Annexure 'O'

SYLLABUS
ECONOMICS (CODE NO. 30)
Class XII (2013-14)

Paper I **3 Hours** **100 Marks**

Units	Periods	Marks
Part A: Introductory Microeconomics		
1. Introduction	10	4
2. Consumer Equilibrium and Demand	32	18
3. Producer Behaviour and Supply	32	18
4. Forms of Market and Price Determination	22	10
5. Simple applications of Tools of demand and supply	8	-
	104	50
Part B: Introductory Macroeconomics		
6. National Income and Related Aggregates	30	15
7. Money and Banking	18	8
8. Determination of Income and Employment	25	12
9. Government Budget and the Economy	17	8
10. Balance of Payments	14	7
	104	50

The question paper will include values based question(s) to the extent of 3-5 marks.

Part A : Introductory Microeconomics

Unit 1: Introduction 10 Periods

Meaning of microeconomics and macroeconomics

What is an economy? Central problems of an economy: what, how and for whom to produce; concepts of production possibility frontier and opportunity cost.

Unit 2: Consumer Equilibrium and Demand 32 Periods

Consumer's equilibrium – meaning of utility, marginal utility, law of diminishing marginal utility, conditions of consumer's equilibrium using marginal utility analysis. Indifference curve analysis of consumer's equilibrium-the consumer's budget (budget set and budget line), preferences of the consumer (indifference curve, indifference map) and conditions of consumer's equilibrium.

Demand, market demand, determinants of demand, demand schedule, demand curve, movement along and shifts in the demand curve; price elasticity of demand - factors affecting price elasticity of demand; measurenment of price elasticity of demand – (a) percentage-change method and (b) geometric method (linear demand curve); relationship between price elasticity of demand and total expenditure.

Unit 3: Producer Behaviour and Supply 32 Periods

Production function: Total Product, Average Product and Marginal Product.
Returns to a Factor.

Cost and Revenue: Short run costs - total cost, total fixed cost, total variable cost; Average fixed cost, average variable cost and marginal cost-meaning and their relationship.
Revenue - total, average and marginal revenue.
Producer's equilibrium-meaning and its conditions in terms of marginal revenue-marginal cost.
Supply, market supply, determinants of supply, supply schedule, supply curve, movements along and shifts in supply curve, price elasticity of supply; measurement of price elasticity of supply – (a) percentage change method and (b) geometric method.

Unit 4: Forms of Market and Price Determination 22 Periods

Perfect competition - Features; Determination of market equilibrium and effects of shifts in demand and supply.

Other Market Forms - monopoly, monopolistic competition, oligopoly - their meaning and features.

Unit 5: Simple applications of Tools of demand and supply 8 Periods (not to be examined)

Part B : Introductory Macroeconomics

Unit 6: National Income and related aggregates — 30 Periods

Some basic concepts: consumption goods, capital goods, final goods, intermediate goods; stocks and flows; gross investment and depreciation.

Circular flow of income; Methods of calculating National Income – Value Added or Product method, Expenditure method, Income method.

Aggregates related to National Income:

Gross National Product (GNP), Net National Product (NNP), Gross and Net Domestic Product (GDP and NDP) - at market price, at factor cost; National Disposable Income (gross and net), Private Income, Personal Income and Personal Disposable Income; Real and Nominal GDP.

GDP and Welfare

Unit 7: Money and Banking — 18 Periods

Money – its meaning and functions.

Supply of money – Currency held by the public and net demand deposits held by commercial banks.

Money creation by the commercial banking system.

Central bank and its functions (example of the Reserve Bank of India).

Unit 8: Determination of Income and Employment — 25 Periods

Aggregate demand and its components.

Propensity to consume and propensity to save (average and marginal).

Short–run equilibrium output; investment multiplier and its mechanism.

Meaning of full employment and involuntary unemployment.

Problems of excess demand and deficient demand; measures to correct them - change in government spending, availability of credit.

Unit 9: Government Budget and the Economy — 17 Periods

Government budget - meaning, objectives and components.

Classification of receipts - revenue receipts and capital receipts; classification of expenditure – revenue expenditure and capital expenditure.

