

# Economics Class 12 Important Question Chapter 4

## Determination of Income and Employment

---

**Q1 What is the aggregate demand ?**

**Ans.** The demand for all the final goods and services in economy during year.

**Q2 What are the components of aggregate demand?**

**Ans.**  $AD = C + I + G + (X - M)$

**Q3 What is the relation between APC and APS?**

**Ans.**  $APC + APS = 1$

**Q4 What is the relation between MPC and MPS?**

**Ans.**  $MPS + MPC = 1$ .

**Q5 If APC is 0.7 then how much will be APS?**

**Ans.**  $1 - 0.7 = 0.3$

**Q6 If MPC = 0.75, what will be MPS?**

**Ans.**  $MPC + MPS = 1$

$1 - 0.75 = 0.25$

**Q7 What is meant by investment?**

**Ans.** Investment means addition to the stock of capital good, in the nature of structures, equipment or inventory.

**Q8 What is the investment demand function?**

**Ans.** The relationship between investment demand and the rate of interest is called investment demand function.

**Q9 What is equilibrium income?**

**Ans.** The equilibrium income is the level of income where  $AD = AS$  i.e.... $AD = AS$  and planned saving equals planned investment.

**Q10 Give the formula of investment multiplier in terms of MPC.**

**Ans.**  $K=1/1-MPC$

**Q11 What can be the minimum value of investment multiplier?**

**Ans.** One.

**Q12 What is the maximum value of investment multiplier?**

**Ans.** Infinity.

**Q13 Give the equation of consumption function?.**

**Ans.**  $C= a + by.$

**Q14 Write down the equation of saving function?**

**Ans.**  $S= -a + (1-b) y.$

### **3 AND 4 MARKS QUESTIONS.**

**Q1- Define the term Aggregate Supply.**

**Ans.** It refers to the total production of commodities in the economy at a given point of time which is measured in terms of value added or the total income generated. It also refers to the disposable income which consist of two components viz, consumption & saving. Since  $AS = Y$ , therefore,  $AS = C + S$

**Q2- Differentiate between Autonomous Investment and Induced Investment.**

**Ans.**

#### **Autonomous investment**

It refers to the investment expenditure which is incurred by the Government with the motive to promote the level of growth & development. It is not influenced by the level of profits or income of an economy.

It is influenced by the change in population structure, natural calamities, change in technology & institution, war etc.

#### **Induced investment**

It refers to the investment expenditure which is incurred by the enterprises with the motive to make greater investments & receive higher returns. It is positively related to level of income. It is influenced by the level of income of an economy. Higher the income, greater is the

induced investments, & vice versa.

**Q3- Explain the distinction between voluntary and involuntary unemployment.**

**Ans.** Voluntary unemployment refers to the situation when people are willing to remain unemployed in the production activities at the current factor prices. Involuntary unemployment refers to the situation when the willing & able bodied people remain unutilized in the economy due to lack of employment opportunities.

**Q4- What is equilibrium income?**

**Ans:** The equilibrium income is defined as the level of income where  $AD = AS$  that means Aggregate Demand is = to the Aggregate supply. Planned savings is always = to the planned investment.

**Q5- Explain the relationship between investment multiplier and MPC?**

**Ans.**  $K=1/1-MPC$ , It shows direct relationship between MPC and the value of Multiplier. Higher the proportion of increased income spend on consumption, higher will be value of investment multiplier. Higher the proportion of increased income spend on consumption, higher will be value of investment multiplier.

**Q6- Define the meaning of Deflationary gap? And measure to correct it.**

**Ans:** It is the economic situation when Aggregate demand is less than Aggregate supply corresponding to the full employment level of output.

Measures to correct it:

a- Fiscal tools-

Increase govt. expenditures.

Decrease the taxes

b- Monetary tools:

Decrease in –CRR, SLR, REPO, REVERSE REPO.

Purchase of bonds and securities in open market operation

Decrease in debt margin.

**Q7- What is Inflationary gap or excess demand? State measures to correct it.**

**Ans:** It is the economic situation when Aggregate demand is more than Aggregate supply corresponding to the full employment level of output.

Measures to correct it:

c- Fiscal tools

decrease govt. expenditures.

Increase the taxes

d- Monetary tools:

Increase in –CRR, SLR, REPO, REVERSE REPO.

sell of bonds and securities in open market operation

increase in debt margin.

**Q8-Explain the role of the following in correcting 'Excess demand in an Economy'**

**Bank Rate**

**Open market**

**Ans.**

To Correct excess demand central bank can rise the bank rate. This forces commercial bank to increase lending rates. This reduces demand for borrowing by the public for investment and consumption. Aggregate demand falls.

When there is excess demand Central Bank sells securities. This leads to flow of money out of the commercial banks to the central bank when people make payment by cheques. This reduces deposits with the banks leading to decline in their lending capacity. Borrowing decline. AD declines.

**Q9 Explain the meaning of investment multiplier? What can be its minimum value and maximum value why?**

**Ans.** Defined as the ratio of change in the income to the change in the investment.

$$K = \Delta Y / \Delta I.$$

The value of the multiplier is determined by the MPC. It is directly related to MPC.

$$K = 1 / 1 - mpc = 1 / 1 - 0 = 1$$

$$K = 1$$

Minimum value of K is when minimum value of MPC=0, the minimum value of K will be unit one.

Maximum value of K is when Value of MPC=1 , the value of K will be infinitive .

**Q10 Explain the working of a multiplier with an example.**

**Ans.** Multiplier tells us what will be the final change in the income, as a result of change in investment. Change in investment results in the change in income. Symbolically:

$$\Delta I \rightarrow \Delta Y \rightarrow \Delta C \rightarrow \Delta Y$$

The working of a multiplier can be explained with the help of the following table which is based on the consumption that is,  $\Delta I=1000$  and  $MPC=4/5$ .