

. Given the savings curve (SS), we can derive the Consumption curve (CC).

Q14. What should be the role of government during deficient demand?

Ans14. There is a need for the government's expenditure to be increased. This increase in expenditure will directly increase AD and thereby be helpful in closing the deflationary gap in the economy.

Q15. Give the role of bank rate during excess AD.

Ans15. For controlling excess demand, the Central bank should increase the bank rate. An increase in bank rate, raises the rate of interest by the commercial banks and as a result credit becomes costly.

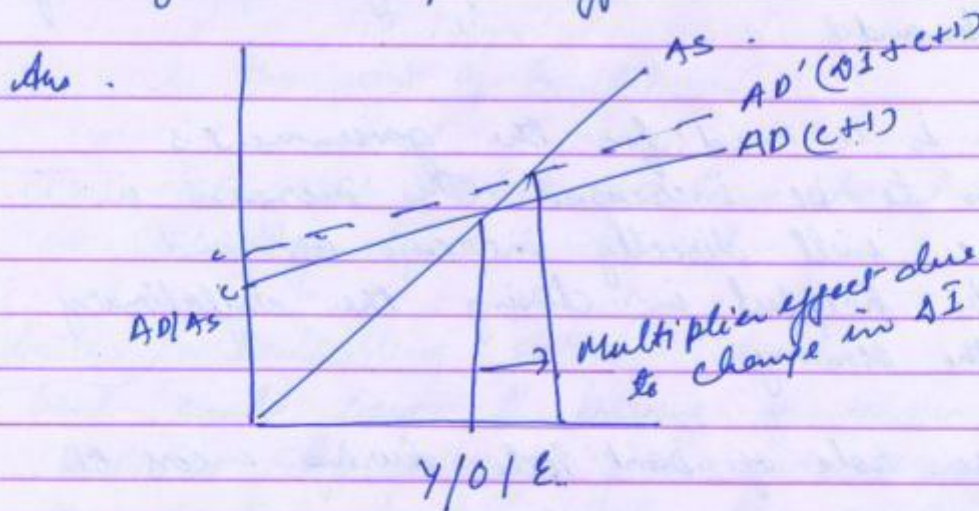
Ans16. Explain "Reduction in government expenditure"  
The government should reduce its expenditure on non-essential and non-development items to correct excess demand in an economy. Transfer payments such as old age pension, subsidies etc should also be reduced.

Q17. What is Legal Reserve Ratio?

Ans17. Commercial banks are required under law to keep with the Central bank a minimum percentage of their deposits. It is called Cash Reserve Ratio. During excess AD the Central bank increase the CRR

to restrict the flow of credit.

Q.18. Draw and show with the help of a diagram Multiplier effect in an economy.



We can see that due to  $\Delta I$  there is multiplier increase in output, income and employment.

Q.19. An economy is in equilibrium. Calculate Marginal propensity to save from the following.

National Income = ₹ 1,000  
 Autonomous Consumption = ₹ 100  
 Investment expenditure = ₹ 200

Ans 19.  $Y = C + MPC(Y) + I$

$$1000 = 100 + MPC(1000) + 200$$

$$MPC = \frac{1000 - 100 - 200}{1000}$$

$$= \frac{700}{1000} = 0.7$$

So,  $MPS = 1 - MPC$

$$= 1 - 0.7$$

$$= 0.3$$

Q20. An economy is in Equilibrium. Calculate the National income from the following:

$$\text{Autonomous Consumption} = ₹ 120$$

$$\text{Margin propensity to save} = 0.2$$

$$\text{Investment expenditure} = ₹ 150$$

Ans 20.  $Y = \bar{C} + MPC(Y) + I$

$$Y = 120 + (1 - 0.2)Y + 150$$

$$Y - 0.8Y = 270$$

$$\therefore 0.2Y = 270$$

$$Y = ₹ 1,350$$

## "Government Budget and the Economy"

Q1. What is government budget?

Ans. A government budget is an annual financial statement of the estimated receipts and expenditure of the government over the fiscal year, which runs from April 1 to March 31<sup>st</sup>. Government at all levels, Central, State or local, prepare budget.

Q2. Name two components of government budget.

Ans. The two components are Revenue budget and Capital budget.

Q3. What are objectives of government budget?

Ans. (i) Redistribution of Income  
(ii) Allocation of Resources  
(iii) To bring economic stability i.e. price stability

Q4. What is a Revenue budget?