Measures of government deficit - revenue deficit, fiscal deficit, primary deficit:their meaning.

Fiscal Policy and its role (**non evaluative topic**)

Unit 10: Balance of Payments — 14 Periods

Balance of payments account - meaning and components; balance of payments deficit-meaning.

Foreign exchange rate – meaning of fixed and flexible rates and managed floating.

Determination of exchange rate in a free market.

DESIGN OF QUESTION PAPER
ECONOMICS (030)
CLASS-XII (2013-14)

Marks – 100 **Duration – 3 hrs.**

1. Weightage by type of questions

Type	**Number of questions**	**Marks**	**Total**	**Estimated time a candidate is expected to take to answer**
Long answer questions	6	6	36	60 minutes
Short answer questions I	6	4	24	36 minutes
Short answer questions II	10	3	30	36 minutes
Very short answer questions	10	1	10	15 minutes

2. Weightage by content

Unit No.	**Unit Title**	**Marks**
1	Introduction	4
2	Consumer Equilibrium and Demand	18
3	Producer Behaviour and Supply	18
4	Forms of Market and Price Determination	10
6	National Income and Related Aggregates	15
7	Money and Banking	8
8	Determination of Income and Employment	12
9	Government Budget and the Economy	8
10	Balance of Payments	7
	Total	**100**

3. Difficulty level of the question paper

Level	Marks	%age of the total marks
A. Easy (Can be attempted satisfactorily by students who have gone through the study material)	30	30
B. Average (Can be attempted by students who have regularly studied the study material but may not have given sufficient time to writing.	50	50
C. Difficult (Can be attempted by top students)	20	20

4. Scheme of Options

There is no overall choice. However, there is an internal choice in one question of 6 marks, one question of 4 marks and one question of 3 marks in each section. Thus there will be internal choice to 6 questions.

5.

Values based questions **The question paper will contain values based question(s) to the extent of 3-5 marks.**

SAMPLE QUESTION PAPER
ECONOMICS (030)
CLASS-XII (2013-14)
BLUE PRINT

Maximum Marks: 100 **Time: 3 hours**

Sl. No.	Content Unit	Unit Title	Forms of Questions			
			Very Short Answer (1 Mark)	**Short Answer (3,4 Marks)**	**Long Answer (6 Marks)**	**Total**
1.	Unit 1	Introduction	1(1)	3(1)	-	4(2)
2.	Unit 2	Consumer Equilibrium and Demand	1(2)	3(2)4(1)	6(1)	18(6)
3.	Unit 3	Producer Behaviour and Supply	1(1)	3(1) 4(2)	6(1)	18(5)
4.	Unit 4	Forms of Market and Price Determination	1(1)	3(1)	6(1)	10(3)
5.	Unit 6	National Income and Related Aggregates	-	3(3)	6(1)	15(4)
6.	Unit 7	Money and Banking	1(2)	-	6(1)	8(3)
7.	Unit 8	Determination of Income and Employment	1(2)	4(1)	6(1)	12(4)
8.	Unit 9	Government Budget and the Economy	-	4(2)	-	8(2)
9.	Unit 10	Balance of Payments	1(1)	3(2)	-	7(3)
	Sub-Total		**10(10)**	**30(10)24(6)**	**36 (6)**	**100 (32)**

Notes:
1. *Figures within brackets indicate the number of questions and figures outside the brackets indicate marks for each question.*
2. *The question paper will include Values based questions to the extent of five marks.*

SAMPLE QUESTION PAPER
ECONOMICS (030)
CLASS – XII (2013-14)

Time – 3 Hours. **Maximum Marks – 100**

Instructions

1. *All questions in both the sections are compulsory.*
2. *Marks for questions are indicated against each.*
3. *Question Nos. 1-5 and 17-21 are very short-answer questions carrying 1 mark each. They are required to be answered in one sentence each*
4. *Question Nos. 6-10 and 22-26 are short-answer questions carrying 3 marks each. Answer to them should not normally exceed 60 words each.*
5. *Question Nos. 11-13 and 27-29 are also short-answer questions carrying 4 marks each. Answer to them should not normally exceed 70 words each.*
6. *Question Nos. 14-16 and 30-32 are long-answer questions carrying 6 marks each. Answer to them should not normally exceed 100 words each.*
7. *Questions marked star (*) are value based questions.*
8. *Answer should be brief and to the point and the above word limit be adhered to as far as possible.*

