INDIAN SCHOOL MUSCAT
SECOND PRELIMINARY EXAMINATION

SET – III

ECONOMICS

CLASS: XII **Sub. Code:030** **Time Allotted: 3 Hrs.**

11.02.2019 **Max. Marks: 80**

EXPECTED VALUE POINTS AND SCHEME OF EVALUATION

Q.NO.	Answers	Marks (with split up)
1.	Total fixed cost remains unchanged at all given levels of output, is the reason behind vertical parallel distance between TVC curve and TC curve. OR Law of variable proportion.	1
2.	Resources are limited, Resources have alternative uses.	½+ ½
3.	b. Perfectly inelastic	1
4.	Price Or Less than average revenue.	1
5.	Shape of indifference curve is determined by the rate of substitution. IC slopes downward. An increase in demand for one good is associated by decrease in demand for the other. This monotonicity of preferences implies that IC is downward sloping. The diminishing marginal rate of substitution ($\Delta X_2/\Delta X1$) makes indifference curve convex to the origin. Amount of $good_2$ the consumer is willing to give up for an extra unit of $good_1$ declines as the consumer has more units of $good_1$	3
6.	PPC of the economy drawn on the assumption that the given resources are fully as well as efficiently utilized and that the state of technology remains unchanged. If unemployment exists in the economy, I implies that the economy is operating somewhere within the PPC. Actual output is less than potential output. If unemployment is reduced the level of actual output is raised and it moves closer to the potential output. OR	3

	<table><tr><th>Good X (Units)</th><th>Good Y (units)</th><th>MRT</th></tr><tr><td>0</td><td>30</td><td></td></tr><tr><td>1</td><td>27</td><td>3Y:1X</td></tr><tr><td>2</td><td>21</td><td>6Y;1X</td></tr><tr><td>3</td><td>12</td><td>9Y;1X</td></tr><tr><td>4</td><td>0</td><td>12Y;1X</td></tr></table> Since Marginal rate of transformation is increasing the PPC is concave to the origin.	
7.	Ed = % change in quantity demanded / % change in price. = 100/ -50 = -2 = -2 = -50 / ΔP/10 x 100 ΔP = -2.5 ; New price =10+2.5 = 12.5 OR It means percentage change in quantity demanded is less than percentage change in price or quantity is less responsive to relative change in price. Ed = % change in quantity demanded / % change in price. = -20/ (2/8) 100 = -20/28 = -0.8 The price elasticity of demand is relatively inelastic.	4
8.	AVC : 20, 18, 18, 20, 22 TC : 60, 76, 94, 120, 150 MC: 20, 16, 18, 26, 30	4
9.	Monopoly is a market structure in which a firm has the sole right over production or sale of the product with no close substitutes. ***No substitute for the product:*** No other commodity works as a substitute for this commodity. As close substitute are not available. Consumers do not have other choices. The demand is relatively inelastic. AR curve slopes downward. MR curve lies downward. Producer can even charge different prices for the same product from deferent consumers. **OR** There are many sellers of the product but the product of each seller is somewhat different from that of other. <u>Differentiated product:-</u> Products are close substitute but not perfect substitute. As the product of the different firms are distinguishable from one another in terms of brand name, packing shape, quality etc., consumer's develop taste or preference for a particular brand. Each firm follows its own price output policy. As products are close substitutes its demand is highly elastic. AR curve is downward sloping and MR curve lies below AR curve.	1+3
10.	(i) Law of Diminishing Marginal Utility: This law states that with the continuous consumption of additional units of a commodity, the utility from each successive unit goes on diminishing and can even become zero or negative. As a result the consumer will buy additional unit at a lower price, since utility derived from additional unit is lower. Therefore the consumer buys more only at lower price. (ii) Income Effect: Real income is that income which is measured in terms of goods and services. A change in quantity demanded is a result of change in real income caused by change in price of the commodity is called income effect. When price of	2+2+2

a commodity falls, less money has to be spent on purchase of the commodity. The purchasing power of the consumer increases.Thus with saved income the consumer can buy more quantity of that good. A fall in price increases the real income of a consumer and can buy more units with given income.