Ans. Revenue budget contains the details of the current receipts (called Revenue receipts) and current expenditure (known as Revenue expenditure) of the government.

Q5. Define Revenue Receipts.

Ans. Revenue Receipts are government receipts which neither create liabilities nor lead to reduction in assets.

Q6. Define <sup>direct</sup> tax. Give two examples of direct taxes.  
Ans. When liability to pay a tax and the burden of that tax lies on the same person, it is called direct tax, e.g., income tax and Corporate tax.

Q7. Define Indirect tax. Give two examples.  
Ans. When the liability to pay a tax is on one person and the burden of that tax falls on some other person, it is called indirect tax.  
e.g. Sales tax and excise duty.

Q8. Why is tax not a Capital receipt, are the borrowings by the government treated as Capital receipt?

Ans. Tax is a revenue receipt and not a Capital receipt, because tax as a revenue receipt neither creates a liability nor leads to reduction in assets. Borrowings by the government are treated as Capital receipts, because borrowing creates liability.

Q9. Why is repayment of loans a Capital expenditure, and payment of interest a revenue expenditure?

Ans. Repayment of loan is a Capital expenditure, because it reduces the liability of the government. Payment of interest is a revenue expenditure, because it does not result in creation of assets or reduction in liability.

Q10. Why are subsidies treated as revenue expenditure?

Ans. Subsidies are treated as revenue expenditure, because they do not result in creation of assets nor reduction in liability, but are given to facilitate the normal functioning of the government.

Q11. Define Fiscal deficit in a government budget.

Ans 11. Fiscal deficit refers to the excess of total expenditure over the sum of revenue receipts and non debt Capital receipts.

Q12. How is Primary deficit calculated?

Ans 12. Primary Deficit = Fiscal deficit - Interest payment

Q14. Explain the two Components of government budget.

Ans 14. The two Components of Government budget are Revenue Budget and Capital budget.

(i) Revenue budget: It consists of revenue receipts of the government and the expenditure met from such revenues. It includes tax revenue and non tax revenue.

(ii) Capital Budget: Capital budget consists of capital receipts and capital expenditure of the government. Capital receipts are the receipts of the government which create liability or reduce financial assets. They include market borrowings, foreign debts, repayment of loans and advances. Capital expenditure refers to the expenditure of the government, which leads to creation of assets or reduction of liabilities.

Q15. Giving reasons with the following form of taxation. Explain.

i) Corporation tax

ii) Sales tax

iii) wealth tax

Ans 15 (i) Corporation tax : is a direct tax, paid by the Companies on profit earned, burden falls on the same entity.

(ii) Sales tax : Indirect tax, burden passes on to the buyer of the product.

(iii) Wealth tax : direct tax, it is directly levied on the wealth of a person, burden falls on the payee.

Q16. In a government budget, Primary deficit is ₹ 10,000 crores and interest payment is ₹ 8,000 cr. How much is the fiscal deficit?

Ans 16. Fiscal deficit = Primary Deficit + Interest payment  
= 10,000 + 8,000  
= ₹ 18,000 crores.

Q17 What is Revenue Deficit?

Ans 17. It is the excess of revenue expenditure over revenue receipts.

$FD = RE - RR$  where  $RE$  = Revenue expenditure,  
 $RR$  = Revenue receipts.

Q18. Name any three kinds of deficits in the government budget.

Ans (i) Revenue Deficit

(ii) Fiscal Deficit

(iii) Primary Deficit.