Section A

*1. A country's resources are fully and efficiently employed. The problem of scarcity exists. What advice will be given to raise the efficiency level of the human resource to fight scarcity? (1)

2. A perfectly elastic price-demand curve is parallel to the X-axis. Why or why not? (1)

3. What is cooperative oligopoly? (1)

4. An individual firm under perfect competition cannot influence the market price, then who can and how? (1)

5. Define supply. (1)

6. A good is an 'inferior' good for one and at the same time 'normal' good for another consumer. Do you agree? Explain. (3)

Or

Price elasticity of demand for flowers and toys are respectively (-) 0.9 and (-) 0.5. Demand for which one is more elastic and Why? (3)

7. Price elasticity of supply for a commodity is 5. When price of the commodity rises from Rs. 9 per unit to Rs. 10 per unit, supply rises by 25 units. Calculate quantity supplied at Rs. 9 per unit. (3)

8. Economic slow down in some parts of the world has adversely affected demand for Indian exports. What will be its effect on the production Possibilities frontier of India? Explain. (3)

9. A consumer consumes only two goods. Explain the conditions of consumer's equilibrium with the help of the Utility Analysis. (3)

10. Why is an indifference curve convex towards the origin? Explain. (3)

11. What is 'market' demand? State four factors causing 'increase' in market demand.

OR

Explain the influence of following on price elasticity of demand of a good:

(i) Substitute goods.

(ii) Own price of the good (4)

12. Find out (a) explicit cost and (b) implicit cost from the following:

		(Rs. Thousand)	
(i)	Investment in fixed assets	2000	
(ii)	Borrowings at 12% interest per annum.	1500	
(iii)	Wages paid during the year	120	
(iv)	Annual rental value of the owner's factory building	180	
(v)	Annual depreciation	100	
(vi)	Estimated annual value of the management services of the owner	240	(4)

13. State the behavior of Total Variable Cost. Draw Total Variable Cost, Total Cost and Total Fixed Cost Curves in a single diagram. (4)

<u>Note: the following question is for the blind candidates only in lieu of Q. No. 13</u>

State the behavior of Total Variable Cost. Prepare a Schedule showing Total Variable Cost and Total Cost.

14. Explain the conditions of equilibrium of a firm based on marginal cost and marginal revenue. Use diagram. (6)

Note: The following question is for the blind candidates only in lieu of Q. No. 14. (6)

Explain the meaning of producer's equilibrium. Also explain the conditions of equilibrium of a firm based on marginal cost and marginal revenue.

15. Explain the implications of the following:

(i) Freedom of entry and exit to firms under perfect competition.
(ii) Interdependence between firms under oligopoly. (6)

16. A consumer consumes only two goods. For the consumer to be in equilibrium why must Marginal Rate of Substitution between the two goods must be equal to the ratio of prices of these two goods? Is it enough to ensure equilibrium?

OR

A consumer consumes only two goods. Why is the consumer said to be in equilibrium when he buys only that combination of the two goods which lies at that point on the Indifference curve where the budget line is tangent to the indifference curve? Explain. Use diagram.

Note: The following question is for the blind candidates only in lieu of the "OR part' of Question No. 16.

Prepare an indifference schedule, also showing Marginal Rate of Substitution. Take at least four combinations.

