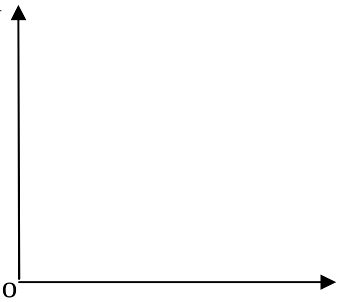
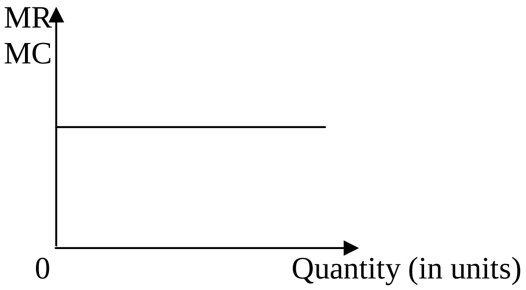
Economics Set II (2015-16)

Answer Key

SECTION-A

Q.No.	Value points to answers	Marks Allocation
1.	$MC_n = TVC_n - TVC_{n-1}$ $MC_{16} = TVC_{16} - TVC_{15}$ = 3,500 – 3,000 = ₹500	(1/2) (1/2)
2.	Demand for desert coolers will increase	(1)
3.	ii) Marginal Utility is zero	(1)
4.	ii) Resources are not equally efficient for the production of the two goods.	(1)
5.	a) What to produce and in what quantity? b) How to produce? c) For Whom to produce? (Any Two)	(1/2) + (1/2)
6.	Yes, we do agree with the given statement that the supply curve is the rising portion of marginal cost curve over and above the minimum of Average Variable cost curve, since no rational producer/seller would like to supply his output to the market if he is unable to recover his per unit variable cost as it would lead to losses between the range of minimum of marginal cost and minimum of average variable cost.	(3)
7.	Black marketing may be termed as a direct consequence of price-ceiling, as it implies a situation whereby the commodity under the government's control policy is illegally sold at a higher price than the one fixed by the government, it may primarily arise due to the presence of consumers who may be willing to pay higher price for the commodity than to go without it. **OR** Buffer stock is an important tool in the hands of government to ensure price floor/minimum support price. If in case the market price is lower than what the government feels should be given to the farmers/producers it would purchase the commodity at higher price from the farmers/producers so as to maintain stock of the commodity with itself to be released in case of shortage of the commodity in future.	(3) (3)
8.	Sources of restricted entry under monopoly, may be: i) Government License. ii) Patents, Trademarks & copyrights. iii) Ownership of scarce resource. (Any Two)	(1 ½ each)
9.	i) P x Q = TE 5 x 20 = 100 7 x 16 = 112 Since the price & total expenditure carry positive relation Ed<1, relatively	(2)

	inelastic demand. ii) $Ed = \frac{\text{Change in Quantity Demanded}}{\text{Change in Price}} \times \frac{\text{Original Price}}{\text{Original Quantity}}$ (Absolute values taken) $= (4/2) \times (5/20)$ $= 0.5$ (Ed<1, relatively inelastic demand.)	(2)
10.	Higher indifference curve represents higher level of satisfaction, in other words any combination that lie on a higher indifference curve i.e. away from origin represents higher level of satisfaction. Good Y  Combination B>A ($OX_2,OY_1 > OX_1,OY_1$) O Good X The underlying assumption here is the assumption of monotonic preference which represents that a consumer will prefer a combination which contains more of at least one and no less of the other. Or If MUx/Px>MUy/Py, then it means that satisfaction of the consumer derives from spending a rupee on Good X greater than the satisfaction derived from spending a rupee on Good Y. The consumer will reallocate his income by substituting Good X for Good Y. As the consumption of Good X increases the marginal utility derived from it goes on diminishing and reverse proposition occurs for Good Y, this process will continue till MUx/Px becomes equal to MUy/Py.	(2+1+1) (4)
11.	Marginal Opportunity Cost (MOC) of a given commodity along a PPC is defined as the amount of sacrifice of a commodity so as to gain one additional unit of the other commodity. MOC can also be termed as Marginal Rate of Transformation i.e. the ratio of number of units of a Good sacrificed to produce an additional unit of the other Good. Schedule	(2) (2)
12(a).	Price rigidity is the price of the product fixed after deliberations and negotiations by the oligopolistic firms, to which they generally stick with a view to avoid any sort of price war.	(2)
12(b).	Firm's equilibrium is that level of output where its profits are maximized Conditions of Firm's Equilibrium: i) Marginal Revenue must be equal to Marginal Cost. ii) Marginal Cost must be rising. The conditions implies that the slope of rising Marginal Cost Curve is equal to the slope of Marginal Revenue curve.	(2)