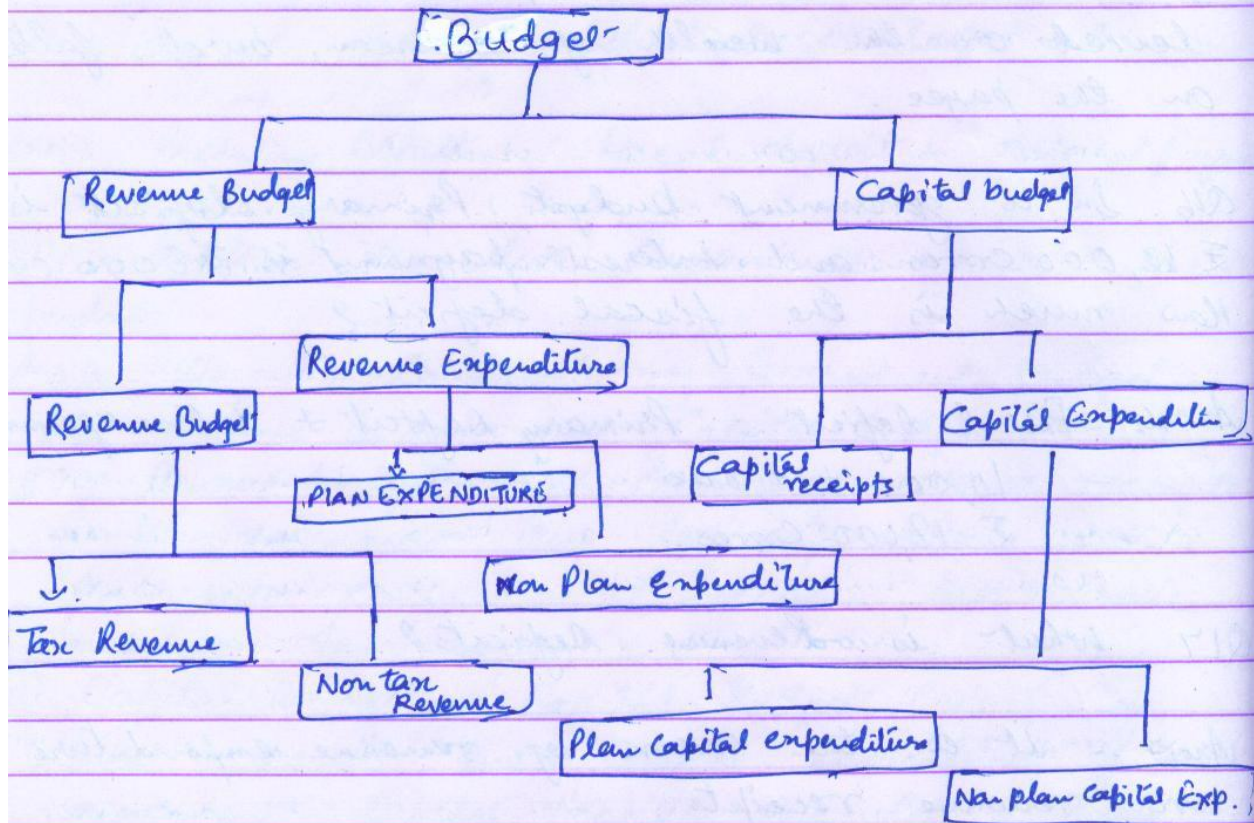
Q19. What are Non tax revenue receipts?

Ans 19. (i) Commercial Revenue

(ii) Interest Receipts

- (iii) Fee, license fees, fines and penalties etc  
(iv) Cash, grants in aid.

Q.20. Explain 'Government Budget' with the help of flow diagram.



## "Balance of Payments"

Q1. What are the important concepts used in trade?

Ans1. Balance of Invisibles and balance of payments are the important concepts that are widely used in international trade.

Q2. What is balance of trade?

Ans2. BOT (Balance of Trade) of a country shows only its visible trade transactions with the rest of the world during a year.

Q3. What is Balance of Payment?

Ans3. It refers to a systematic record of all economic transactions that take place between one country and the rest of the world during a given period (say a year).

Q4. What do you mean by visible items?

Ans. Tangible goods (export of goods and services)

Q5. What are Invisibles items included in BOT?

Ans. Services like insurance, banking, shipping, travel services, consultancy services rendered and received from abroad, investment incomes (interest, profits, dividends and royalties), Unilateral transfers like donations.

Q6. What are the main components of BOP?

Ans6. Capital Account and Current Account. These components are based on the divisions of transactions into real and financial.

Q7. What is Current Account?

Ans7. The Current account of balance of payments includes both balance of trade account and invisible account. So, the sum of trade balance and

Q8. Name three such items which are not included in balance of trade.

Ans8. (i) Export and import of services such as shipping, insurance and banking.

(ii) Interest and dividend payments between two countries.

(iii) Expenditure by tourists.

Q9. Define Autonomous items.

Ans9. Those transactions that are undertaken for certain economic or profit motive. These items are also known as above the line items. It is due to these items that there is surplus or deficit in the BOP account.

Q10. Define accommodating items.

Ans. Those transactions that are undertaken by the government with a view to correcting imbalances in the economy's BOP account.

These items are known as below the line items.

Q11. What is Current account deficit?

Ans11. Current account includes receipts and payments of foreign exchange on account of all items of exports and imports (visibles and invisibles). Current account deficit occurs when the foreign exchange