+2 ECONOMIC

New Syllabus Study Material for the academic year 2019

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Chapter 1 -Introduction of economic
Very short answer

1. Define Macro Economics. Pg. 2

Macroeconomics define by John Maynard Keynes in his book "The General Theory of Employment, Interest and Money".

- The word 'Macro' is derived from the Greek word 'Makros' meaning 'large'.
- Hence, Macro Economics is the study of the economy as a whole.
- Macro economics deals with - national income, employment and output.
- Macro Economics is also known as 'Income Theory.

2. Define the term 'Inflation'. Pg. 2

Inflation refers to steady increase in general price level.

Estimating the general price level by constructing various - price index numbers such as -

- ➢ Wholesale Price Index,
- ➢ Consumer Price Index, etc

3. What is meant by an 'Economy'?

Economy has been defined by A. J. Brown

An economy is a cooperation of producers and workers to make goods and services that satisfy the wants of the consumers.

In short, an economy is referred to any system or area where economic activities are carried out.

4. Classify the economies based on status of development.

Economies can be classified on the basis of status of development, They are –

1. Developed economy
2. Underdeveloped economy
3. Undeveloped and developing economic

5. What do you mean by Capitalism?

Adam Smith is the 'Father of Capitalism

- In capitalism, there is total freedom and private ownership of means of production.
- Manufacturers produce goods and services with profit motive
- The private individual has the freedom to undertake any occupation and develop any skill.
- Capitalistic economy is also termed as a **free economy** (Laissez faire, in Latin) or **market economy**

6. **Define 'Economic Model'.**

➢ A model is a simplified representation of real situation.

➢ A model is an explanation of how the economy, or part of the economy, works.

➢ Most economic models are built with mathematics, graphs and equations,

The commonly used economic models are the

1. supply-demand models
2. circular flow models
3. Smith models

7. **'Circular Flow of Income' - Define.**

The circular flow of income is a model of an economy - showing connections between different sectors of an economy. It shows –

➢ Flows of income,

➢ Goods and services and

➢ Factors of production between - economic agents such as firms, households, government and nations

8. **What are the models of circle flow of income**

There are three models of circle flow of income –

1. Two Sector Model: It is for a simple economy with households and firms.

2. **Three Sector Model:** It is for a mixed and closed economy with households, firms and government.

3. **Four Sector Model:** It is for an open economy with households, firms, government and rest of the world (External sector).

Paragraph

1. **State the importance of Macro Economics. Pg. 2**

Importance of Macro Economics

1. Macro economic helps to understand the functioning of the economy and to solve the basic problems prevailing in an economy.

2. Macro economic helps to Understanding the future problems, needs and challenges of an economy.

3. Macro economics provides opportunities to use scientific investigation to understand the reality.

4. Macro economics helps to make meaningful comparison and analysis of economic indicators.

5. Macro economics helps for better prediction about future and to formulate suitable policies.

2. **Describe the different types of economic systems. Pg. 4,7,8**

   There are three major types of economic systems. They are:

   1. **Capitalistic Economy (Capitalism)**

      Adam Smith is the 'Father of Capitalism

      - In capitalism, there is total freedom and private ownership of means of production.
      - Manufacturers produce goods and services with profit motive
      - The private individual has the freedom to undertake any occupation and develop any skill.
      - Capitalistic economy is also termed as a **free economy** (Laissez faire, in Latin) or **market economy**
      - The USA, West Germany, Australia and Japan are the best examples for capitalistic economies.
      -

   2. **Socialistic Economy (Socialism)**

      The Father of Socialism is Karl Marx.

      - Socialism refers to a system of -
        - ❖ Total planning,
        - ❖ Public ownership and
        - ❖ State control on economic activities.
      - Socialism is defined as a way of organizing a society in which major industries are owned and controlled by the government,
      - A Socialistic economy is also known as 'Planned Economy' or 'Command Economy'.
      - Russia, China, Vietnam, Poland and Cuba are the examples of socialist economies.

   3. **Mixed Economy (Mixedism)**

      - In a mixed economy system both private and public sectors co-exist and work together towards economic development.
      - In these economies, resources are owned by individuals and the government.
      - India, England, France and Brazil are the examples of mixed economy.

3. **Outline the major merits of capitalism. Pg.6 (any 5)**

   1. **<u>Automatic Working:</u>**

      Without any government intervention, the economy works automatically.

   2. **<u>Efficient Use of Resources:</u>**

      All resources are put into optimum use.

   3. **<u>Incentives for Hard work:</u>**

      Hard work is encouraged and entrepreneurs get more profit for more efficiency.

   4. **<u>Economic Progress:</u>**

      Production and productivity levels are very high in capitalistic economies.

   5. **<u>Consumers Sovereignty:</u>**

      All production activities are aimed at satisfying the consumers.

   6. **<u>Higher Rates of Capital Formation:</u>**

      Increase in saving and investment leads to higher rates of capital formation.

   7. **<u>Development of New Technology:</u>**

      As profit is aimed at, producers invest on new technology and produce quality goods.

4. **Indicate the demerits of socialism.**

   Demerits of Socialism

   1. **<u>Red Tapism and Bureaucracy:</u>**

      → As decision are taken by government agencies, approval of many officials.

      → The movement of files from one table to other takes time and leads to red tapism.

   2. **<u>Absence of Incentive:</u>**

      → The major limitation of socialism is that this system does not provide any incentive for efficiency.

      → Therefore, productivity also suffers.

   3. **<u>Limited Freedom of Choice</u>**:

      Consumers do not enjoy freedom of choice over the consumption of goods and services.

   4. **<u>Concentration of Power</u>**:

      → The State takes all major decisions.

      → The private takes no initiative in making economic decisions.

      → Hence, the State is more powerful and misuse of power can also take place.

5. **Enumerate the features of mixed economy.**

   Features of Mixed Economy

   1. **Ownership of Property and Means of Production:**

      → The means of production and properties are owned by both private and public.

      → Public and Private have the right to purchase, use or transfer their resources.

   2. **Coexistence of Public and Private Sectors:**

      → In mixed economies, both private and public sectors coexist.

      → Private industries undertake activities primarily for profit.

