CBSE
Class XII Economics
Sample Paper – 4

SECTION A

Answer 1

The correct answer is (a). Break-even point is said to take place when the firm can cover all the costs. At this point, TR is equal to TC.

(OR)

The correct answer is (a). Producer will not feasible to exist in the market, when MR is zero or MR is less than MC.

Producer will not be equilibrium, when MR is more than MC as it will be possible to increase profits by producing more. So equality between MR= MC is a better situation.

Answer 2

The correct answer is (a). Under perfect competition, the demand curve of a firm is a horizontal straight line parallel to the x-axis. This indicates perfectly elastic demand under perfect competition.

Answer 3

Oligopoly refers to a form of market in which there are only few giant firms against a large number of firms. There is a high degree of interdependence among the firms.

Answer 4

The Indian government believes in fixing the 'support price' for crops because the prices of some crops fall below the certain level which is not fair for the farmers to earn their livelihood.

(OR)

The minimum support price is fixed by the government to protect and safeguard the interest of the farmers. Therefore, the market price must be equal to greater than the support price fixed by the government.

Answer 5

$$\text{Price elasticity of demand} = \frac{\text{Percentage change in demand}}{\text{Percentage change in price}}$$

$$(-0.5) = \frac{10}{\text{Percentage change in price}}$$

$$\text{Percentage change in price} = (-)20\%$$

$$\therefore \text{ Price falls by } 20\%$$

(OR)

Normal goods	Inferior goods
Normal goods refer to those goods that share a positive relationship with income.	Inferior goods refer to those goods that share an inverse relationship with income.
That is as the income increases, demand for normal goods increases. On the other hand, as the income falls, the demand for normal goods falls.	That is as against normal goods, as the income increases, the demand for inferior goods falls and vice-versa.
For example, clothing is a normal good. As income increases, the demand for clothing increases.	For example, coarse cereals are inferior goods. As the income increases, the consumer reduces its demand for coarse cereals and instead shifts its demand towards superior quality cereals.

Answer 6

Fixed Costs	Variable Costs
Fixed costs refer to the costs which remain constant irrespective of the level of output.	Variable costs refer to the costs which vary with the level of output.
They are never zero; even at zero level of output, fixed costs have to be incurred.	They are zero at zero level of output. They rise with the rise in output and fall with the fall in the level of output.
Example: Costs of plant and machinery	Example: Cost of raw material

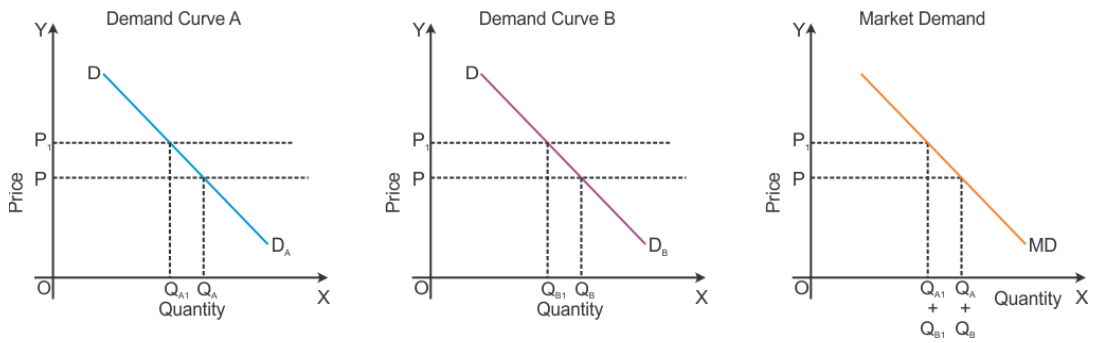
Answer 7

Market demand for a commodity refers to the total demand for the commodity by all the individual consumers in the market.

The market demand curve shows the different total quantities of the commodity which are demanded by all consumers in the market at different prices.

The market demand curve is derived from the individual demand curve by horizontally summing the various individual demand curves.

This can be understood with the help of the following diagram:



Suppose for a commodity in the market, there are two consumers A and B. D_A is the demand curve for consumer A and D_B is the demand curve for consumer B. At P_0 price, the quantity demanded of the commodity by the two consumers is Q_A and Q_B. Accordingly, the market demand and the summation of the individual demand curve is $Q_A + Q_B$. As the price rises to P_1, the individual demand falls to Q_{A1} and Q_{B1}. The market demand is $Q_{A1} + Q_{B1}$. By joining the two points as obtained for the market demand, we get the market demand curve M_D.