Section B

17. What is involuntary unemployment? (1)

18. What is the value of multiplier and when Marginal Propensity to Save is zero? (1)

19. Name the market exchange rate system in which the Central Bank can actively intervene. (1)

20. State the two components of money supply. (1)

21. What is Cash Reserve Ratio? (1)

22. Find Net Value Added at Factor Cost:

		(Rs. Lakh)
(i)	Sales	100
(ii)	Closing Stock	20
(iii)	Excise	15
(iv)	Opening Stock	10
(v)	Depreciation	12

(3)

23. Increase in per capita real income means increase in per capita availability of goods and services. Does it necessarily mean rise in the welfare of the people of the country? Give any one argument in support of your answer and explain the same. (3)

24. During a given year nominal national income increased by 14 percent while the real national income increased by only 6 percent. Population increased by 2 percent. What has caused the difference between nominal income and real income? What is real per capital income? (3)

25. Explain the effects of appreciation of domestic currency on exports.

OR

Explain the effects of appreciation of domestic currency on imports. (3)

26. What does the Balance of Payments Account record? Distinguish between the “balance on current account” and the “balance of trade” in this account.

(3)

27. Find (a) fiscal deficit and (b) primary deficit from the following:

(Rs.Crore)

Revenue expenditure = 70,000

Borrowings = 15,000

Revenue receipts = 50,000

Interest payments = 25% of revenue deficit. (4)

28. In the Government of a country's budget for the year 2013-14 the Finance Minister proposed to raise the excise duty on cigarettes. He also proposed to increase income tax on individuals earning more than Rs. one crore per annum. Is the objective only to earn revenue for the government? What possible welfare objective can you think of from these proposals? Explain. (4)

29. Using the 'saving and investment' approach explain how is the equilibrium level of national income determined? Also explain what will happen if the equilibrium condition is not fulfilled.

OR

Explain the role of "open market operations" in controlling the inflationary gap. (4)

30. Giving a numerical example, explain the process of money creation by the commercial banks.

OR

Explain (a) store of value and (b) measure of deferred payments functions of money. (6)

31. Draw a straight line consumption curve. From it derive a saving curve. Explain the process of derivation. Show in this diagram:

(a) The point at which the Average propensity to Consume is equal to one.

(b) Any point at which the Average Propensity to Save is negative. (6)

Note: <u>The following question is for the blind candidates only in lieu of the Question No. 31.</u>

Explain the process of working of 'multiplier' with the help of a numerical example

32. Find (a) National Income and (b) Gross National Disposable Income.

(Rs. Crore)

(i)	Net current transfers to abroad		5	
(ii)	Private final consumption expenditure		200	
(iii)	Subsidies		20	
(iv)	Net domestic fixed capital formation		40	
(v)	Net. Factor income to abroad		10	
(vi)	Government final consumption expenditure		50	
(vii)	Change in Stocks	(-)	10	
(viii)	Net imports.	(-)	20	
(ix)	Consumption of fixed capital		30	
(x)	Income tax		60	(4,2)

MARKING SCHEME FOR SAMPLE QUESTION PAPER

SECTION – A

*****1. Spread of education and training. 1

2. A perfectly elastic demand curve is parallel to the X-axis because the buyers are willing to buy any quantity of the good at a given price. 1

3. When in an oligopoly market, the firms cooperate with each other in determining price and output, it is called Cooperative Oligopoly. 1

4. Under perfect competition the 'industry' can influence market price by raising or lowering output. 1

5. Supply refers to the quantity of a good the firm/industry is willing to sell at a price during a period of time. 1

6. Yes, the same good can be inferior for one and normal for another. Whether a good is inferior or normal is determined by the income level of the consumer. A good which is a normal good for the consumer having lower income, may become an inferior good for the consumer having higher income. When a consumer moves to higher income, he/she may consider some goods below their income status, and treats them as inferior. 1

OR

Demand for flowers is more elastic. It is because with one percent fall in price of flowers demand for flowers rises by 0.9 percent, while in case of toys one percent fall in price raises demand for toys by 0.5 percent. 1

7. $Es = \frac{P}{Q} \times \frac{\Delta Q}{\Delta P}$ 1

$5 = \frac{P}{Q} \times \frac{25}{1}$ 1 ½

$\left.\begin{array}{r} 5Q = 225 \\ Q = 45 \text{ Units} \end{array}\right\}$ ½

8. There will be no effect on PPF. It is because PPF shows only what a country can potentially produce, and not what it actually produces. Slow down by reducing demand for exports, may ultimately bring down output. Assuming that the country's actual production is somewhere on the PPF, Slowdown may result in the country producing at a point somewhere below the PPF.