      → Public sector firms are owned by the government with a view to maximize social welfare.

   3. **Economic Planning:**

      → The central planning authority prepares the economic plans.

      → National plans are drawn up by the Government and both private and public sectors

   4. **Solution to Economic Problems:**

      The basic problems of -

      - What to produce,

      - How to produce,

      - For whom to produce and how to distribute

      The problem are solved through the price mechanism as well as state intervention.

   5. **Freedom and Control:**

      Though private has freedom to –

      - own resources,

      - produce and distribution goods and services.

6. **Distinguish between Capitalism and Globalism.**

   CapiCapitalism

   Adam Smith is the 'Father of Capitalism

   ➢ In capitalism, there is total freedom and private ownership of means of production.

   ➢ Manufacturers produce goods and services with profit motive

   ➢ The private individual has the freedom to undertake any occupation and develop any skill.

   ➢ Capitalistic economy is also termed as a **free economy** (Laissez faire, in Latin) or **market economy**

Globalism

➢ **The term globalism coined by Manfred D Steger (2002)** to denote the new market ideology of globalisation

➢ that connects nations together through international trade and aiming at global development.

➢ This ideology is also termed as 'Extended Capitalism'.

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7. **Briefly explain the two sector circular flow model.**

   There are only two sectors namely, household sector and firm sector.

   1. **Household Sector:**
      ❖ The household sector is the sole buyer of goods and services, and the sole supplier of factors of production, i.e., land, labour, capital and organisation.
      ❖ It spends its entire income on the purchase of goods and services produced by the business sector.
      ❖ The household sector receives income from firm sector by providing the factors of production owned by it.

   2. **Firms:**
      ❖ The firm sector generates its revenue by selling goods and services to the household sector.
      ❖ It hires the factors of production, i.e., land, labour, capital and organisation, owned by the household sector.
      ❖ The firm sector sells the entire output to households.

      Y = C + I

      Where

      Y is Income; C is Consumption; I is investment

Long answer

1. **Discuss the scope of Macro Economics. Pg. 2**

   Meaning of macro economic

   ✓ The word 'Macro' is derived from the Greek word 'Makros' meaning 'large'.

   ✓ Hence, Macro Economics is the study of the economy as a whole.

   ✓ Macro economics deals with - national income, employment and output.

   ✓ Macro Economics is also known as 'Income Theory.

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1. **National Income:**

   Measurement of national income and its composition by sectors are the basic aspects of macroeconomic analysis.

   It provide a long term understanding of the growth process of an economy.

2. **Inflation:**

   Inflation refers to steady increase in general price level.

   Estimating the general price level by constructing various - price index numbers such as -

   ➤ Wholesale Price Index,

   ➤ Consumer Price Index, etc

3. **Business Cycle:**

   ✓ Almost all economies face the problem of - **business fluctuations and business cycle.**

   ✓ The cyclical movements - **boom, recession, depression and recovery** in the economy need to be carefully studied based on **aggregate economic variables**.

4. **Poverty and Unemployment:**

   ✓ The major problems of rich nations are poverty and unemployment.

   ✓ This is one of the economic paradoxes.

   ✓ A clear understanding about the magnitude of poverty and unemployment - facilitates allocation of resources and initiating corrective measures.
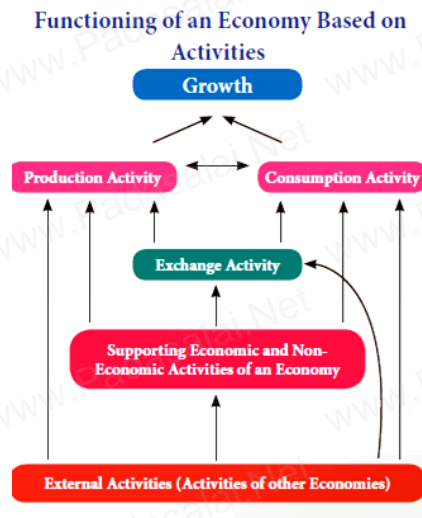
5. **Economic Growth:**

   The growth and development of an economy and the factors determining them could be understood only through macro analysis.

6. **Economic Policies:**

   ✓ Macro Economics is significant for evolving suitable economic policies.

   ✓ Economic policies are necessary to solve the basic problems, to overcome the obstacles and to achieve growth.

7. Illustrate the functioning of an economy based on its activities. Pg.4

Functioning of an Economy Based on Activities

➤ In an economy, the fundamental economic activities are –

- production and consumption..

➤ The ultimate aim of these activities is to achieve growth.

➤ These activities are influenced by several economic and non-economic activities.

i. **Economic activities include** -

- Transportation,

- Banking,

- Advertising,

- Planning,

- Government policy and others.

ii. **Non-economic activities include** –

- Environment,

- Health,

- Education,

- Entertainment,

- Governance,

- Regulations etc.,

iii. **External activities such as –**

- Import,

- Export,

- International relations,

- Emigration,

- Immigration,
- Foreign investment,
- Foreign exchange earnings, etc. Also influence the entire functioning of the economy.

Economies can be classified into different types based on the

1. **Status of Development:** Developed, underdeveloped, undeveloped and developing economies.
2. **System of Activities:** Capitalistic, Socialistic and Mixed Economies.
3. **Scale of Activities:** Small and Large Economies.
4. **Nature of Functioning:** Static and Dynamic Economies.
5. **Nature of Operation:** Closed and Open Economies.
6. **Nature of Advancement:** Traditional and Modern Economies.
7. **Level of National Income:** Low Income, Middle Income and High Income Economies.

8. **Compare the features of capitalism and socialism. Pg. 5 to 10**

9. **Compare the feature among Capitalism, Socialism and Mixedism. (Any 6)**

S.No	Features	Capitalism	Socialism	Mixedism
1	Ownership of Means of Production	**Private ownership –** All resources namely- ➢ land, ➢ capital, ➢ machines, ➢ mines etc. Are owned by **private individuals**	**Public ownership -** All resources are owned by the government. It means that all the factors of production are- nationalized and managed by the public authority.	**Private and public ownership-** All Production and properties are owned by both private and public. Public and private have the right to purchase, use or transfer their resources.
2	Economic Motive	**Profit -** The golden rule for a producer under capitalism is 'to **maximize profit**.' Each individual and organization produce only those goods which ensure high profit.	**Social welfare –** In socialism Maximization Social **welfare** - is the guiding principle behind all economic activities.	**Social welfare and profit motive -**In mixed economies, both private and public sectors coexist. **Private sector** undertake activities of profit maximization.

