Paper Details: 3A00142-F.Y.B.A. (Sem-II) (Choice Base) / 96027 – Economics (Optional).
Date: 09/05/2019
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QP Code 33946

Model Answer

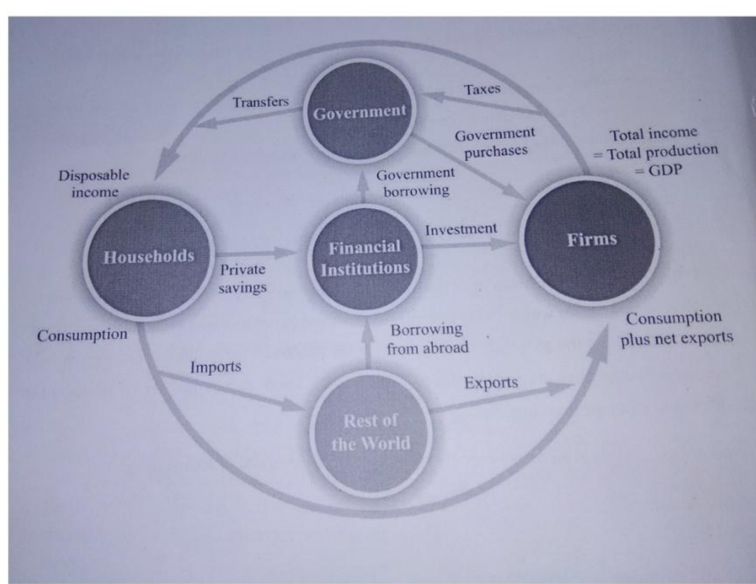
1. **Attempt any two of the following.**

a) Explain circular flow of income in an open economy.

Ans: An open economy is an economy that trades with other economies. The players in an open economy can be divided into four categories.

a) Households
b) Firms
c) Government
d) Rest of the world with whom this country engages in trade in goods and services.

Figure and its explanation



b) Explain the components of GDP.

Ans: GDP is the money value of all final goods and services produced with in the economy in a given period of time.

Components of GDP

GDP = C + I + G + (X-M)

1) Consumption Expenditure (C)
2) Investment Expenditure (I)

3) Government Expenditure (G)
4) Net Export (Exports – Imports)

c) Country A produces two goods X and Y. Following table gives data regarding quantities of goods produced and their prices in the years 2013 and 2014.

Year	(In Kgs)		(In Rs)	
	Quantities of 'X'	Quantities of 'Y'	Price of 'X'	Price of 'Y'
2013	8,000	10,000	50	32
2014	10,000	13,000	60	40

Calculate

i) GDP at current prices (Nominal GDP) in 2013 and 2014.
ii) GDP at constant prices (Real GDP) for 2014.
iii) GDP growth rate at current prices and constant prices.

i) Ans:

GDP at current prices for 2013 = (Qty of X) x (Price of X) + (Qty of Y) x (Price of Y)
= (8,000 x 50) + (10,000 x 32)
= 4,00,000 + 3,20,000

GDP at current prices for 2013 = 7,20,000

b) GDP at current prices for 2014 = (Qty of X) x (Price of X) + (Qty of Y) x (Price of Y)
= (10,000 x 60) + (13,000 x 40)
= 6,00,000 + 5,20,000

GDP at current prices for 2014 = 11,20,000

ii) GDP at constant prices for 2014 = (Qty of X in 2014) x (Price of X in 2013) + (Qty of Y in 2014) x (Price of Y in 2013)

GDP at constant prices for 2014 = (10,000 x 50) + (13,000 x 32)
GDP at constant prices for 2014= 5,00,000 + 4,16,000
GDP at constant prices for 2014 = 9,16,000

iii) GDP growth rate at current prices = (11,20,000 – 7,20,000 / 7,20,000) x 100

GDP growth rate at current prices = (4,00,000 / 7,20,000) x 100

GDP growth rate at current prices = (0.5556) x100

GDP growth rate at current prices = 55.56%

2. **Attempt any two of the following.**

a) What is Keynes' Psychological law of consumption? Explain objective factors affecting consumption functions.

Ans: People increase their consumption as their income increases, but not by as much as increase in their income. It means that when you earn an extra rupee, you spend some part of it and save some of it.