3

9. The consumer is in equilibrium when:

(1) Ratio of marginal utility to price in case of each good is the same. Let the two goods be X and Y, then

$$\frac{MUx}{Px} equals \frac{MUy}{Py}$$

Suppose $\frac{MUx}{Px} > \frac{MUy}{Py}$ which means per rupee marginal utility by spending on X is greater than on Y. This induces the consumer to spend more on X by reducing spending on Y. This leads to fall in MUx and rise in MUy. The shift of spending from on Y to on X continues till $\frac{MUx}{Px} = \frac{MUy}{Py}$

(2)

(2) Marginal utility falls as more is consumed, i.e. the Law of diminishing marginal utility is operating. This ensure fulfillment of the first condition. 1

10. An indifference curve being convex towards origin means that slope of the curve declines as the consumer moves along the curve from left to right. Slope is nothing but Marginal Rate of Substitution which means the number of units of the good on the y-axis, the consumer is willing to sacrifice to obtain one more unit of the good on the X-axis. So convexity means MRS declining as consumer obtains more and more of the good on the X-axis. This is due to the Law of Diminishing Marginal Utility. 3

11. 'Market demand' means the quantity of a good, which all the buyers of that good are willing to buy at a price during a period of time.

(1) Rise in income (normal good)
(2) Rise in the price of substitute good
(3) Fall in the price of complementary good
(4) Change in taste in favour of the good.
(5) Rise in the number of consumers
(6) Change in distribution of income in favour of those who demand the good.

½ x 6

OR

(a) More the number of substitutes of a good higher the price elasticity of demand for that good. It is because when there is a price change the buyers can conveniently shift from one substitute to another. 2

(b) Higher the own price of the good, higher is likely the price elasticity of demand for that good. It is because a change in price of the higher price good has substantial effect on the budget of the consumer. 2

(Rs. Thousand)

12. (a) Explicit cost = Interest on borrowings = 180
+ Wages paid + 120
+ Depreciation +100

=Total 400

(b) Implicit cost = Imputed interest on
Own investment of Rs. 500
Thousand @ 12% 60
+ Rental value 100
+ Imputed value of
Owner's services 240

400
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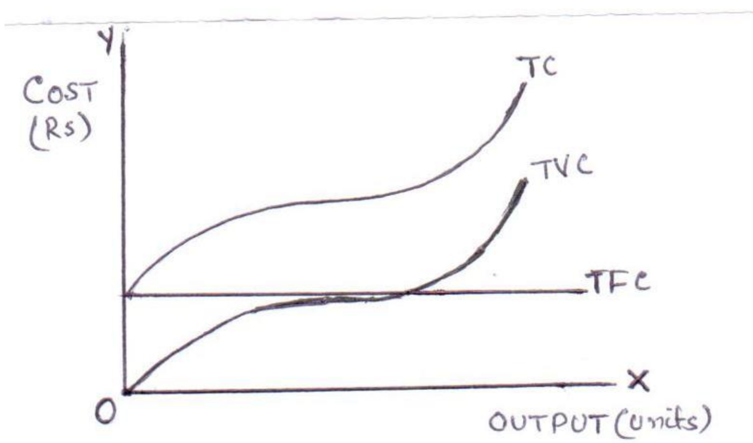
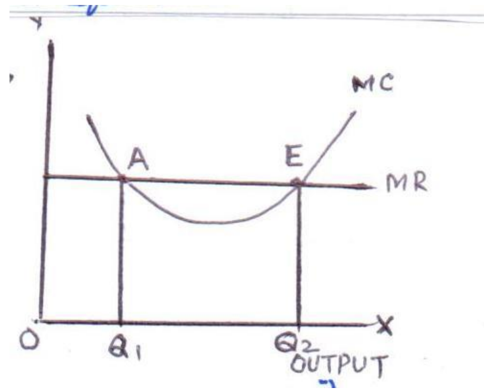
13. TVC initially rises at decreasing rate and after a level of output at an increasing rate 1



For the Blind candidates 1
Behaviour of TVC: (Same as above) 3
Schedule

14. A firm is in equilibrium, i.e. maximizes profits, when it produces that quantity of output at which:
(1) MC = MR and
(2) MC becomes greater than MR if more output is produced 2



In the graph the equilibrium is at E and the equilibrium output is OQ2 . At point A also MC =MR but this is not equilibrium because beyond A, MC is lower than MR. It is in the interest of the firm to produce more and add to profits. Therefore, only that output level at which MC= MR, and beyond which MC >MR, is the equilibrium.