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			Public sector undertakes with a view of social welfare.
3	Solution of Central Problems	**Free Market System -** The government or any authority cannot prevent firms from buying or selling in the market.	**Central Planning System** - . In this system, all decisions are undertaken and completely controlled by the central planning authority. Such as - - What to produce - How to produce - For whom to produce	**Central Planning System and Free Market System** The central planning authority prepares the economic plans. National plans are drawn up by the Government and both private and public sectors. The private has freedom to own resources, produce goods and services and distribute
4	Government Role	**Interanal Regulation -** The government has a limited role in a capitalistic economy. The government provides basic services such as – - Defense, - Public health, - Education, etc.	**Complete Involvement** Central planning authority of government control and regulates- - Pricing system, - Production and didtribution. - Reduction in economic inequalities	**Limited Role –** In a mixed economy, the government can ensure proper utilization of resources. The government controls most of the important activities directly and the private sector indirectly.
5	Income Distribution	**Unequal -** A capitalist society is	**Equal –** A essential feature of	**Less unequal –** Mixedism promotes

		divided into two classes – • **'haves'** that is those who own property • **'have-nots'** who do not own property and work for their living. The outcome of this situation is that the rich become richer and poor become poorer. Here, economic inequality goes on increasing.	socialism is the removal and reduction of economic inequalities . That helps in equal distribution of income.	balanced growth of the economy It promotes balanced growth between ➢ Agriculture and industry, ➢ Consumer goods and capital goods, ➢ Rural and urban etc.
6	Nature of Enterprise	**Private Enterprise** – which are owned and controlled by the private sector.	**Government Enterprise -** which are owned and controlled by the government.	**Both Private and State Enterprises** – which are owned and controlled by the both private individuals and government.
7	Economic Freedom	**Complete Freedom -** Each individual is free to carry out any occupation or trade at any place and produce any commodity. Similarly, consumers are free to buy any commodity as per their choice	**Lack of Freedom** – Consumers do not enjoy freedom of choice over the consumption of goods and services.	**Limited Freedom -** Though private has freedom to own resources, produce goods and services and distribute the same, the overall control on the economic activities rests with the government.
8	Major Problem	Inequality	Inefficiency	Inequality and Ineffiency

Chapter 2 National Income

Very short answer

1. **Define National Income**.

    National income   -Alfred Marshall

    "The labour and capital of a country acting on its natural resources produce annually a certain net aggregate of commodities, material and immaterial including services of all kinds. This is the true net annual income or revenue of the country or national dividend".

2. **Write the formula for calculating GNP.**

    GNP is the total measure of the flow of final goods and services at market value resulting from current production in a country during a year, including net income from abroad.

    GNP at Market Prices = GDP at Market Prices + Net Factor income from Abroad.

3. **What is the difference between NNP and NDP?**

    Net Domestic Product (NDP)

    NDP is the value of net output of the economy during the year.

    Some of the country's capital equipment wears out or becomes outdated each year during the production process.

    Net Domestic Product = GDP – Depreciation

    Net National Product (at Market price)

    Net National Product refers to the value of the net output of the economy during the year.

    NNP = GNP – depreciation allowance

    Depreciation is also called as Capital Consumption Allowance

4. **Trace the relationship between GNP and NNP.**

    Gross National Product (GNP)

    GNP is the total measure of the flow of final goods and services at market value

    GNP at Market Prices = GDP at Market Prices + Net Factor income from Abroad.

    Net National Product (at Market price)

    Net National Product refers to the value of the net output of the economy during the year.

    NNP = GNP – depreciation allowance

    Depreciation is also called as Capital Consumption Allowance

5. What do you mean by the term 'Personal Income'?

Personal income is the total income received by the individuals of a country from all sources before payment of direct taxes in a year.

Personal income is never equal to the national income, because the former includes the transfer payments, whereas they are not included in national income.

Personal Income = National Income – (Social Security Contribution and undistributed corporate profits) + Transfer payments

6. Define GDP deflator.

GDP deflator is an index of price changes of goods and services.

GDP deflator = $\dfrac{\text{Nominal GDP}}{\text{Real GDP}} \times 100$

7. Why is self consumption difficult in measuring national income? Pg.29

➢ Farmers keep a large portion of food and other goods produced for self consumption.

➢ National income by product method is measured by the value of final goods and services at current market prices. But prices do not remain stable. They rise or fall.

➢ To solve this problem, economists calculate the real national income at a constant price level by the consumer price index.

Paragraph.

1. Write a short note on per capita income. Pg. 22

The average income of a person of a country in a particular year is called Per Capita Income.

Per capita income is obtained by dividing national income by popuunion.

Per Capita income = $\dfrac{\text{National Income}}{\text{Population}}$

2. Differentiate between personal and disposable income. Pg.21,22

1. Personal Income

Personal income is the total income received by the individuals of a country from all sources before payment of direct taxes in a year.

Personal income is never equal to the national income, because the former includes the transfer payments, whereas they are not included in national income.

Personal Income = National Income – (Social Security Contribution and undistributed corporate profits) + Transfer payments

2. Disposable Income

- Disposable Income is also known as Disposable personal income.
- It is the individuals income after the payment of income tax.
- This is the amount available for households for consumption.

  Disposable Income = Personal income – Direct Tax.

  Disposal income = consumption + saving

3. Explain briefly NNP at factor cost. Pg.21

NNP at Factor cost

NNP refers to the market value of output. Whereas NNP at factor cost is the total of income payment made to factors of production.

Thus from the NNP at market price, we deduct the amount of indirect taxes and add subsidies to arrive at the net national income at factor cost.

NNP at factor cost = NNP at Market prices – Indirect taxes + Subsidies.

4. Give short note on Expenditure method. Pg.25

1. Expenditure Method (Outlay method)

Under this method, the total expenditure incurred by the society in a particular year is added together.