(OR)

Factors affecting the demand curve to shift rightward:

- Increase in income in the case of normal goods: When income of the consumer increases the demand for normal goods tend to increase. This is a situation the demand curve shifts right ward. For example: Demand for Ghee increases with an increase in income.
- Fall in income in the case of inferior goods: When income of the consumer falls, the consumption of inferior goods increases. For example: Demand for oil increases with a fall in income.
- Increase in price of the substitute good: Increase in the price of one good causes an increase in the demand for another. For example: Demand for ink pen increases with an increase in the price of refill pen
- Fall in the price of the complementary goods: A fall in the price of one good causes an increase in demand for another good. For example: Demand for pen increases with a fall in the price of ink.
- Change in taste and preferences of the consumers: When taste and preferences of the consumers changes in favour of the goods due to change in trend and fashion. This implies that the consumers purchase more of a good even when its price remains the same. This is a situation where there is increase in demand i.e. rightward shift in demand curve.

Answer 8

$$\text{Price elasticity of supply} = \frac{\text{Percentage change in quantity supplied}}{\text{Percentage change in supply}}$$

Now,

$$\text{Percentage change in quantity supplied} = \frac{550-500}{500} \times 100 = 10$$

So,

$$\text{Price elasticity of supply} = \frac{10}{10} = 1$$

Answer 9

a. The production possibility curve refers to the curve which presents the alternative combinations of production possibilities of two goods which can be produced with the given resources and the given technology.

b. The slope of the production possibility curve is the marginal opportunity cost or the marginal rate of transformation. It indicates the units of one good which must be sacrificed for each additional unit of the other good.

The slope of PPC is given by $\frac{\Delta Y}{\Delta X}$.

The PPC is concave to the origin because of a rising marginal rate of transformation, or in other words, the rising slope of PPC. As the number of units produced of one good rises, for each additional unit of the good, greater units of the other good must be sacrificed. In other words, the opportunity cost of producing the good rises. This gives rise to the concave shape of PPC.

(OR)

Marginal rate of transformation is the ratio of number of units sacrificed to gain an additional unit of another good.

$$\text{MRT} = \frac{\Delta Y}{\Delta X} = \frac{\text{Amount of good Y sacrified}}{\text{Amount of good X gained}}$$

For example, assuming that resources and technology remain constant, an economy is producing Good X and Good Y. Different combinations of production of Good X and Good Y are given in the product possibility schedule:

Production Possibilities	**Good X**	**Good Y**	$\text{MRT} = \frac{\Delta Y}{\Delta X}$
I	0	30	-

II	1	27	**−3**
III	2	21	**−6**
IV	3	12	**−9**
V	4	0	**−12**

In the beginning, at the production point II, where 1 unit of Good X and 27 units of Good Y are produced. To produce an additional unit of Good X, 3 units of Good Y must be sacrificed.

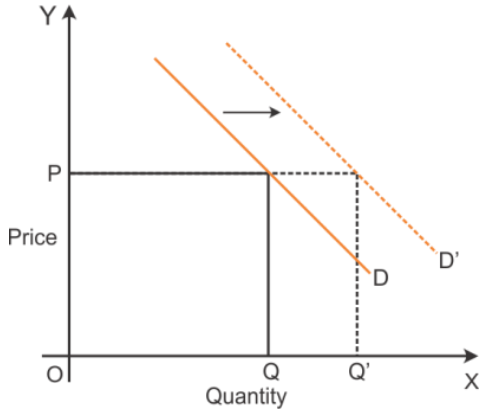
Here, the marginal rate of transformation (MRT) is

$$\text{MRT} = \frac{\Delta Y}{\Delta X} = \frac{\text{Amount of good y sacrifed}}{\text{Amount of good x gained}} = \frac{27-30}{2-1} = -3$$

Thus, MRT or the opportunity cost of getting an additional unit of Good X is 3 units of Good Y.