Objective factors affecting consumption function:

i) Change wage units ii) Change in net income iii) Change in the interest rate **iv)** Change in the capital value v) Fiscal policy v) Expectations about the future income vi) Change in depreciation allowance vi) Permanent and transitory income vii) Demographic factor viii) Social security

b) Income level and consumption expenditure for an economy is given as follows: Fill the above table by Calculating Saving (S), Marginal Propensity to Consume (MPC)

Income (Y)	Consumption (C)	Saving (S)	Marginal Propensity to Consume (MPC)	Marginal Propensity to save (MPS)
0	750	-750	_--	---
1000	1500	-500	0.75	0.25
2000	2250	-250	0.75	0.25
3000	3000	0	0.75	0.25
4000	3750	250	0.75	0.25
5000	4500	500	0.75	0.25
6000	5250	750	0.75	0.25

Marginal Propensity to consume (MPC) = Change in consumption / Change in income

Marginal Propensity to Save (MPs) = Change in saving / Change in income

c) Explain the following concepts.

i) Investment Multiplier

The concept of Investment Multiplier was propounded by Prof. J.M. Keynes. According to Keynes an initial increment in investment increases the final income by many times.

$K = \Delta Y / \Delta I$

K - Investment Multiplier

ΔY - Increase in national income

ΔI - Increase in Investment

(Brief Explanation)

ii) Marginal Efficiency of Capital

The concept of Marginal Efficiency of Capital (MEC) was introduced by J.M. Keynes. He defined MEC as "the rate of discount which would make the present value of the series of annuities given by the returns expected from the capital assets during its life just equal its supply price."

(Brief Explanation)

3. Attempt any two of the following.

a) Discuss the sources of revenue of central government.

Ans: Revenue of central government implies the income or earning of the public authorities from all the sources in the economy. Following are the sources of revenue of central government.

I) Tax Revenue   II) Non-tax Revenue

I) Tax Revenue : A fund raised through the various taxes is referred to as tax revenue. Taxes can be classified into A) Direct Taxes B) Indirect Taxes

A) Direct Taxes: Following are the various types of direct taxes.

i) Income tax ii) Corporate tax iii) Wealth tax iv) Capital gain tax

B) Indirect Taxes : Following are the various types of indirect taxes.

i) Service tax ii) Excise duty iii) Vat iv) Custom duty

II) Non-tax Revenue: Besides taxes, the other sources of revenue available to the government are termed as non-tax sources and it includes the following.

i) Profit from public sector enterprises ii) Administrative revenue iii) Gifts and grants iv) Special assessment v) Public borrowing and deficit financing

b) Distinguish between the following.

i) Public goods and merit goods

Public goods : Public goods are defined as products where, for any given output, consumption by additional consumers does not reduce the quantity consumed by existing consumers.

Examples of Public goods: National defence, Law and order, Public services, Public health, Street lighting, Parks etc.

Merit goods: Merit goods are those goods and services that the government feels that people will under consume and which ought to be subsidized or provided free at the point of use so that consumption does not depend primarily on the ability to pay for the goods and services.

Examples of Merit goods: Education, Health care, Welfare services, Housing and Public parks etc.

ii) Revenue deficit and primary deficit

Revenue deficit: Revenue deficit is the difference between current or revenue receipts and current or revenue expenditure. Revenue deficit is a basic concept of deficit because all other types of deficits are found in revenue deficit only.

Primary deficit: This is a new concept of deficit introduced by the Ministry of Finance. Primary deficit is obtained by subtracting net interest payment from the fiscal deficit. thus

Primary deficit = Fiscal deficit – Interest payment

This concept is an expanded form of fiscal deficit and throws light on the real position of the national treasury.

c) Explain meaning of subsidies and various types of subsidies in India.

Ans: A subsidy is a financial contribution by a government, or agent of a government, that confers a benefit on its recipients. The most basic form of subsidy is a cash payment or grant.

In India subsidies can be classified in two categories.

i) Economic subsidies: Economic subsidies are given to the following.
Power, Agriculture and Irrigation, Communication and Industry, Transport and others, Cooperation, Flood control, Energy etc.

ii) Social subsidies: Social subsidies are given to the following.
Water supply, Education, Health and Sanitation, Rural housing and others.

4.Attempt any two of the following.

a) Explain the following concepts:

i) Balance of Payment

ii) Balance of Trade

Balance of Payment: The balance of payments of a country be defined in simple words " It is a systematic records of all its economic transactions with the outside world in a period of one year."