To calculate the expenditure of a society, it includes

- ✓ Personal consumption expenditure,
- ✓ Net domestic investment,
- ✓ Government expenditure on consumption of capital goods and net exports.

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

  C - Private consumption expenditure

  I - Private Investment Expenditure

  G - Government expenditure

  X-M = Net exports

Items not to be included –

1. Expenditure made on second hand goods
2. Expenditure on purchase of old shares and bonds
3. Expenditure on government old aged pension
4. Expenditure on seeds and fertilizers

Items are to be included –

Expenditure on final products

5. **What is the solution to the problem of double counting in the estimation of national income? Pg.24**

    The following are the solution to the problem of double counting in the estimation of national income -

    Double counting is to be avoided under value added method.

    1. Any commodity which is either raw material or intermediate good for the final production should not be included.

        For example, value of cotton enters value of yarn as cost, and value of yarn in cloth and that of cloth in garments. At every stage value added only should be calculated.

    2. The value of output used for self consumption should be counted while measuring national income.

    3. In the case of durable goods, sale and purchase of second hand goods (for example pre owned cars) should not be included.

6. **Write briefly about national income and welfare. Pg. 31**

    National Income is considered as an indicator of the economic wellbeing of a country.

    The higher per capita income indicates greater economic welfare with a higher standard of living.

    The per capita income as an index of economic welfare suffers from limitations -

    1. The economic welfare depends upon the composition of goods and services

    2. 2. Higher GDP with greater environmental hazards such as air, water and soil pollution 3.

    3. The production of war goods will show the increase in national output but not welfare.

    4. An increase in per capita income may be due to employment of women and children or forcing workers to work for long hours. But it will not promote economic welfare.

    Therefore the Physical Quality of Life Index (PQLI) is considered a better indicator of economic welfare. It includes standard of living, life expectancy at birth and literacy.

7. **List out the uses of national income. Pg.27**

    The following are the uses of national income -

    1. From the calculation of national income –

        -   We could find how income is produced,

        -   How it is distributed,

        -   How much is spent, saved or taxed.

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2. To formulate the national policies such as –

    - monetary policy,

    - fiscal policy and other policies

    It bring the economy to the right path with the help of collecting national income data.

3. To build economic models both in short - run and long - run.

4. To know the distribution of income for various factors of production in the country.

5. To arrive at many macro economic variables namely –

    a) Tax – GDP ratio

    b) Current Account Deficit - GDP ratio

    c) Fiscal Deficit - GDP ratio

    d) Debt - GDP ratio etc

Long answer

1. **Explain the importance of national income. Pg. 27**

    National Income means - the total money value - of all final goods and services produced- in a country - during a particular period of time

    National income is of great importance for the economy of a country.

    Nowadays the national income is regarded as accounts of the economy, which are known as social accounts. It enables us

    1. To know the relative importance of the **various sectors of the economy** and their **contribution towards national income**

    2. From the calculation of national income, we could find –

        - How income is produced,

        - How it is distributed

        - How much is spent, saved or taxed.

    3. It helps to formulate the national policies such as –

        - Monetary policy

        - Fiscal policy and other policies

    4. With the help of collecting national income data -

        - the proper measures can be adopted

        - that bring the economy to the right path

    5. To formulate planning and evaluate plan progress –

        - a country's gross income,

        - output, saving and consumption from different sources are very essential.

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6. To build economic models both in short - run and long - run.

7. Nation income is important to make –

    - international comparison,

    - inter - regional comparison

    - inter - temporal comparison of growth of the economy during different periods.

8. Nation income helps to know – a country's per capita income which reflects the economic welfare of the country

9. To know the distribution of income for various factors of production in the country.

10. To arrive at many macro economic variables namely –

    - Tax – GDP ratio,

    - Current Account Deficit - GDP ratio,

    - Fiscal Deficit - GDP ratio,

    - Debt - GDP ratio etc.

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2. Discuss the various methods of estimating the national income of a country.

All goods and services produced in the country must be counted and converted against money value during a year.

Thus, whatever is produced is either used for consumption or for saving.

Thus, national output can be computed at any of three levels, viz.

1. Production or value added method

2. Income method or factor earning method

3. Expenditure method

Output = Income = Expenditure

4. **Product Method**

Product method measures the output of the country. It is also called inventory method.

The gross value of output from different sectors like –

- Agriculture,

- Industry,

- Trade

- Commerce, etc., is obtained for the entire economy during a year.

In India, the gross value of the farm output is obtained as follows :

1. Total production of 64 agriculture commodities are estimated and valued at market prices.

2. The gross value of the agricultural output are obtained by multiplying average yield per hectare.

The net value of the agricultural output is measured by making deductions of -

- Cost of seed , Fertilisers,

- Market charges,

- Repairs and depreciation from the gross value.

3. The gross value of the husbandry, forestry, fishery, mining and factory out are obtained by - multiplying total production with market prices.

Net value of these sector are derived by making deductions of –

  ➢ Cost of materials

  ➢ Depreciation allowances, etc. From gross value.

5. **Income Method (Factor Earning Method)**

   Under this method, national income is calculated by adding up all the incomes generated in the course of producing national product.

   Steps involved

   1. The enterprises are classified into various industrial groups.

   2. Factor incomes are grouped under

      a. Labour income - Wages and salaries, fringe benefits, employer's contribution to social security.

      b. Capital income – Profit, interest, dividend and royalty iii)

      c. Mixed income – Farming, sole proprietorship and other professions. 3.

   National income

   = domestic factor income + net factor incomes from abroad.

   In short, Y = w + r + i + π + (R-P)

   w = wages, r = rent, i = interest, π = profits, R = Exports and P = Imports

6. **Expenditure Method (Outlay method)**

   Under this method, the total expenditure incurred by the society in a particular year is added together.

   To calculate the expenditure of a society, it includes

   ✓ Personal consumption expenditure,

   ✓ Net domestic investment,

   ✓ Government expenditure on consumption of capital goods and net exports.

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

   C - Private consumption expenditure

   I - Private Investment Expenditure

   G - Government expenditure

   X-M = Net exports

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3. **What are the difficulties involved in the measurement of national income? Pg. no 28**

   1. **Transfer payments**
      ➤ Government makes payments in the form of pensions, unemployment allowance, subsidies, etc. These are government expenditure.
      ➤ But they are not included in the national income. Because they are paid without adding anything to the production processes.