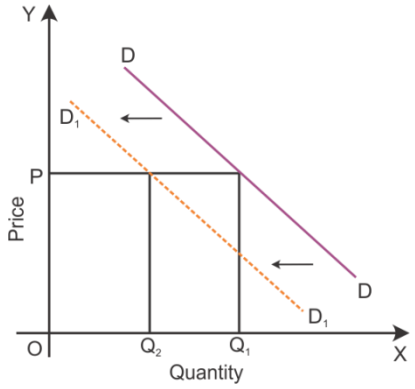
Answer 10

a. Rise in income: With a rise in income of the consumer, the demand for normal good increases. This can be understood with the help of the following diagram:



According to the diagram, DD is the initial demand curve. At OP price, OQ_1 quantity is demanded. If the income of the consumer rises, the demand curve shifts parallelly rightwards to D_1D_1. Here, at the same price, the quantity demanded of the commodity rises to OQ_2.

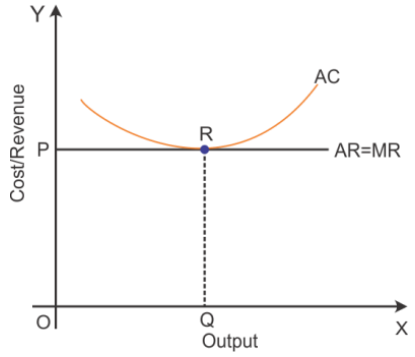
b. ***Change in taste and preferences of consumers away from the commodity***: With change in taste and preferences of consumers away from the commodity, the quantity demanded of the commodity falls. This can be understood with the help of the following diagram:



According to the diagram, DD is the initial demand curve. At OP price, OQ_1 quantity is demanded. If the taste and preferences of the consumer moves away, the demand curve shifts parallelly leftwards to D_1D_1. Here, at the same price, the quantity demanded of the commodity falls to OQ_2.

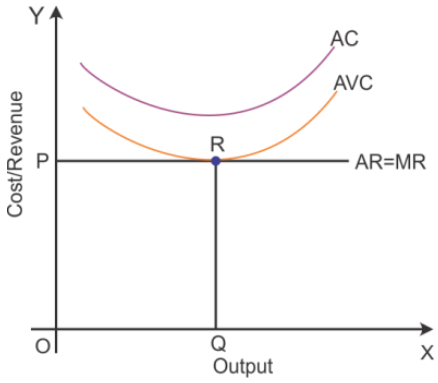
Answer 11

a. ***Break-even point***: A firm is said to be at the break-even point when it is just able to cover all its costs, i.e. when price is equal to average cost.



According to the diagram, the break-even point is at Point R where price (OP) is equal to average cost (OQ).

b. ***Shut-down point***: A firm is said to be at the shut-down point when it is just able to cover only the variable costs. At this point, price is equal to average variable cost. As the firm is not able to cover the fixed cost, it is incurring loss equal to fixed costs. However, the firm will continue production till it can cover the fixed costs.



According to the diagram, the break-even point is at Point R where price (OP) is equal to average variable cost (OQ).

Answer 12

a. ***Large number of buyers and sellers***: Under a perfect competition market, there are a large number of buyers and sellers such that each individual buyer or each individual seller constitutes only a small proportion of the total market. Consequently, no individual firm or individual buyer can influence the price in the market by altering the supply or demand of the commodity. This implies that in a perfect competition market, the price remains constant as determined by the industry. An individual firm is only a price taker.
   Implications of the feature:
   i. Firms remain a price taker.
   ii. Firms face a perfectly elastic demand curve.

b. ***Homogeneous products***: Under perfect competition, the products sold by firms are completely homogeneous. In other words, they are exactly identical to each other in terms of size, shape and colour. Accordingly, the products of various firms are perfect substitutes of each other. Also, there is no need for any kind of selling costs or advertising costs.
   The presence of homogeneous products has the following implications:
   i. No single firm can control the market prices. There prevails uniform market price.
   ii. There is absolutely zero product differentiation.
   iii. Because of homogeneity of products, the market price which prevails is the minimum possible.

(OR)

a. ***No barriers in the way of firms leaving or joining industry in a perfectly competitive market:*** The new firms are free to enter and the existing firms are free to exit in a perfectly competitive market. This situation is possible only in the long period because the new firms will join the industry with the attraction of extra-normal profit. There will be an increase in the market supply, and hence, the price will decrease. Thereby the extra normal profit will decrease. Further, if the industry incurs extra normal loss, some existing firms will tend to leave the industry which will lead to a decline in market supply and market price. The industry will not incur extra normal loss. This is how the firms in the long run earn neither extra profit nor extra loss in the industry. Thus, firms were able to earn normal profit which prevents a firm from exiting or a new firm from entering the industry.

b. ***Monopolistic competition demand curve is much flatter than monopoly's curve:*** The demand curve for monopoly and monopolistic competition curve slope downwards from left to right. But the monopolistic competition demand curve is much flatter than monopoly's curve. If the demand curve is more flat then it implies more elastic. The degree of elasticity is high in the case of monopolistic competition than monopoly as

they deal with wide range of products with close substitutes. While the monopoly deals with a product of no substitutes.