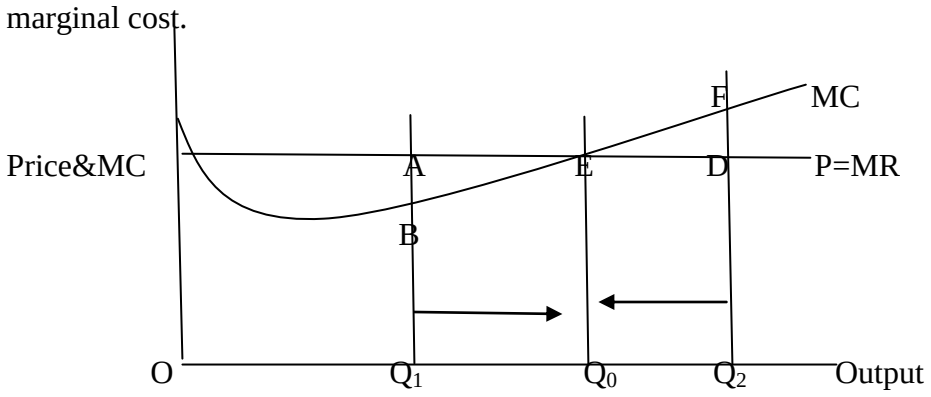
(iii) Substitution effect: It refers to the substitution of one commodity in place of other commodity when it became relatively cheaper. Hen the price of a commodity rises, consumer buys more of substitute goods and less of the good whose price has risen, this shows an inverse relationship between price and quantity demanded.

11. In perfect competition Market Price is constant so that it is equal to Marginal revenue. Market price becomes addition to total revenue from an additional unit of output produced. 6

If Market price is more than the marginal cost, addition to total revenue is more the addition to total cost when firm increases the output. Firms can increase profits by increasing output. Firm cannot be at equilibrium because it wants to increase the output.

If market price is less than the marginal cost, addition to total cost is more than the addition to total revenue by increasing the output. Profit falls by increasing the output. On the other hand if the firm reduces the output, decrease in total cost is more than the decrease in revenue. Firm can increase the profits by reducing the output Firm cannot be at equilibrium because it wants to reduce the output.

This means that firm can make maximum profit when market price is equal to marginal cost and firm is at equilibrium when it produces a level of output when market price is equal to marginal cost.



At Q_1 output MP is more than the MC. Firm increases Output. By increasing the output to Q0Increase in Total Revenue Q_1Q_0EA is more than the increase in total cost Q_1Q_0EB. Firm's gross profit will increase by an area ABE.

At Q_2 level of output MC is more than MP. Firm will reduce the level of output. By reducing the output, decrease in total cost Q_0Q_2FE is more than decrease in total revenue Q_0Q_2DE. Firm can increase the profit by reducing the output by an area EDF.
At output Q_0 MC=MP, firm gets maximum profits and is at equilibrium.

OR

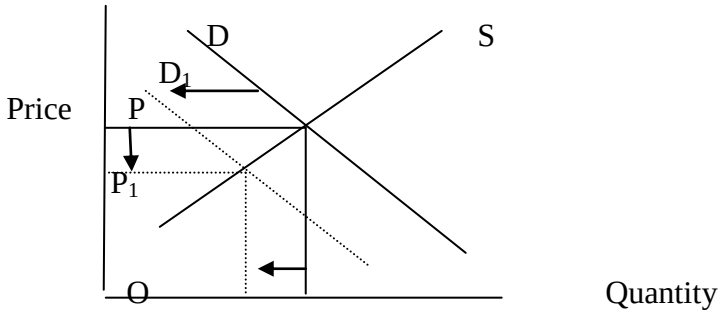
The law of variable proportion states that as more and more of variable factor is combined with the fixed factor, marginal product initially rises, reaches maximum and then falls finally it becomes negative.

Fixed Factor (Land)	Variable Factor (units of labour)	Total Product	Marginal Product
1 acre	0	0	----
1 acre	1	4	4
1 acre	2	10	6
1 acre	3	18	8
1 acre	4	24	6
1 acre	5	28	4
1 acre	6	30	2
1 acre	7	30	0
1 acre	8	28	-2

There are three stages in the law of variable proportion"
Stage 1 Total product increases at an increasing rate, Marginal product rises. This stage ends when marginal product is maximum. This stage is called increasing returns to a factor.
Stage 2: Diminishing returns to a factor: Total product increases at a diminishing rate. Marginal product falls but positive. When TP is maximum, MP=zero.
Stage 3: Negative returns: TP falls, Mp becomes negative.