   2. **Difficulties in assessing depreciation allowance**
      ➤ The deduction of depreciation allowances, accidental damages, repair and replacement charges from the national income is not an easy task.
      ➤ It requires high degree of judgment to assess the depreciation allowance and other charges.

   3. **Unpaid services**
      ➤ A housewife renders a number of useful services like preparation of meals, serving, tailoring, mending, washing, cleaning, bringing up children, etc.
      ➤ These are not measured in monetary terms. They are excluded from national income
      ➤ Similarly, there are a number of goods and services which are difficult to be assessed in money, such as rendering services to their friends, painting, singing, dancing, etc.

   4. **Income from illegal activities**
      Income earned through illegal activities like –
      gambling, smuggling, illicit extraction of liquor, etc., is not included in national income.

   5. **Production for self-consumption and changing price**
      ➤ Farmers keep a large portion of food and other goods produced for self consumption.
      ➤ National income by product method is measured by the value of final goods and services at current market prices. But prices do not remain stable. They rise or fall.
      ➤ To solve this problem, economists calculate the real national income at a constant price level by the consumer price index.

   6. **Capital Gains**
      ➤ Capital gains arise when a capital asset such as a-
      -   house, other property, stocks or shares, etc. Is sold at higher price than was paid for it at the time of purchase.
      ➤ Capital gains are excluded from national income.

7. Statistical problems

There are statistical problems, such as -

1. 1 Accurate and reliable data are not adequate.

2. Different languages, customs, etc., also create problems in computing estimates.

3. People in India are indifferent to the official inquiries. They are in most cases non-cooperative also.

4. Most of the statistical staff are untrained and inefficient.

4. Discuss the importance of social accounting in economic analysis pg. no 27

National income is of great importance for the economy of a country, which are known as social accounts. It enables us

1. To know the importance of various sectors of the economy; from the calculation of national income –
   - We could find how income is produced,
   - How it is distributed,
   - How much is spent, saved or taxed.

2. To formulate the national policies such as –
   - monetary policy,
   - fiscal policy and other policies

   It bring the economy to the right path with the help of collecting national income data.

3. The data pertaining to a country's gross income, output, saving and consumption are essential for formulate economic planning and Evaluate plan progress.

4. To build economic models both in short - run and long - run.

5. To make international comparison, inter - regional comparison and inter - temporal comparison of growth of the economy during different periods.

6. To know a country's per capita income which reflects the economic welfare of the country (Provided income is equally distributed)

7. To know the distribution of income for various factors of production in the country.

8. To arrive at many macro economic variables namely –
   a) Tax – GDP ratio
   b) Current Account Deficit - GDP ratio
   c) Fiscal Deficit - GDP ratio
   d) Debt - GDP ratio etc

Addition question

The following are some of the concepts used in measuring national income.

1. GDP
2. NDP
3. GNP
4. NNP
5. NNP at factor cost
6. Personal Income
7. Disposable Income
8. Per capita Income
9. Real Income
10. GDP deflator

3. Gross Domestic Product (GDP)

GDP is the total market value (market price) of final goods and services produced within the country during a year.

GDP = C + I + G + (X – M)

C – consumption goods;

I – Investment goods;

G – Government purchases;

X – Exports; M – Imports (X – M) is net export which can be positive or negative.

4. Net Domestic Product (NDP)

NDP is the value of net output of the economy during the year.

Some of the country's capital equipment wears out or becomes outdated each year during the production process.

Net Domestic Product = GDP - Depreciation.

5. Gross National Product (GNP)

GNP is the total measure of the flow of final goods and services at market value resulting from current production in a country during a year, including net income from abroad.

GNP at Market Prices = GDP at Market Prices + Net Factor income from Abroad.

6. Net National Product (at Market price)

Net National Product refers to the value of the net output of the economy during the year.

NNP = GNP – depreciation allowance

Depreciation is also called as Capital Consumption Allowance)

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7. NNP at Factor cost

NNP refers to the market value of output. Whereas NNP at factor cost is the total of income payment made to factors of production.

NNP at factor cost = NNP at Market prices – Indirect taxes + Subsidies.

8. Personal Income

Personal income is the total income received by the individuals of a country from all sources before payment of direct taxes in a year.

Personal income is never equal to the national income, because the former includes the transfer payments, whereas they are not included in national income.

Personal Income = National Income – (Social Security Contribution and undistributed corporate profits) + Transfer payments

9. Disposable Income

- Disposable Income is also known as Disposable personal income.
- It is the individuals income after the payment of income tax.
- This is the amount available for households for consumption.

Disposable Income = Personal income – Direct Tax.

Disposal income = consumption + saving

10. Per Capita Income

The average income of a person of a country in a particular year is called Per Capita Income.

Per Capita income = National Income

Population

11. Real Income

Nominal income is expressed in terms of a general price level of a particular year in other words, real income is the buying power of nominal income.

National income is the final value of goods and services produced and expressed in terms of money at current prices

NATIONAL INCOME AT CONSTANT PRICE =

National Income at current price $\div P_1 / P_0$

✓ P_1 – Price index during current year
✓ P_0 – Price index during base year

12. GDP deflator

GDP deflator is an index of price changes of goods and services.

GDP deflator = Nominal GDP x 100

Real GDP

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Chapter – 3 Theories Of Employment And Income

Very short answer

1. **Define full employment. Pg. 37**

   Keynes defines full employment as the absence of involuntary unemployment.

   Lerner defines full employment as "that level of employment at which any further increase in spending would result in an inflationary spiral of wages and price".

2. **What is the main feature of rural unemployment ? pg. 38**

   The major feature of rural unemployment is the existence of unemployment in the form of -

   1. Disguised unemployment
   2. Seasonal unemployment.

3. **Give short note on frictional unemployment. Pg. 39**

   Frictional Unemployment (Temporary Unemployment)

   Frictional unemployment arises due to imbalance between supply of labour and demand for labour.

   This is because of immobility of labour, lack of necessary skills, break down of machinery, shortage of raw materials etc.

