GUESS Paper - 2015
Class – XII
Subject – Economics (Solved)

SECTION-A
[INTRODUCTORY MICRO ECONOMICS]

1. What do you mean by complementary good. Give two examples? (1 Mark)
Ans. It may be defined as the goods which are used together to satisfy a given want. The examples are pen and ink, car and petrol etc.

2. Why are goods demanded? (1 Mark)
Ans. We demand goods and services because they have the capacity to satisfy our wants. The capacity to satisfy human wants is called "Utility''. Thus, we can state that goods are demanded because they possess utility.

3. Can a consumer go beyond the budget line? (1 Mark)
Ans. Consumer cannot go beyond the budget line as given his budget and prices of Good –1 and Good-2, any point beyond the budget line shows a non attainable combination or a non- feasible combination.A consumer can only afford to buy combinations that fall along his budget line or inside it.

4. What does slope of IC show? (1 Mark)
Ans. Slope of IC shows the rate at which the consumer is willing to substitute one commodity for the other. It is called Marginal Rate of Substitution.

5. How is total utility derived from marginal utility. (1 Mark)
Ans. Total utility can be estimated as the sum total of all individual or marginal utilities.TU = ΣMU

6. Give the assumptions of consumer equilibrium in case of one commodity. (3 Marks)
Ans. The concept of consumer equilibrium is based on following assumptions:-
(a) A consumer should be a rational person. It means that he tries to maximise his satisfaction.
(b) Utility can be measured in cardinal number system.
(c) Consumption of the commodity should be a continuous process.
(d) All the units of the commodity should be homogeneous.(e) There should be no change in taste or preference of the consumer during the consumption period.
(g) The marginal utility of money is given and assumed to be constant. Which is possible when the income of the consumer and the price level of the commodity (commodities) remains constant.

7. What is budget line? Give an example. (3 Marks)
Ans. The budget line represents all the commodities which a consumer can purchase with his entire money income. Letus have two commoditiesX andY.Their respective prices are Rs P1 and Rs P2. The entire incomeof theconsumer is Rs 100. The budget line can be written as fallows:P1x + P2Y = 100

8. The marginal utility schedule of an individual "B" is given. Derive his total utility schedule.
Amount consumed 0 1 2 3 4 5 6 7
Marginal Utility 0 7 10 8 6 3 0 -2 (3 Marks)
Ans.Total Utility 0 7 17 25 31 34 34 32 Formula Used :- TU = MU

9. What is the logical explanation of "Law of Diminishing Marginal Utility"? (3 Marks)
Ans. Law of diminishing marginal utility states that "With every increase in units of the commodity consumed, the additional satisfaction decreases and hence marginal utility derived by the consumer decreases." This law is based on the concept ofchanges in intensity of desire of the consumer due to changes in level of consumption by the consumer.Initially theintensity of desire for the commodity for the consumer is very high. Due to which, the marginal utility for the first unit of the commodity is also high. But as soon as the consumer consumes the first unit of the commodity his intensity of desire falls and hence the marginal utility also falls. This process continues till the level where the consumer does not have any desire left for the commodity. At this level the marginal utility for the commodity becomes zero.Thus, with the decrease in the intensity of desire with every increase in consumption of the commodity, the marginal utility of the commodity also falls.This is stated by the law of diminishing marginal utility.

10. What determines tastes and preferences of consumers? (3 Marks)
Ans. Tastes and preferences ofconsumers are determined by three factors, as under:
1. Individual's likes and dislikes: If one likes a particular good he/she will tend to buy it.
2. Fashion: We are influenced by the emerging trends and fashion and prefers to buy things as per latest fashion.
3. Weather: Tastes and preferences changes according to change in weather. In winter we preferto havecoffee, tea etc. whereas in summer we prefer cold coffee, ice cream, cold drinks etc.Thus,weather conditions affect our tastes and preferences.

11. State the relationship between MU and TU on the basis of a utility schedule. (4 Marks)
Ans. Marginal utility represents the changes in total utility and hence any change in marginal utility will also represent the rate of change in total utility. The relationship between TU and MU can be explained with the help of following schedule.
Amount consumed 1 2 3 4 5 6 Marginal Utility 10 8 6 3 0 -2Total Utility 10 18 24 27 27 25From the given table it can be concluded :-
(1) When MU decreases but remains positive, the TU also increases but at a diminishing rate. In the given schedule MU decreases from 1st unit till 5th unit and hence TU increases at a diminishing rate.
(2) At 5th unit of consumption, MU becomes zero due to which TU becomes maximum and constant.
(3) At 6 units of consumption, MU becomes negative and TU starts diminishing.

