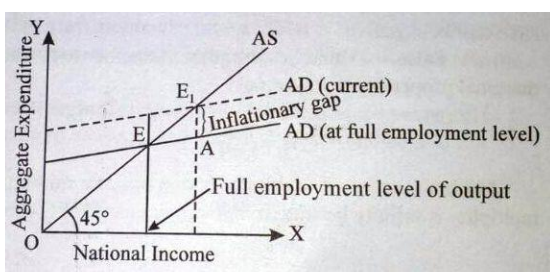
29. Explain the situation of deficient demand in an economy with the help of a diagram.
Ans. Deflationary gap or deficient demand may be defined as an excess of aggregate supply over aggregate demand at the full employment level. Thus,
Deflationary gap= Equilibrium level of expenditure– Planned aggregate expenditure.
Following is the diagram showing deflationary gap:



In the above diagram, E is the equilibrium point but the current actual demand is less than full employment level of income. The gap between E and K is deflationary gap.

30: Explain the situation of excess demand in an economy with the help of a diagram.
Ans: Inflationary gap may be defined as an excess of aggregate demand over available aggregate supply at the full employment level. Thus,

Inflationary gap= Planned aggregate expenditure– Equilibrium level of expenditure
Inflationary gap is the result of excess demand. Excess demand is a situation under which aggregate demand is for a level of output more than the full employment level. Excess demand causes a rise in the price level i.e. inflation.



In the above diagram, we find that E is the full employment level equilibrium point. But, the current aggregate expenditure is more than the full employment level aggregate expenditure. As a result, equilibrium is at point E_1 and E_1A represents inflationary gap.

31. Difference between Capital Expenditure and Revenue Expenditure

Capital Expenditure	Revenue Expenditure
1.It create assets for the government. Eg. Construction of roads, dams, school buildings	1.It do not create assets for the government. Eg. Student's scholarship,Old age pensions,subsidies
2.It reduce liability of the government. Eg. Repayment of loan	2.It do not reduce liability of the government. Eg. Interest payment on loan.

32. Difference between Capital Receipt and Revenue Receipt

Capital Receipt	Revenue Receipt
1.It create liability for the government. Eg. Loan by the government	1.It do not create liability for the government. Eg. Income Tax
2.It reduce assets of the government. Eg. Selling of the government property, selling of the shares of Hindustan Petrolium.	2.It do not reduce assets of the government. Eg. Income Tax

33. Difference between direct taxes and indirect taxes

Direct Taxes	Indirect Taxes
1.The burden of direct tax cannot be shifted.	1.The burden of indirect tax can be shifted.
2.Imposition and incidence lies on the same person	2.Imposition and incidence lie on different person
3.Imposed on income and wealth of people. Eg. Income tax , wealth tax	3.Imposed on goods and services. Eg. Sales tax, Service tax
4.It is progressive in nature	4.It is regressive in nature.

34	***Explain the concept of 'primary deficit' in a government budget. What does it indicate?***
Ans.	Primary deficit is the difference between fiscal deficit & interest payments. It indicates estimated borrowing by the govt. on account of excess of current year expenditures over current year receipts, exclusive of the burden of interest payments related to past debts. Primary deficit thus indicates the extent to which the govt. needs to borrow to implement its budgetary programmes& policies for the year ahead. In other words primary deficit shows that the country is in debt trap.

35: Define a government budget. State any four of its main objectives.

Ans. A government budget may be defined as the annual financial statement containing an estimate of all revenues and expenditures of the government for the coming year.

Following are the main objectives of a budgetary policy:

(i) Reallocation of resources- The primary objective of budget is to secure a reallocation of resources in line with social and economic prospective.

(ii) Redistribution of income and wealth- Another objective of budget is to redistribute income and wealth so as to reduce inequalities.

(iii) Economic stability- One of the objectives of budget is to prevent business fluctuations and to maintain economic stability.

(iv) Social welfare- The last objective of budget is to manage public enterprises so as to promote social welfare.

36. Distinguish between autonomous and accommodating transactions of BOP account

Autonomous Items	Accommodating Items
1.It refers to those international economic transactions, which take place due to some economic motive such as profit maximization.	1.It refers to the transactions that are undertaken to cover deficit or surplus in autonomous transactions.
2.Autonomous transactions are independent of the state of BOP account.	2.Accomodating transactions are undertaken to maintain the balance in BOP account.*
3.Autonomous transactions take place on both current and capital accounts.	3.Accomodating transactions take place only on capital account.
4.These items are also known as 'above the line items'.	4.These items are also known as 'below the line items'.
	*(If there is current a/c deficit in the BOP then it is settled by capital inflow from abroad)

37. Sources of Demand for foreign exchange :

1. To make the payment for imports of goods and services.
2. Repayment of international loans.

3. To make investment in rest of the world.
4. For giving gifts and grants to other country.
5. To purchase assets like land , shares , bonds etc. in the foreign countries.