4. **Give reasons for labour retrenchment at present situation. Pg. 39**

   The reasons for labour retrenchment at present situation-

   ✓ Invention and innovations leads to the adoption of modern technology.

   ✓ Modern technology requires less labourers and contributes to technological unemployment – there by the existing labours are retrenched.

   ✓ Labour saving devices are responsible for technological unemployment.

5. **List out the assumptions of Say's law. Pg. 41**

   1) No single buyer or seller of commodity or an input can affect price.
   2) Full employment.
   3) There will be a perfect competition in labour and product market.
   4) There is wage-price flexibility.
   5) Money acts only as a medium of exchange.

6. **What is effective demand ? pg. 42**

   ✓ Effective demand denotes money actually spent by the people on products of industry.

   ✓ The money which entrepreneurs receive is paid in the form of rent, wages, interest and profit.

   ✓ Therefore effective demand equals national income.

7. **What are the components of aggregate supply ? pg.44**

   The components of aggregate supply are :

   1. **A**ggregate (desired) consumption expenditure (C)
   2. Aggregate (desired) private savings (S)
   3. Net tax payments (T)
   4. Personal (desired) transfer payments to the foreigners (Rf)

   Aggregate Supply = C + S + T + Rf = Aggregate income generated in the economy

---

Paragraph.

1. **Explain the following in short (i) Seasonal unemployment (ii) Frictional unemployment (iii) Educated unemployment . pg. 39 (refer long answer 1)**

   1. **Seasonal Unemployment**
      - This type of unemployment occurs during certain seasons of the year.
      - In agriculture and agro based industries like sugar,production activities are carried out only in some seasons.
      - Seasonal unemployment happens from demand side also; for example ice cream industry, holiday resorts etc.

   2. **Frictional Unemployment (Temporary Unemployment)**
      - Frictional unemployment arises due to imbalance between supply of labour and demand for labour.
      - This is because of immobility of labour, lack of necessary skills, break down of machinery, shortage of raw materials etc.

   3. **Educated Unemployment**

      Sometimes educated people are underemployed or unemployed when qualification does not match the job.

      Educated unemployment caused due to
      - Faulty education system,
      - Lack of employable skills,
      - Mass student turnout and
      - Preference for white collar jobs are highly responsible for educated unemployment in India.

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2. **According to classical theory of employment, how wage reduction solve the problem of unemployment diagramatically explain. Pg. 45**

> **According to classical theory of employment, reduction in wage solve the problem of unemployment –**
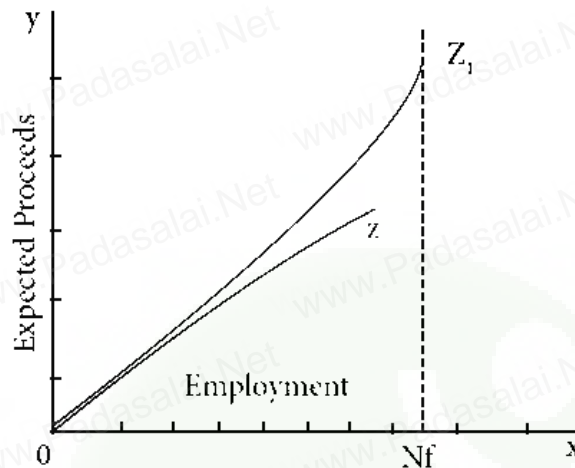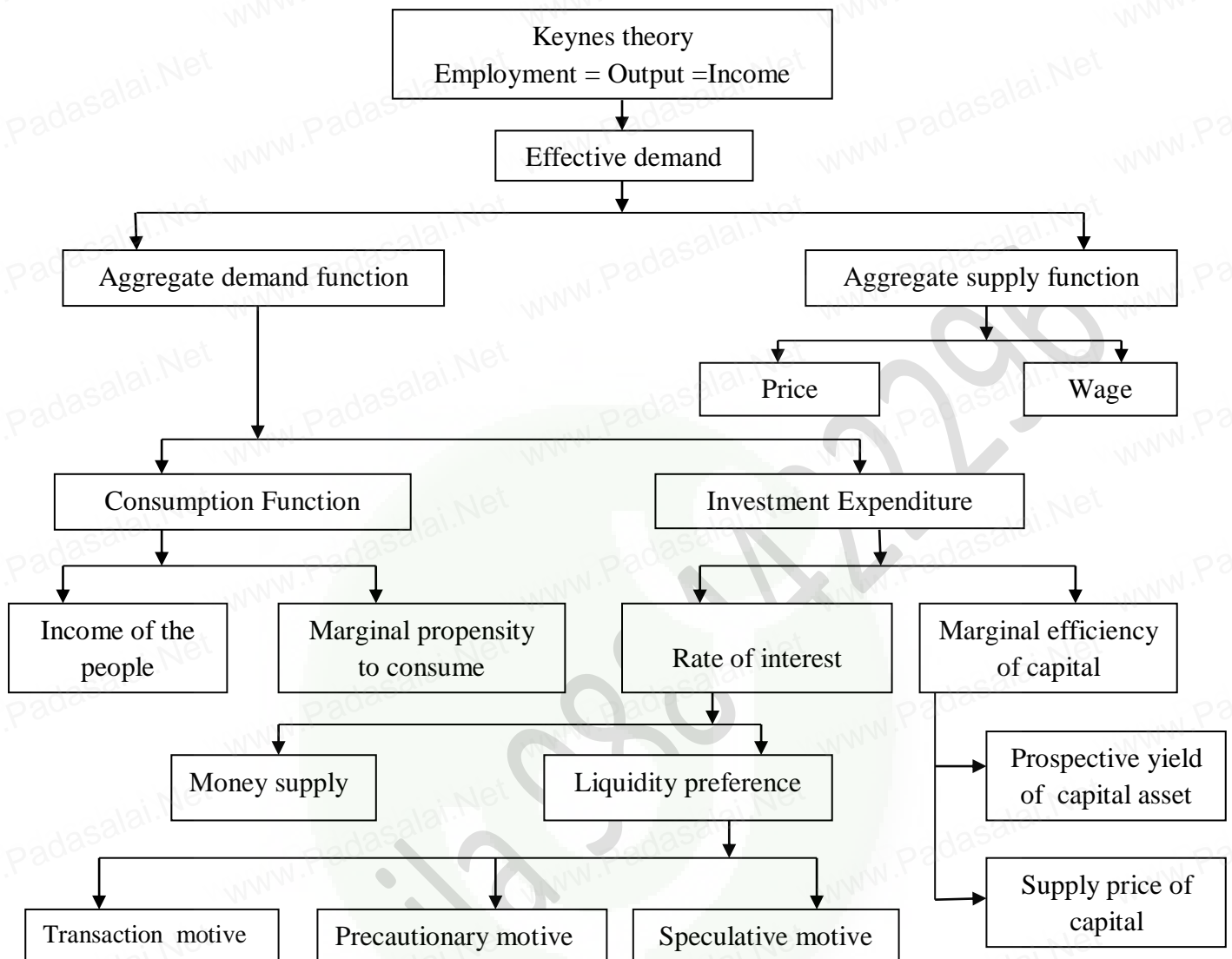