<u>For the Blind Candidates</u>

Statement of conditions (as above) 2

Explanation (on the above lines) 4

15. (i) Freedom of entry and exit of firms under perfect competition ensures that firms get just the normal profit, i.e. Zero economic profit, in the long run. If in the short run, the existing firms are earning super normal profits, the new firms start entering the industry being attracted by profits. This raises industry's output which in turn reduces market price and leads to lowering of profits. This continues till the profits are reduced to normal, i.e. to zero economic profit. Opposite happens if the existing firms are facing losses. The firms start leaving, industry's output falling, market price rising, till losses are wiped out and the firms earning just the normal profits. 3

    (ii) In oligopoly it is assumed that the rival firms are likely to react to any price and output decision taken by a firm. Therefore, an individual firm, before taking any price and output decisions takes into account the likely reactions by the rival firms. It makes the firms interdependent on each other in an oligopoly market. 3

16. Let the two goods be X and Y. MRSxy is the number of units of Y the consumer is willing to sacrifice to obtain one extra unit of X. The ratio of prices is Px/Py which also equals the ratio of the number of units of Y required to be sacrificed to obtain one extra unit of X in the market.

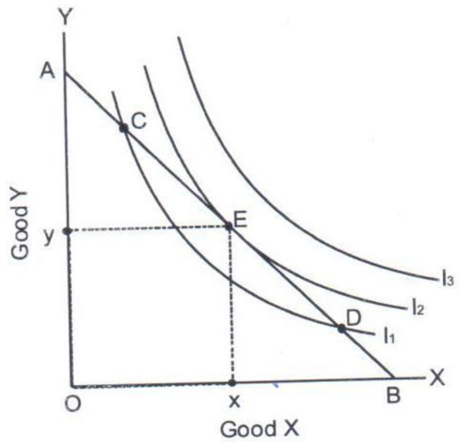
    2

    Initially when the consumer starts purchases, MRSxy is greater than Px/Py. It means that to obtain one extra unit of X the consumer is willing to sacrifice more than he has to sacrifice actually. The consumer gains. As he goes on obtaining more and more units of X, marginal utility of X goes on declining. Therefore the consumer is willing to sacrifice less and less of Y each time he obtains one extra unit of X. As a result MRSxy falls and ultimately becomes equal to Px/Py at some combination of X and Y. At this combination the consumer is in equilibrium. 3

If the consumer attempts to obtain more units of X beyond the equilibrium level, MRSxy will become less than Px/Py and his total utility will start falling. So he will not try to obtain more of X.

1

OR



Let the two goods be X and Y as shown in the diagram. The tangency is at point E where:

Slope of indifference curve = Slope of budget line

Or MRSxy = Px/Py

The equilibrium purchase is Ox of X and Oy of Y on the indifference curve I_2 2

The consumer cannot get satisfaction level higher than I_2 because his income does not permit him to move above the budget line AB. The consumer will not like to purchase any other bundle on the budget line AB, for example the bundle at C and D, because they all lie on the lower indifference curve, and give him lower satisfaction. Therefore, the equilibrium choice is only at the tangency point E. 2

For the Blind candidates in lieu of 'OR PART' of Q.No. 16

Definition of indifference curve 1

Definition of M.R.S. 1

Schedule 4

SECTION – B

17. Involuntary unemployment occurs when those who are able and willing to work at the prevailing wage rate do not get work. 1