12. State the law of Diminishing Marginal Utility. (4 Marks)
Ans. Law of diminishing marginal utility is the most logical explanation of consumer's behaviour. According to Prof. Marshall, this law states that , " The additional benefit which a person derives from a given stock of a thing diminishes with every increase in the stock that he already has." Thus we can say that whenever the unitsof a commodity consumed by the consumer are increased, keeping other factors

constant, the marginal utility of the commodity goes on decreasing.After a certain stage marginal utility derived becomes zero. If the consumer further consumes the commodity then marginal utility becomes negative.Assumptions : The law of diminishing marginal utility is based on following assumptions:-
(a) Units of the commodity under study should be in proper units, i.e. we should compare the marginal utility of cup of tea and not a spoonful.
(b) Consumption of the commodity should be a continuous process. That is there should be no time interval in consumption. i.e. a second glass of water may give the same satisfaction or have the same marginal utility if it is consumed after 5 hours.
(c) All the units of the commodity should be homogeneous.
(d) There should be no change in taste or preference of the consumer during the consumption period.

13. Differentiate between contraction in demand and decrease in demand. (4 Marks)
Ans. CONTRACTION IN DEMAND DECREASE IN DEMANDOther things being equal, when the consumeris ready to purchaseless quantity of the commodity at a higher price then, it is known as contraction in demand.If due to change in factors other than the price of the commodity concerned, the consumeris ready to purchase less quantity at a given price then, it is termed as decrease in demand.It is caused due to an increase in price of the commodity, other factors remaining constant.Factors responsible for decrease in demand are:
(i) Decrease in income and wealth of consumer
(ii) Unfavourable change in consumer’s tastes
(iii) Expectation of lower prices in future(iv) Decrease in the price of substitute goodsIt is represented by an upward movement along the demand curve It is represented by a leftward shift in demand curve

14. Explain the factors responsible for a rightward shift in market demand curve of a commodity. (6 marks)
Ans. A rightward shift in demand curve for the commodity represents that the consumer is ready to consume more quantity of the commodity at a given price. It is also termed as increase in demand and arises due to following factors :-(i) Increase in the price of the substitute goods : When the price of substitute goods increases then these goods become relatively costlier as compared toother commodity.As a resultthe consumer changes his preference towards the cheaper commodity and is ready to consume more quantity of the commodity at a given price. For example, an increase in the price of tea will lead to an increase in demand for coffee.
(ii) Decrease in the price of the complementary goods : When the price of complementary goods decreases then, due to joint demand the consumeris ready to consume more quantity of the other commodity at a given price. For example, a decrease in price of petrol will lead to an increase in demand for cars.
(iii) Increase in the income and wealth of the consumer : Increase in income and wealth of the consumer leads to an increase in purchasing powerof the consumer.As a result consumer will beready to purchase more quantity of the commodity at a given price.
(iv) Favourable changes in consumer’s tastes: If the consumer changes his tastes and preferences in favour of the commodity, then he will be ready to consume more units of the commodity at a given price.

(v) Increase in market size : If the market size of the commodity increases then the total number of consumers for the commodity will increase and hence, the market demand for the commodity will increase at a given price.

15. State and explain the law of diminishing marginal utility. (6 Marks)
Ans. This law is the most logical explanation of consumer's behaviour. According to Prof. Marshall, this law states that whenever the units of a commodity consumed by the consumer are increased, keeping other factors constant, the marginal utility of the commodity goes on decreasing. Assumptions : The law of diminishing marginal utility is based on the following assumptions:
(a) Units of the commodity under study should be homogeneous, i.e. units should be same in all respect.
(b) Consumption of the commodity should be a continuous process. There should be no timegapin consumption.
(c) There should be no change in tastesand preferences of the consumer during the consumption period.
Explanation : The law is based on the intensity of the desire of the consumer for a particular commodity. When the consumer does not have even a single unit of a commodity then the intensity of his desire is very high. As a result, Marginal Utility is high. But as soon as he consumes one unit of the commodity his intensity of desidiminishes. As a result of which the marginal utility or satisfaction from the second unit also falls. This process goes on till a level where the consumer becomes fully satisfied with the commodity. At this level theconsumer does not derive any satisfaction from the additional unit of the commodity. This level of consumption is known as Zero Marginal Utility level or Saturation level. With further increase in units of the commodity consumed the marginal utility of the commodity becomes negative, i.e. instead of getting satisfaction, the consumer gets dissatisfaction from the additional unit of the commodity. This law can be explained with the help of following diagram :-In the given diagram, the marginal utility of the commodity first decreases and then becomes zero. This level of output represents the level of saturation or zero marginal utility. After this level of consumption, if units are increasedthen marginal utility of the commodity becomes negative.Total utility first increases then after reaching maximum point, it starts declining. When TU is maximum MU is zero.