- The slope of the aggregate supply curve depends on the relation between the employment and productivity.
- The capital stock is often fixed and hence the law of diminishing marginal returns takes place as more workers are employed.
- Based upon this relation, the aggregate supply curve can be expected to slope upwards.
- In reality the aggregate supply curve will be like Z1 in figure
- Therefore, the aggregate supply depends on the relationship between price and wages.
- If the wages low, the producers will try to employ labourers, thus **reduction in wage solve the problem of unemployment .**

3. **Write short note on the implications of Say's law. Pg. 41**
   1. There is no possibility for over production or unemployment.
   2. If there exist unutilized resources in the economy, it is profitable to employ them up to the point of full employment. This is true under the condition that factors are willing to accept rewards on a par with their productivity.
   3. As automatic price mechanism operates in the economy, there is no need for government intervention.
   4. Interest flexibility brings about equality between saving and investment.
   5. Money performs only the medium of exchange function in the economy, as people will not hold idle money.

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6. Explain Keynes' theory in the form of flow chart. Pg. 43

   Keynes' theory of employment and income based on the –

```
              ┌─────────────────────────────────┐
              │          Keynes theory          │
              │ Employment = Output = Income     │
              └─────────────────────────────────┘
                              │
                              ▼
                  ┌───────────────────────┐
                  │   Effective demand    │
                  └───────────────────────┘
                     │                  │
                     ▼                  ▼
        ┌─────────────────────┐   ┌─────────────────────┐
        │ Aggregate demand    │   │ Aggregate supply    │
        │ function            │   │ function            │
        └─────────────────────┘   └─────────────────────┘
                  │                   │            │
                  ▼                   ▼            ▼
                              ┌─────────┐    ┌─────────┐
                              │  Price  │    │  Wage   │
                              └─────────┘    └─────────┘
```

Consumption Function	Investment Expenditure
Income of the people	Marginal propensity to consume
Rate of interest	Marginal efficiency of capital
Money supply	Liquidity preference
Transaction motive	Precautionary motive
Speculative motive	Prospective yield of capital asset
	Supply price of capital

7. What do you mean by aggregate demand ? Mention its components. Pg. 43

In the Keynesian model, output is determined mainly by aggregate demand.

The aggregate demand is the amount of money which entrepreneurs expect to get by selling the output produced by the number of labourers employed.

Therefore, it is the expected income or revenue from the sale of output at different levels of employment.

Aggregate demand has the following four components:

1. Consumption demand

2. Investment demand

3. Government expenditure and

4. Net Export (export – import)

$$AD = C + I + G + (X – M)$$

8. **Explain about aggregate supply with the help of diagram. Pg. 44**

      Aggregate supply refers to the value of total output of goods and services produced in an economy in a year.

      In other words, aggregate supply is equal to the value of national product, i.e., national income
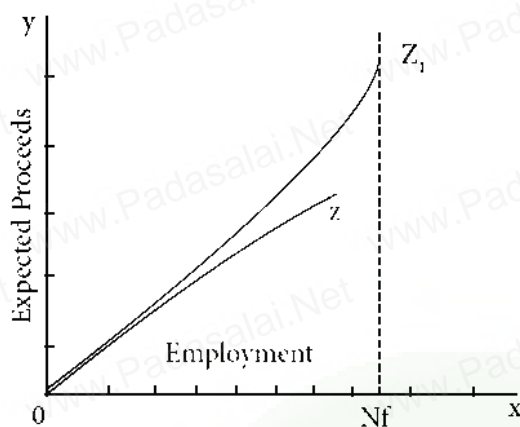
Aggregate Supply = C + S + T + Rf = Aggregate income generated in the economy

✓ Z curve is linear where money wages remains fixed;

✓ Z1 curve is non - linear since wage rate increases with employment.

✓ When full employment level of Nf is reached it is impossible to increase output by employing more men.

✓ So aggregate supply curve becomes inelastic

✓ The slope of the aggregate supply curve depends on the relation between the employment and productivity.

9. **Write any five differences between classism and Keynesianism.pg. 46 (refer long answer 4)**

Sl.No	Keynesianism	Classicism
1.	Short-run equilibrium	Long-run equilibrium
2.	Saving is a vice	Saving is a social virtue.
3.	The function of money is a medium of exchange on the one side and a store of value on the other side.	The function of money is to act as a medium of exchange
4.	Macro approach to national problems	Micro foundation to macro problems
5.	State intervention is advocated.	Champions of Laissez-fair policy

Long answer

1. **Describe the types of unemployment. Pg. 38**

   4. **Cyclical Unemployment**

      ➢ Cyclical unemployment exists in a business cycle during the period of –

         • Recession and depression

         • Fall in income and output

      ➢ Cyclical unemployment can be cured by public investment or expansionary monetary policy.

   5. **Seasonal Unemployment**

      ➢ This type of unemployment occurs during certain seasons of the year.

      ➢ In agriculture and agro based industries like sugar,production activities are carried out only in some seasons.

      ➢ Seasonal unemployment happens from demand side also; for example ice cream industry, holiday resorts etc.

   6. **Frictional Unemployment (Temporary Unemployment)**

      ➢ Frictional unemployment arises due to imbalance between supply of labour and demand for labour.