38. Sources of Supply for foreign exchange :

1. It comes through exports of goods and services.
2. Recovery of international loans.
3. Through Foreign Direct Investment in domestic market.
4. By receiving gifts and grants from other country.
5. When foreigner purchase assets like land , shares , bonds etc. in domestic market.

39.	***When price of a foreign currency falls, its demand rises. Why?***
Ans.	When price of foreign currency falls Less Indians rupees are needed to get one unit of the foreign currency. Accordingly demand for goods & services for which payments are to be made in terms of foreign currency tends to rise. This leads to a rise in demand for the foreign currency. The various components of a rise in demand for foreign currency are as these : (i) With a fall in the price of foreign currency, imports tend to rise, leading to a rise in demand for foreign currency. (ii) A fall in the price of foreign currency makes travelling to rest of the world less expensive. Accordingly, demand for foreign currency rises. (iii) Investment in rest of the world becomes less expensive, leading to rise in demand for foreign currency. (iv) Opportunity cost of holding foreign currency tends to fall. Accordingly, demand for foreign currency tends to expand.

40.	***Distinguish between current account & capital account of balance of payments account.***
Ans.	**Current Account BOP** is that part of BOP which records items of : (i) Export & imports of goods (visible) (ii) Export & import of services (invisibles) Includes: (a) Non-factor services (b) Income (arising out of factor services) and (c) Unilateral transfers. **Capital Account BOP** is that part of BOP which records items of: (i) Borrowing (External assistance & commercial borrowings) (ii) Investments (FDI as well as portfolio investment) (iii) NRI deposits (iv) Banking capital (v) Short-term trade credit & (vi) Other capital

41. Distinguish between balance of trade and balance on current account.

Ans. Following table shows the distinction between balance of trade and balance on current account:

Balance of Trade	**Balance on Current Account**
It records transactions relating to goods only.	It records transactions relating to both goods and services and unilateral transfers.
It is a narrower concept.	It is a wider concept and includes balance of trade.
It is an indicator of difference of imports and exports	It is an indicator of difference between receipts and payments on account of visible and invisibles.

42. Distinguish between fixed and flexible foreign exchange rate.

Ans. Following table shows the distinction between fixed and flexible foreign exchange rate:

Fixed foreign Exchange rate	**Flexible foreign exchange rate**
Fixed exchange rate means the exchange rate which is officially declared and fixed.	Flexible exchange rate means the exchange rate which is floating because it is determined by demand and supply.

It requires regular control and monitoring by the government.	It does not require any intervention by the government.
It is stable and certain and not subject to wide fluctuations.	It is uncertain and subject to wide fluctuations.
It checks speculation in foreign exchange market.	It encourages speculation.

43: Explain the meaning of the managed flexible foreign exchange rate.

Ans: Managed flexible foreign exchange rate means flexible foreign exchange rate system in which gradual adjustments in rate of exchange take place through the intervention of the government.

This is done to control the exchange rate i.e. to make exchange rate stable. Thus, managed floating system is a mixture of flexible and fixed exchange rates. However, managed floating strict rules and guidelines otherwise it may be abused to detriment of other countries.

44: Explain sources of demand for foreign exchange.

Ans. Sources of Demand of foreign exchange are as follows:

(i) Import of goods and services- When the residents of one country want to use the goods and services produced by the rest of the world, they have to make payments in foreign exchange. This gives rise to demand for foreign exchange in domestic country's foreign exchange market.

(ii) Tourists going abroad- Tourists need to have foreign exchange with them to meet their expenditure abroad. Tourists purchase foreign exchange in foreign exchange market.

(iii) Remittances- Foreigners working in domestic country need foreign exchange to remit money to their families in the rest of the world. Besides, MNCs and foreign institutional investors need foreign exchange to remit its profit to rest of the world.

(iv) Payment of interest and repayment of loans- Residents and various institutions need foreign exchange to pay interest on loans and repayment of loans.

45: Explain sources of supply of foreign exchange.

Ans. Sources of supply of foreign exchange are as follows:

(i) Export of goods and services- Whenever rest of the world purchases goods and services produced by the domestic country, domestic country receives foreign exchange. This generates foreign exchange.

(ii) Remittances- Residents of a country settled in foreign countries send their savings to their families in the domestic country. This generates foreign exchange.

(iii) Foreign tourists in domestic country- Foreign tourists need to have foreign exchange with them to meet their expenditure in domestic country.

(iv) Foreign direct investment- When MNCs and other agencies make their investment in Indian business houses, they bring foreign currency in India.