SECTION-B
[INTRODUCTORY MACRO ECONOMICS]

17. What is wealth tax? (1 Mark)
Ans. Wealth tax is a direct tax because its liability to pay tax and burden of tax falls on the same person.

18. What is the basic difference between revenue expenditure and capital expenditure? (1 Mark)
Ans. Any expenditure, which neither creates an asset nor reduces a liability is categorised as revenue expenditure. For example, expenditure on law and order.
Any expenditure that creates an asset or reduces a liability is categorised as capital expenditure. For example, investment in shares.

19. What is escheat? (1 Mark)
Ans. Escheat means all the claims of the government on the property of a person who died without having any legal heirs or without leaving a will.

20. Give two examples of development expenditure? (1 Mark)
Ans. Development expenditure includes followings expenditures:
i. Plan expenditure on departmental enterprises of government like, railway, post and telegraph etc.
ii. Plan expenditure on non-departmental enterprises of government like Air India and Indian Airlines etc.

21. What are the main components of capital receipts? (1 Mark)
Ans. Main component of capital receipts are:
a) Recovery of loans
b) Borrowings and other liabilities
c) Other receipts

22. What is fees? Explain the main features of fees. (3 Marks)
Ans. Fee is a payment to the government for services that it renders to the people.
Main features of fee are the following:
a) Fee is a compulsory payment. If a person wants to avail a service, he is required to pay fees for it.
b) Fee provides specific benefits to the payer. It also implies general advantage.
c) Fee is not a payment for commercial service. It is the payment for the administrative and judicial services provided to the people.
d) Amount of fee is equivalent to the cost of service provided.

23. Discuss the difference between progressive and regressive taxation. (3 Marks)
Ans. Progressive and regressive taxation system is very different from each other. The main difference between progressive and regressive tax system are following:

i. Progressive tax is that system of taxation in which rate of tax increases with increase in income but in case of regressive taxation rate of tax decreases with increase in income.ii. In Progressive taxation system burden of tax is more on the rich and less on the poor, whereas in regressive taxation system real burden of tax is more on poor and less on the rich.

24. Distinguish between current account and capital account. (3 Marks)
Ans.
Current Account Capital Account1. It records economic transactions relating to goods and services and unilateral transfers.
1. Records capital transactions such as sale and purchase of assets.
2. Balance in current account has a direct influence on the level of income. It brings change in current level of income.
2. The capital account does not have a direct effect on the level of income. It brings change in the capital stock of a country.
3. Current account transactions are flow in nature.
3. Capital account transactions are stock in nature.

25. Give reasons why people desire to have foreign exchange. (3 Marks)
Ans. Some reasons why people desire to have foreign exchange are:
(i) For importing goods and services from foreign countries
(ii) For making transfer payments in the form of gifts, donations etc.
(iii) For making investment abroad in financial and physical assets
(iv) For speculatingthe value of exchange rate

26. State four categories in which balance of payment transactions are classified. Explain any one of them. (3 Marks)
Ans. The balance of transactions are classified into the following four categories:
(i) Visible transactions
(ii) Invisible transactions
(iii) Unilateral transfers
(iv) Capital transfersCapital transfers: It relates to capital receipts and capital payments. These includes sale of assets, borrowings, capital repayments etc. There relate to short and long term movements of capital between nations.