Definitions of Balance of Payments are given by Economists Kinleberger and Bo Sodersten.

Balance of Trade: It is the difference between exports and imports of items, typically referred as visible or tangible items. It is part of current account.

b) What are the causes of disequilibrium in balance of payments? Explain.

Ans: Disequilibrium in the BOP means that there is an excess effective demand for foreign exchange over its supply at given rate of exchange. The causes of disequilibrium in balance of payments are as follows.

i) Cyclical fluctuations ii) Decrease in Exports iii) Economic development

iv) Rising population v) Structural changes vi) Natural calamities

vii) International capital movement viii) Technological change
ix) Imports of essential goods and services

c) Explain the components of foreign exchange reserve.
Ans: Reserve Bank of India Act and Foreign Exchange Management Act 1999 set the legal provisions for governing the foreign exchange reserve. The RBI accumulates foreign exchange reserves by purchasing from authorized dealers in open market operations.

The FOREX Reserves of India consists of a) Foreign Currency Assets b) Gold c) SDRs d) Reserve Tranche Position in the IMF

In India, Reserves comprise of Gold, or specific currency. They are also SDRs and marketable securities denominated in foreign currencies like treasury bills, government bonds, corporate bonds, equities and foreign currency loans.

5. Write notes on any two of the following.

a) Sectoral contribution in the GDP of India
Ans: Indian economy is classified in three sectors namely:
1) Agriculture and allied: This sector includes Agriculture (Agriculture and Live stocks), Forestry and logging, Fishing and related activities.
2) Industry: This sector includes Manufacturing (Registered and unregistered), Electricity, Gas, Water supply and construction.
3) Service Sector: This sector includes Trade, Repairs, Hotels and Restaurants, Transport, Storage, Communication and services related to Broadcasting, Financial, Real estate, professional services, Community services and Social services.
(Give statistical data of these sector)

b) Composition of domestic savings in India
Ans: In India domestic savings accrue from three sectors, these are as follows. (Explain with help of table)
1) Government or Public sector
2) Private corporate sector
3) Household sector

Gross saving as percentage of GDP at market prices.

	1950-60	1960-70	1970-80	1980-90	1990-2000	2000-10
Household sector	7.14	8.24	11.96	13.83	18.13	23.38
Private corporate sector	0.98	1.35	1.51	1.78	3.87	6.91
Public sector	2.13	3.23	4.55	3.42	1.34	1.55
Gross Domestic Saving	10.25	12.82	18.01	19.03	23.24	31.84

c) Merits and demerits of direct taxes

Merits of direct taxes: i) Equity ii) Economy in collection iii) Certainty iv) Elasticity and productivity v) convenience vi) Creates civic consciousness
Demerits of direct taxes: i) Unpopular or Pinching ii) Easy to evade iii) Inconvenient iv) Difficult to pay v) Uneconomical to collect vi) narrow base vii) Arbitrary

d) Determination of foreign exchange rate under open market

Ans: A exchange rate is the rate at which one currency is exchanged for another or the price of one currency in terms of another currency. Under free market conditions the foreign exchange is determined by the market forces demand and supply in the foreign exchange market.

A nation's demand for exchange arises from the desire to import goods and services and invest in other nations and from speculators when they expect the foreign currency to appreciate.

A nation's supply of foreign exchange, on the other hand, result from exporting goods and services to other nations, from inflow of foreign investments and from sale of the foreign currency by speculators when they expect the foreign currency to depreciate. The determination of the exchange rate with help of diagram

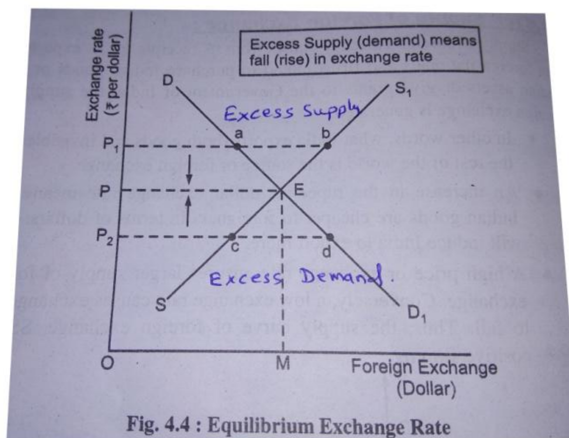


Fig. 4.4 : Equilibrium Exchange Rate