SECTION B

Answer 13

Revenue deficit in a budget refers to a situation where the revenue receipts of the government are less than the revenue expenditure during a fiscal year.

Answer 14

The correct answer is (d). Capital expenditure refers to expenditures of the government as a result of which there is either a creation of liability or a reduction in assets of the government.

Repayment of loans is a capital expenditure as it leads to reductions in assets of the government. On the other hand, subsidies, expenditure on salaries to government staff and expenditure on tax collection are revenue expenditure.

(OR)

Tax receipts are the revenue receipts which do not create any liability as it is one sided compulsory payment made towards government. And also it does not create reduction in the asset in the assets of the government.

Answer 15

One reason that gives rise to excess demand is the increase in public expenditure on goods and services.

Answer 16

Given that

$$\text{MPC} = 0.5$$

The value of multiplier is

$$\text{Multiplier (k)} = \frac{1}{1 - \text{MPC}} = \frac{1}{1 - 0.5} = 2$$

Answer 17

Money supply is the total amount of money which is held by individuals and business firms at a certain point of time. However, it does not include the cash held by the government or the banking system. Money supply is a stock concept as it is measured at a point of time.

RBI has defined four measures of money supply—M1, M2, M3 and M4. Of these, M1 is the most liquid measure.

M1 = Currency held by the public + Demand deposits of commercial banks + Other deposits with RBI

i. ***Currency held by the public***: It comprises the currency notes and coins as held by the public. Currency money is fiat money or legal tender money. That is, it is backed by the government and is legally accepted as the medium of payment.
ii. **Demand deposits of commercial banks:** It refers to the demand deposits of the public held by commercial banks. Such deposits are payable on demand. They are treated at par with currency. It must however be noted that it does not include interbank deposits of commercial banks.
iii. ***Other deposits with RBI***: It comprises the deposits of foreign banks, World Bank, public financial institutions etc. held by the RBI. However, it does not include the deposits of Indian commercial banks and the Indian government.

(OR)

a. The common device to measure goods is completely absent in this property valuation. Generally, this type of problem faced under barter system. However, the monetary system of exchange provides a common unit of value. So this problem does not exist in a monetary system of exchange.
b. Yes, stored wealth is a source of future investment. This is because the convenient storage of wealth in terms of money enabled the people to save money. This saving habit increases the investment potential and results in growth and development of an economy. But if the saved resources have not efficiently used in the productive activities, it may affect the growth of GDP.

Answer 18

Legal reserve requirements, as defined by the RBI, refer to the minimum reserves which must be held by commercial banks. Reserve requirements are of the following two types:

i. ***Cash reserve ratio***: CRR refers to the minimum proportion of net time and demand liabilities which commercial banks must hold with the Central Bank. An increase in CRR implies a reduction in the excess reserves held by commercial banks, which in turn implies a reduction in their credit creation capacity.
ii. ***Statutory liquidity ratio***: SLR refers to the minimum proportion of net time and demand liabilities which commercial banks must hold with themselves in the form of liquid assets. An increase in the SLR implies a reduction in the proportion of deposits which can be used by commercial banks for providing credit.

Answer 19

We know,

$$\text{Multiplier} = \frac{1}{1 - \text{MPC}} = \frac{1}{1 - 0.80} = 5$$

Now,

$$\text{Multiplier} = \frac{\Delta Y}{\Delta I}$$

$$5 = \frac{\Delta Y}{300}$$

$$\Delta Y = 1,500$$

Also,

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

$$0.80 = \frac{\Delta C}{1,500}$$

$$\Delta C = 1,200$$

(OR)

a. When MPC = 0, the value of multiplier is:

$$\text{Multiplier}(k) = \frac{1}{1 - \text{MPC}} = \frac{1}{1 - c}$$

$$= \frac{1}{1 - 0} = 1$$

b. When I > S, it indicates that AD > AS. This will lead to an increase in the level of output. However, it will raise only up to the level of full employment level.