<table>
<tr><td></td><td>

Implication of the conditions lies in the fact that beyond the equilibrium point MC would become greater than MR, i.e. for each additional unit sold beyond output OQ the cost of producing that unit will be more than the revenue generated by the unit.</td><td>(2)</td></tr>
<tr><td>13(a).</td><td>Stock refers to the total quantity of a commodity available with the seller at any given time. Whereas, Supply refers to that quantity of a commodity which a seller is willing to sell at different prices during a given period of time.</td><td></td></tr>
<tr><td>13(b).</td><td>
<table>
<tr><th>Units Produced</th><th>TPP (in₹)</th><th>APP (in₹)</th><th>MPP (in₹)</th></tr>
<tr><td>0</td><td>0</td><td>-</td><td>-</td></tr>
<tr><td>1</td><td>100</td><td>100</td><td>100</td></tr>
<tr><td>2</td><td>240</td><td>120</td><td>140</td></tr>
<tr><td>3</td><td>420</td><td>140</td><td>180</td></tr>
<tr><td>4</td><td>480</td><td>120</td><td>60</td></tr>
</table>
</td><td>(8 x ½ = 4)</td></tr>
<tr><td>14.</td><td>i) We know that the equilibrium price and quantity are achieved at;

$$Q_d = Q_s$$
$$200 - p = 50 + 2p$$
$$(-)\ 3p = (-)\ 150$$

Therefore, Equilibrium Price $p = 50$
And, Equilibrium Quantity $q = 200 - 50 = 150$ units

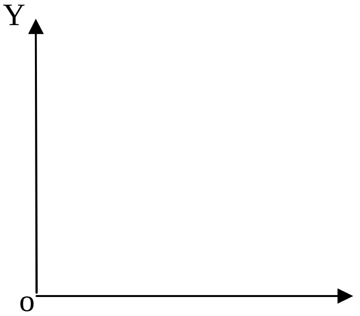
ii) If the price of factor of production has changed, then under the new conditions;

$$Q_d = Q_s$$
$$200 - p = 80 + 2p$$
$$(-)\ 3p = (-)\ 120$$

Therefore, Equilibrium Price $p = 40$
And, Equilibrium Quantity $q = 200 - 40 = 160$ units

Thus as the equilibrium price is decreasing the equilibrium quantity is increased.</td><td>(3)

(3)</td></tr>
<tr><td>15.</td><td>In the Hicksian/ Indifference Curve analysis, a consumer attains equilibrium when</td><td>3</td></tr>
</table>

	i) Budget line is tangential to the Indifference curve at a unique combination of two goods. i.e, Slope of Indifference Curve = Slope of Budget line or $MRS_{xy} =$ (-) P_x / P_y ii) Indifference Curve is strictly convex to origin at the point of tangency i.e., MRS_{xy} must be diminishing.  Explanation to the diagram	1 2
	SECTION-B	1
16.	(iii) Both (i)and (ii)	1
17.	(iii)Ministry of finance	1
18.	(ii) Real flow	1
19.	(iv) None of the above. Budgetary Deficit = Revenue expenditure+Capital Expenditure-(Revenue receipts+ Capital receipts) = 25000+ 35000-(20000+3000) =₹ 50,000 crores	1
20.	(iii) Borrowing by a government represents a situation of fiscal deficit.	1
21.	*Devaluation is the fall in the value of domestic currency in relation to foreign currency as planned by the government in a situation when exchange rate is not determined by the forces of demand & supply but is fixed by the government of different countries **whereas** Depreciation is the fall in the value of domestic currency in relation to foreign currency in a situation when exchange rate is determined by the forces of demand & supply in the international money market. As a general phenomena, any depreciation/devaluation of currency may result into increase in exports of the goods and services from the country since it would increase the global competiveness of the goods.	1 1 1
22.	Yes all the given values are correct S= -50+0.2Y S= -50+.02(2000) =-50 +400	1