      ➢ This is because of immobility of labour, lack of necessary skills, break down of machinery, shortage of raw materials etc.

   7. **Educated Unemployment**

      Sometimes educated people are underemployed or unemployed when qualification does not match the job.

      Educated unemployment caused due to

         • Faulty education system,

         • Lack of employable skills,

         • Mass student turnout and

         • Preference for white collar jobs are highly responsible for educated unemployment in India.

   8. **Technical unemployment**

      ➢ Invention and innovations leads to the adoption of modern technology.

      ➢ Modern technology requires less labourers and contributes to technological unemployment – there by the existing labours are retrenched.

      ➢ Labour saving devices are responsible for technological unemployment.

9. **Structural Unemployment**

   ➢ Structural unemployment is due to drastic change in the structure of the society.

   ➢ Lack of demand for the product or shift in demand to other products cause this type of unemployment.

   ➢ For example rise in demand for mobile phones has adversely affected the demand for cameras, tape recorders etc.

10. **Disguised unemployment**

   ➢ Disguised unemployment occurs when more people are there than what is actually required.

   ➢ This type of unemployment is found in agriculture.

   ➢ In this situation ,marginal productivity of labour is zero or less or negative.

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2. **Critically explain Say's law of market. Pg. 40**

   Say's law of market – Jeans Baptist (1767 – 1832)

   According to Say, "When goods are produced by firms in the economy, they pay reward to the factors of production.

   The households after receiving rewards of the factors of production spend the amount on the purchase of goods and services produced by them.

   Therefore, each product produced in the economy creates demand equal to its value in the market.

   Output ⟷ **Income**
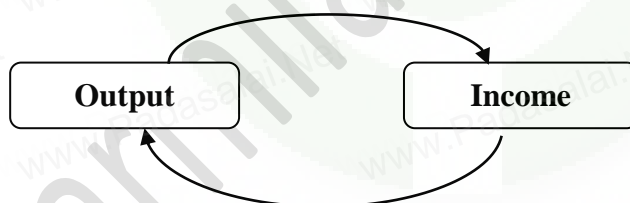
Assumptions of the Say's law of market (any 8)

The Say's Law of market is based on the following assumptions:

1. No single buyer or seller of commodity or an input can affect price.
2. Full employment.
3. People are motivated by self interest and self – interest determines economic decisions
4. There will be a perfect competition in labour and product market.
5. There is wage-price flexibility.
6. Money acts only as a medium of exchange.
7. Long - run analysis.
8. There is no possibility for over production or unemployment.
9. Unutilized resources used until reaches full employment.
10. No Government intervention .

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Implications of Say's Law

1. There is no possibility for over production or unemployment.
2. As automatic price mechanism operates in the economy, there is no need for government intervention.
3. Interest flexibility brings about equality between saving and investment.

Criticisms of says's law (any 3)

1. Acording to Keynes, supply does not create its demand.
2. Automatic adjustment process will not remove unemployment. Unemployment can be removed by increase in the rate of investment.
3. Money is not neutral. Individuals hold money for unforeseen contingencies while businessmen keep cash reserve for future activities.
4. The need for state intervention arises in the case of general over production and mass unemployment.

3. **Narrate the equilibrium between ADF and ASF with diagram.pg. 45**

 Equilibrium between ADF and ASF

Under the Keynes theory of employment, a simple two sector economy consisting of the household sector and the business sector is taken to understand the equilibrium between ADF and ASF.

There are two approaches to determination of the equilibrium level of income in Keynesian theory. These are :

1. Aggregate demand – Aggregate supply approach
2. Saving – Investment approach
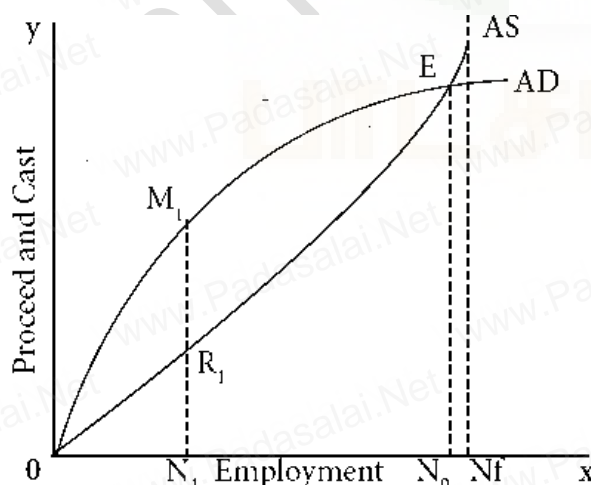
➢ In the figure, the aggregate demand and aggregate supply reach equilibrium at point E.
➢ The employment level is N_o at that point.
➢ At ON_1 employment, the aggregate supply is N1 R1.

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- But they are able to produce M1 N1.
- The expected level of profit is M1 R1.
- To attain this level of profit, entrepreneurs will employ more labourers.
- The tendency to employ more labour will stop once they reach point E.
- At all levels of employment beyond, ON_o, the aggregate demand curve is below the aggregate supply curve indicating loss to the producers.
- That the difference between $N_o - N_f$ is the level of unemployment.
- Thus the concept of effective demand becomes significant in explaining the under employment equilibrium.

4. **Explain the differences between classical theory and Keynes theory**

Sl.No	Keynesianism	Classicism
6.	Short-run equilibrium	Long-run equilibrium
7.	Saving is a vice	Saving is a social virtue.
8.	The function of money is a medium of exchange on the one side and a store of value on the other side.	The function of money is to act as a medium of exchange
9.	Macro approach to national problems	Micro foundation to macro problems
10.	State intervention is advocated.	Champions of Laissez-fair policy
11.	Capitalism has inherent contradictions	Capitalism is well and good.
12.	Budgeting should be adjusted to the requirements of economy.	Balanced budget
13.	Rate of interest is determined by the demand for and supply of money.	Rate of interest is determined by saving and investment.
14.	Rate of interest is a flow.	Rate of interest is a stock.
15.	Demand creates its own supply.	Supply creates its own demand.
16.	Rate of interest is a reward for	Rate of interest is a reward for saving

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	parting with liquidity.	

Thank you

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