12. 6

Complementary goods are those goods demanded together to satisfy one want. If good X and goody are complementary goods, demand for good X will decrease when price of good Y increases. Demand curve of goody X shifts to left. Equilibrium market price of good X will fall quantity exchanged in the market will decrease.



a. Substitute goods are those goods demanded one in place of other and provides same level of satisfaction. If good X and good Y are substitutes, when price of good Y increases consumers will shift over to good X. Demand for good X will increase. Demand curve of good X shift to right. Equilibrium market price of good X will increase and more units of good X will be exchanged in the market.
(Diagram)

SECTION B

13.	0.5	1
14.	When there is excess demand Central Bank should decrease the Margin Requirement.	1
15.	Currency component and deposit component.	1
16.	Lower than repo rate. OR There is a direct relationship between investment multiplier and marginal propensity to consume.	1
17.	Fiscal deficit is the sum of borrowings and other liabilities . Fiscal deficit = Total Expenditure-Total Receipts other than borrowings and other liabilities. Implications: It determines total borrowing requirements of the government It increases the liability of the government It increases foreign dependence.	1+2
18.	The budgetary policy reduces inequalities of income through redistribution of income and wealth in the economy. To achieve this objective, government uses fiscal instruments of taxation and subsidies. By imposing taxes on rich and giving subsidies to the poor, the government redistributes income in favour of poorer sections of the society. Higher rate of taxation on higher incomes and lower rate of taxation on lower incomes reduces the gulf between income of rich and poor. OR The government tries to prevent business fluctuations and maintain price and employment stability. Economic stability stimulates inducement to invest and increases the rate of growth and development	3
19.	Gross domestic product when expressed in physical quantities called real GDP. It is measured on the basis of base year price. When expressed in terms of the current market value of these quantities, it is called nominal GDP. (b) Nominal Income = Real income x price index/100 = 200x135/100 = Rs.270 crore	4
20.	**Fiscal Policy measures to correct Deficient Demand**: Fiscal policy is the taxation and expenditure policy of the government. When there is deficient demand, aggregate demand should increase to the extent of deflationary gap. For this two fiscal policy measures are suggested. i. Increasing the level of government expenditure:- An increasing the government expenditure equal to the amount of deflationary gap can push up the AD. Economy can restore the full employment equilibrium ii. Reduction of Taxation: A reduction in taxes will increase the disposable income of the people. As a result consumption demand increased to the extent of MPC times of increase in disposable income. This increases AD. Thus, a mix of increasing government expenditure and reduction of taxation can solve the problem of deficient demand. OR S=-200+0.25Y	4

	At equilibrium savings are equal to investment. S=-200+0.25x2000 S=300 I=300 Autonomous consumption = 200 Investment Multiplier = 1/0.25 = 4 As the banker to banks, the central bank holds a part of the cash reserves of banks.	
21.	As the banker to banks, the central bank holds a part of the cash reserves of banks. It lends them short term funds and provides them with centralized clearing and remittance facilities. The central bank supervises, regulates and controls the commercial banks. The regulation of the bank may be related to their licensing, branch expansion, liquidity of assets etc.	4
22.	GDP mp = Compensation of employees + Rent+ Interest+ profit+ depreciation+ Net Indirect Tax 1600+300+400+550+ (700+50 – 650) +300 + Rs.3250cr NFIA = GNPmp – GDPmp = 3000+300 – 3250 = Rs.50cr Factor Income from abroad = NFIA + factor income to abroad = 50+120 = Rs.170cr. Gross Domestic Product at Market price = Rs.3250cr Factor Income from abroad = Rs.170cr.	6
23.	The extent to which the current aggregate demand becomes higher than the aggregate demand required for full employment is termed as inflationary gap. Excess demand occurs when aggregate demand is more than aggregate supply. It leads to inflation. In the diagram F is the full employment equilibrium. The difference between F and G is the inflationary gap. (Diagram) Bank rate is the rate of interest at which the central bank lends to commercial bank. In a situation of excess demand the RBI increases the bank rate or interest rate which makes the credit dear. It discourages people to borrow money from the banks. People prefer to deposit in banks. Thus their purchasing power goes down which reduces aggregate demand. **OR** Y = Rs.80cr C = Rs.64cr S =Y-C = 80-64=Rs.16cr. APS = S/Y = 16/80=0.20 APC = C/Y = 78/100= 0.78 MPC = $\Delta C/\Delta Y$ = 14/20 = 0.70	6
24.	No, devaluation and depreciation of currency is not one and the same thing.	3+3

	Devaluation is fall in the value of domestic currency in relation to foreign currency as planned by the central bank. Depreciation of domestic currency occurs when the value of domestic currency decreases under flexible exchange rate system, as determined by the market forces of demand and supply. Export of a country tends to rise when its currency is either devalued or depreciated. (b) Foreign Investment in India will be recorded in the credit side of the capital account of the balance of payment. Capital account records the capital transactions such as loans and investments between India and the rest of the world, which causes a change in the assets and liabilities status of the residents of the country or the government. Foreign Investment is one of the components of capital account. All transactions causing flow of foreign exchange in the country are recorded in the credit side.	