	= ₹350 crores At equilibrium level of income: Y = C + S 2,000 = C + 350 C = 2000 – 350 = 1,650(in ₹ crores) MPC + MPS = 1 MPC + 0.2 = 1 MPC = 1-0.2 = 0.8 OR Since the sum of MPC and MPS is unity any increase in Marginal Propensity to Save (MPS) would directly lead to decrease in Marginal Propensity to Consume (MPC). This means that may lead to lesser proportion of the additional income going to consumption which is a vital factor of Aggregate Demand/Expenditure. This may further lead to fall in equilibrium level of income in the economy.	 1 1 3
23.	As per the S-I approach equilibrium if achieved where ex-ante Savings are equal to ex-ante investments. Savings and investments indicate leakages and injections respectively, thus at equilibrium the leakages and injections are equal to each other.	3
24.	NNP_{fc} = GDP_{mp} – Consumption of fixed capital – Net factor income to abroad – Net indirect taxes 2500 = 4000-CFC -450 -400 2500 = 3150 – CFC CFC = 650 (in ₹ crores)	1 1 1 1
25.	Transactions by a central bank that cause changes in its official reserves. These are usually purchases or sales of its own currency in the exchange market in exchange for foreign currencies or other foreign-currency-denominated assets. They may be Autonomous Receipts and Autonomous Payments, disequilibrium between which may occur as deficit/surplus in balance of payment.	
26.	Components of Expenditure method:- (a) Private Final Consumption Expenditure (b) Government Final Consumption Expenditure (c) Investment Expenditure (d) Net Exports Or Two main difference between GDP at current prices and at constant price are: 1. GDP at current prices are measured at Current Year's Prices whereas GDP at constant prices are measured at base year's prices. 2. GDP at current prices may increase even if there is no flow of goods and services whereas GDP at constant prices will only increase when there is an increase in the flow of goods and services.	(1x4) 2 2
27.	The term fiscal deficit is the difference between the government's total	

<table>
<tr><td></td><td>expenditure and its total receipts (excluding borrowing).
Such borrowings are generally financed by issuing new currency which may lead to inflation, however, if the borrowings are for the infrastructural developmental purposes this may lead to capacity building and may not be inflationary.</td><td>4</td></tr>
<tr><td>28.</td><td>C = 20 + 0.6Y.

<table><tr><td>Y</td><td>C</td><td>S</td></tr><tr><td>100</td><td>80</td><td>20</td></tr><tr><td>200</td><td>140</td><td>70</td></tr><tr><td>300</td><td>200</td><td>100</td></tr></table>
Properly Labeled Diagram</td><td>3

3</td></tr>
<tr><td>29.</td><td>Repo rate is the rate of interest at central bank lends money to commercial banks for a short term. The central bank fixes the Repo Rate and it plays the role of an indicator of lending rate and deposit rate fixation by the banks.
Under inflationary conditions central bank increases the Repo Rate.

Marginal requirement refers to the difference between market value of the security offered for loans and the amount of loans offered by the commercial banks. The central bank fixes the margin requirements and under deflationary conditions central bank reduces the margin requirements.</td><td>3

3</td></tr>
<tr><td>30.</td><td>Domestic Income = xi + ii + iv – vi + vii – x – viii
= 2200 + 2500 + 1190 – 100 – 420 – 145 – 470
= 4755 (in ₹ crores)

Net National Disposable Income = National Income + Net Indirect Taxes + Net Current Transfers from ROW
=Domestic Income - v + viii+ ix
= 4755 -125+470+350
= 5450 (in ₹ crores)

OR
Four limitations of using GDP as a measure/index of welfare of a Country are:
I. Distribution of GDP
II. Composition of GDP
III. Non-Monetary Exchanges
IV. Externalities.</td><td>1
1
1

1
1
1

(1 ½ x 4)</td></tr>
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