28. What are the three exchange rate systems that have been followed in the foreign exchange market? Define one of them. (4 Marks)
Ans. Three exchange rate systems that have been followed in the foreign exchange market are:
(i) Fixed exchange rate system
(ii) Flexible exchange rate system
(iii) Managed floating
Managed Floating: Managed floating is a mixture of a flexible and fixed exchange rate system. The central banks intervene to buy and sell foreign currencies to moderate

exchange rate movements whenever they feel that such actions are appropriate.

28. Distinguish between fixed and flexible exchange rate. (4 Marks)
Ans.
Fixed Exchange Rate Flexible Exchange Rate
1. Fixed Exchange Rate is decided by the government and it remains unchanged.
1. Flexible Exchange Rate system is determined by demand and supplyof foreign exchange.
2. The exchange rate may vary slightly.
2. Exchange rate keeps changing all the times.
3. Banks sell and purchase currencies at fixed prices to maintain fixed exchange rate
3. Determined freely without intervention of central bank.

29. Explain the meaning of plan and non-plan expenditure. (4 Marks)
Ans. Plan expenditure is that expenditure which is incurred by the government to fulfil its planned development programmes. It includes both the consumption as well as investment expenditure by the government or planning commission of country. Expenditure on agriculture, power and transport, communication, industry health and education are some notable example of plan expenditure.
Non-plan development expenditure is that expenditure of government, which are beyond the scope of its planned development. Any expenditure other than planned expenditure is treated as non-plan expenditure. It includes consumption as well as investment expenditure done by the government.

30) Show the differences between direct tax and indirect tax. (6 Marks)
Ans. Distinction between Direct Tax and Indirect Tax :
Direct Tax Indirect Tax
(i) Direct tax is the tax in which the liability to pay the tax and the burden of the tax falls on the same person.
(i) Indirect tax is the tax in which the liability to pay the tax is on one person and the burden of the tax falls on some other person.
(ii) Direct tax is paid by the person on whom it is imposed. Hence, shifting of burden is not possible.
(ii) Indirect tax is paid by the consumers i.e., the person other than the person on whom it is imposed. Thus, shifting of burden is possible.
(iii) The burden of tax is more on rich people than the poor.
(iii) The burden of tax is more onpoor people than the rich.
(iv) Impact and incidence of tax is on the same person.
(iv) Impact is on one person and indicence is on some other person.
(v) Examples are:
(a) Income Tax (b) WealthTax (c) Gift Tax.
(v) Examples are:
(a) Sales Tax (b) Excise Duty (c) Custom Duty

31. Explain the components of revenue receipts of the government. (6 Marks)
Ans. Revenue redeipts are the receipts which neither create liabilities nor cause any reduction in assets. Revenue receipts of the government have two components:i. Tax Receipts: Tax is a major source of revenue receipts of the governments. A tax is a legal compulsory payment imposed by the government

on the people ofthe country. Tax can be classified as direct tax and indirect tax.a) Direct tax: Direct taxis the tax which is levied on the property and income of the person andit ispaid directly by the person on whomit isimposed. Income tax wealth tax and corporation tax are some examples of direct tax.
b) Indirect tax: Indirect taxis levied on one person and it is paid by some another person.In case of indirect taxes the liability of payment of the tax to the government lies on the producer or seller while the actual burden falls on the buyer. Thus,the burden of indirect tax can be shifted. Sales tax, excise duties, custom duties aresome examples of indirect tax.ii. Non-Tax Receipts: Non-tax receipts include the income accruing to the government from sources other than tax. It includes:
a) Commercial revenue: It is the revenue received by the government in the form of prices paid for the government supplied commodities and services, like payment of postage, electricity, railway services tc.
b) Interest and dividends on investments made by the government.
c) Administrating revenue includes fee, license fees, fines and penalties, forfeiture of security or bonds and escheat etc.

32. Explain the meaning of fiscal deficit and its importance in economic development? (6 Marks)
Ans. Fiscal deficit is the excess of total expenditure (revenue + capital) over total receipts (revenue + capital other than borrowings). Fiscal deficit is equal to the total borrowings and other liabilities of the government.Fiscal deficit is the sign of increase in government expenditure. Government increases expenditure to increase the rate of development in the country.Government spend money for various development projects in the sectors which are lagging behind in the process of development. Government spend this moneyin theagriculture sector, rural development and various infrastructure schemes.Government spendings create employment opportunities in various fields. Fiscal deficit facilitate nations to escape from economic recession because increase in government expenditure increases aggregate demand in the market.

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