Answer 20

Operating surplus = GDP at market price – Depreciation – Net indirect taxes – Compensation of employees – Mixed income of self-employed
= 1,500 – 30 – 100 – 100 – 300
= Rs 970 crore

Answer 21

Revenue receipts refer to receipts of the government as a result of which there is neither any creation of liability nor any reduction in assets of the government.

Two main sources of revenue receipts of the government:

i. ***Tax receipts***: It refers to the receipts from taxes and other such duties as imposed by the government. Taxes can further be classified as follows:

a. ***Direct taxes***: Direct taxes refer to taxes which are imposed directly on the individual and companies. The burden of such taxes cannot be passed onto others. Examples: Income tax, corporation tax

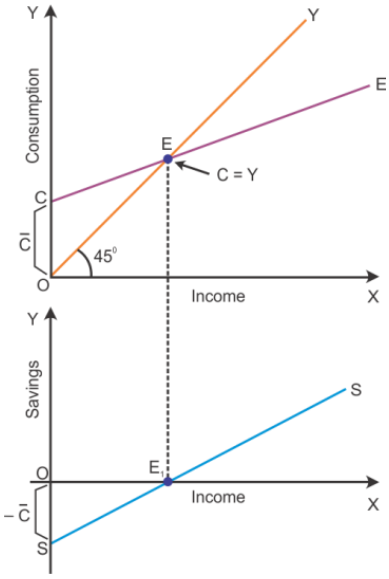
b. ***Indirect taxes*:** Indirect taxes are taxes which are imposed on the consumption of goods and services. The burden of such taxes can be shifted to others. Examples: Sales tax, service tax

ii. ***Non-tax receipts***: Non-tax receipts refer to various receipts of the government from sources other than taxes. Some major sources of non-tax revenue receipts are interests on loans, fees and fines, licence fees, escheats, forfeitures, gifts and grants etc.

The system of taxation and subsidies by the government can be used to reduce the inequality of income in the economy. This can be done by imposing higher taxes on high-income groups and providing subsidies to low-income groups.

Answer 22

The consumption curve can be derived from the saving curve with the help of the following diagram.



At zero level of income, savings are negative. Accordingly, there is autonomous consumption equal to OC. Point C becomes the start point of the consumption curve. At E1 level of income, savings are zero. Corresponding to this, consumption is equal to income. It is represented by Point E on the consumption curve.

By joining Point C and Point E and extending further, we get the consumption curve.

(OR)

Excess demand occurs in a situation when the aggregate demand is more than the aggregate supply corresponding to full employment. It leads to reduction in inventories and inflation in the economy. This situation is considered an inflationary gap—the difference between aggregate demand beyond full employment and aggregate demand at full employment.

Cash Reserve Ratio (CRR) is the necessary minimum percentage of a bank's total deposits which is to be kept with the Central Bank. Commercial banks need to maintain with the

Central Bank a certain percentage of their deposits in the form of cash reserves. The Central Bank can vary CRR between 3% and 15%. When a bank holds a large portion of deposits as CRR, it reduces the provision of credits to the public. This leads to a decline in the demand for loans and consumption expenditure. Thus, the aggregate demand reduces and the economy attains equilibrium.

Answer 23

a.

Autonomous Items	***Accommodating Items***
Autonomous items in BOP refer to economic transactions which arise out of profit motive or other such economic motive.	Accommodating items in BOP refer to transactions which arise out of the motive to cover a deficit or a surplus in BOP.
Such transactions are undertaken independently of the status of BOP.	Such transactions are dependent on the status of BOP and are undertaken with the motive to cover a deficit or a surplus in BOP.
These transactions can take place in both current account and capital account of BOP.	These transactions take place only in capital account of BOP.
These are also called 'above the line items'.	These are also called 'below the line items'.

b. Deficit or surplus in BOP is determined by autonomous transactions. BOP is said to be in surplus when the inflow of foreign exchange because of autonomous transactions is more than the outflow of foreign exchange because of autonomous transactions.

Answer 24

GNP at market price = Private final consumption expenditure + Government final consumption expenditure + (Net domestic fixed capital formation + Closing stock − Opening stock + Consumption of fixed capital) − Net imports − Net factor income to abroad

= 600 + 100 + (50 + 10 − 10 + 30) − 30 − (−20)

= Rs 770 crore