18. Multiplier $= \frac{1}{MPS} = \frac{1}{0} =$ Infinity 1
19. Managed floating exchange rate 1
20. The two components of money supply are:
    (1) Currency held by public and (2) demand deposits with commercial banks.
21. Cash Reserve Ratio is the ratio of bank deposits that commercial banks must keep as reserves with the central bank. 1
22. NVA fc = (i) +(ii) –(iv)-(vi)-(v)-(iii) 1 ½

= 100+20-10-50-12-15 1
= Rs. 33 lakh. 1 ½

23. Increase in per capita availability of goods and services does raise the standard of living and consequently welfare. But it may not necessarily always be so. For example, manufacturing etc. does raise output but at the same time also leads to water and air pollution which reduces welfare of the people. Such a reduction in welfare may outweigh the increase in welfare and thus lead to overall reduction in welfare. 3

24. Change in nominal income over a year is on account of (a) change in quantity of goods and services and (b) change in price level. However, change in real income refers to change in quantity of goods and services only. Therefore, a change of 14 percent in nominal income over the year is partly on accont of 6 percent change in quantity of goods and services and the remaining 8 percent must be on account of rise in general price level. 2
Real per capital income rise = Rise in real national income
- Rise in population
- = 6-2 = 4 percent 1

25. Appreciation of domestic currency takes place when the price of foreign currency in terms of domestic currency falls. This makes exports costlier. It is because the foreign buyers now get less quantity of goods from the domestic economy by paying the same amount of foreign exchange. This reduces demand for exports. 3

OR

Appreciation of domestic currency takes place when the price of foreign currency in terms of domestic currency falls. This makes imports cheaper. It is because the importers now get more imports by paying the same amount of domestic currency. This raises demand for imports. 3

26. Balance of Payment Account records inflows and outflows of foreign exchange during a period of time.
"Balance of trade" is the difference between exports of goods and imports of good i.e. between visible inflows and visible outflows of foreign exchange. On the other hand "Balance on Current Account" is the difference between the sum of both visible and invisible (Services, incomes and transfers) inflows and outflows of foreign exchange.

2

27. (a) Fiscal deficit = Borrowings = Rs.15000 crore. 1
(b) Primary deficit = Fiscal deficit – Interest payments 1
=15000 – 25% of (70000 – 50000)
=15000 – 25% of 20000 1
= 15000 – 5000 = Rs.10000 crore. 1

*****28. Besides the objective of raising more revenue, the proposals also serve some welfare objectives. Firstly, raising excise duty on cigarettes will make cigarettes costlier and discourage smoking. Less smoking will have positive influence on health and raise welfare of the people. Secondly, raising income tax on incomes above Rs. one crore will help in reducing inequalities in income. Thirdly, the extra revenue raised from these proposals, if spent on health and education of the poor will also raise welfare of the poor.

4

29. According to the 'saving and investment' approach, the economy's national income is in equilibrium when
Planned Saving = Planned Investment 1

Suppose planned saving is higher than planned investment. It means that aggregate supply is greater than aggregate demand. In simple terms, it means that planned output is greater than planned demand for this output. As a result the producers find that inventory level is becoming higher than the planned level. To bring it back to the planned level, the producers cut down production. This reduces aggregate supply. The process continues till aggregate supply becomes equal to aggregate demand, i.e. till planned saving becomes equal to planned investment. Opposite happens when planned saving is lower than planned production. 3

OR

Inflationary gap means the excess of aggregate demand over the aggregate supply at the full employment level of national income. It is called inflationary because it brings in inflationary tendency in the economy. 1

Open market operations refers to the sale and purchase of government securities by the central bank in the open market. In case of inflationary gap there is a need to reduce the money supply in the economy. To do so the central bank can start selling government securities. Those who buy make payment by cheques to the central bank. The money flows out of commercial banks and into the central bank. This reduces deposits with the commercial banks. It has twin effects. It reduces money supply as well as reduces money creation power of the commercial banks. Reduction in money supply helps in controlling inflationary tendencies. 3

30. Money creation (or deposit creation or credit creation) by the banks is determined by (1) the amount of the initial fresh deposits and (2) the Legal Reserve Ratio (LRR), the minimum ratio of deposit legally required to be kept as liquid assets by the banks. It is assumed that all the money that goes out of banks is redeposited into the banks.

Let the LRR be 20% and there is a fresh deposit of Rs.10,000. As required, the banks keep 20% i.e. Rs.2000 as reserves. Suppose the banks lend the remaining Rs.8000. Those who borrow use this money for making payments. As assumed those who receive payments put the money back into the banks. In this way banks receive fresh deposits of Rs.8000. The banks again keep 20% i.e. Rs.1600 as reserves and lend Rs.6400, which is also 80% of the last deposit. The money again comes back to the banks leading to a fresh deposit of Rs.6400. The money goes on multiplying in this way, and ultimately total money creation is Rs.50000.

Given the amount of fresh deposit and the LRR, the total money creation is:

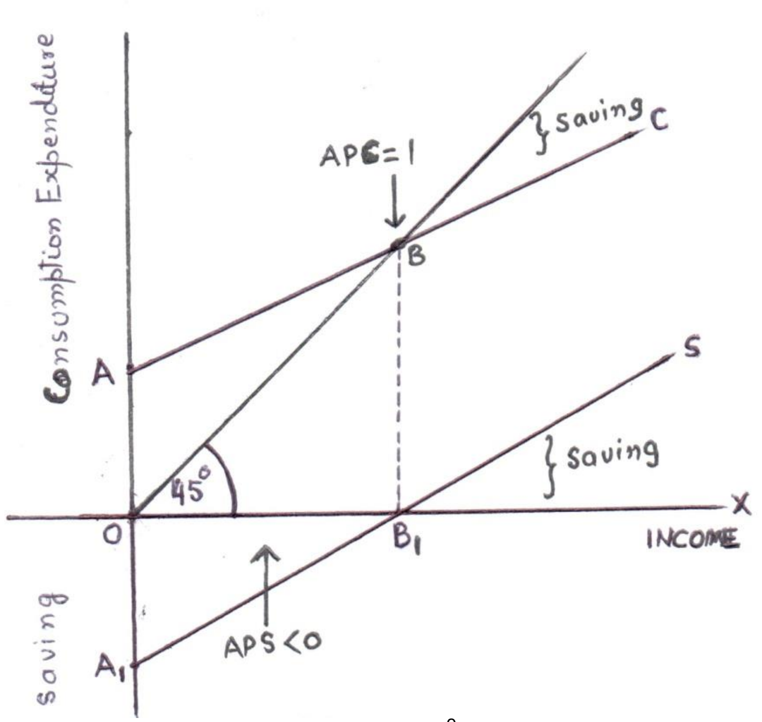
Total money creation = Initial deposit x $\frac{1}{LRR}$

6

OR

(i) Store of value function : Storing assets for use in future. Money performs this function. An individual can hold his earnings until the time he wants to spend the same. The main advantages of holding money, rather than goods, are: easily exchanged for goods, easily portable and comes in convenient denominations. 3

(ii) Deferred payments means payments to be made in future. Money serves as a standard of such payments e.g. repayment of loan, interest etc. This function has made possible smooth working of the borrowing and lending activities. 3



Given consumption curve C intersecting 45^0 line at B. The steps in deriving saving curve are:

(1) Take OA_1, on the Y-axis below the point of origin as equal to OA on the Y-axis above the point of origin because positive consumption expenditure at zero income must be equal to negative saving at zero income. A_1 is thus the starting point of the saving curve.

(2) Draw a perpendicular from B intersecting X-axis at B_1. Saving at both B and B_1 is zero. B_1 is then another point on the Saving curve.
(3) Joint A_1 and B_1 and extend the same to get the Saving Curve S.

2

(i) APC = 1 at point B because consumption expenditure equals income. 1
(ii) APS <O at all the levels of income below the OB_1 level of income. 1

<u>For the Blind candidates</u>
Meaning of multiplier 2
Working of multiplier 4

32. N.I = ii+vi+(iv+vii)-viii-v-x+iii 2
= 200+50+40+(-10)-(-20)-10-60+20 1 ½
= Rs.250 crore ½

G.N.D.I. = N.I +ix+x-iii-I 1
=250+30+60-20-5 ½
=Rs.315 crore ½