NCERT SOLUTIONS

CLASS - 12th

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Subject : Economics

Chapter : 4

Chapter Name : Determination of Income and Employment

Q1 What is marginal propensity to consume? How is it related to marginal propensity to save?

Answer. Marginal propensity to consume is the rate of change in consumption due to a change in income.
Marginal propensity to save is the rate of change in savings due to a change in income.
The entire part of the income is either consumed or saved. So, C + S = I, where C = consumption, S = savings, I = Income
Dividing the equation by I, we get,

$$\frac{C}{I} + \frac{S}{I} = 1$$

So, $\frac{\triangle C}{\triangle Y} + \frac{\triangle S}{\triangle Y} = 1$

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Q2 What is the difference between ex ante investment and ex post investment?

Answer. Ex-ante investment is the investment which is planned. Ex-post investment is the investment which is actually made.
The key differences between the two are as follows -

Basis	Ex-ante investment	Ex-post investment
1. Definition	It is the planned investment in an economy.	It is the actual investment made in the economy.
2. Real /Assumption	It is only an assumption of the firm/producer about the level of investment that would be made.	It is the real investment that is made in the economy and is based on the facts and data.
3. Unsold goods	The unsold goods don't pile	The unsold goods are piled

	up in this investment.	up in this kind of investment.

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Q3 What do you understand by 'parametric shift of a line'? How does a line shift when its (i) slope decreases, and (ii) its intercept increases?

Answer. The shift in the graph of a function due to a change in any of its variables on which its value is dependent.
The equation of a line is - y = mx + c, where
m = slope, c = intercept, x,y are variables.
So, the parametric shift may take place due to a change in the slope or by intercept.
When the slope of the line decreases, the line becomes more flat and it rotates downwards.
When the intercept of the line increases, then it shifts upward. Due to an increase in intercept of the line, it moves parallel to the original line in the upward direction.

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Q4 What is 'effective demand'? How will you derive the autonomous expenditure multiplier when price of final goods and the rate of interest are given?

Answer. The level where aggregate demand in an economy is equal to the aggregate supply,is known as the effective demand. At this point, the economy is in equilibrium.
As we know that aggregate demand = C + I, where C = consumption, I = investment
Aggregate supply = C + S, where S = savings.
If the autonomous expenditure will increase, then the aggregate demand will rise but the supply would remain the same. This leads to the disturbance in the equilibrium state. So the production will be increased to increase the supply. This will increase the national income.
Again with the increase in the national income, the consumption will rise and thus the aggregate demand will increase which will force the production to rise. So, this process will continue till they both reach the same level.

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Q5 Measure the level of ex-ante aggregate demand when autonomous investment and consumption expenditure (A) is Rs 50 crores, and MPS is 0.2 and level of income (Y) is Rs 4000 crores. State whether the economy is in equilibrium or not (cite reasons).

Answer. The consumption expenditure (A) = 50 crores.
MPS = 0.2, MPS + MPC = 1
Hence, MPC = 1 - 0.2 = 0.8

AD = C + I = A + bY, where A = autonomous consumption expenditure, b = MPC, Y = Income
AD = 50 + 0.8 $\times$ 4000
= 50 + 3200
= 3250 crores.
The economy is in equilibrium when the aggregate demand is equal to the aggregate supply.
So the aggregate supply = 4000 crores, while the aggregate demand is 3250 crores. Hence, we can say that the economy isn't in equilibrium.

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Q6 Explain 'Paradox of Thrift'.

Answer. Paradox of Thrift is the effect of increase in the savings by all the households. As per this theory, if all the households will start saving more, then the total savings in the economy will not increase rather it may remain the same or even fall.
In an economy, if people would save more then they will make less consumption expenditure.
Hence, this would give rise to equilibrium at lower level.
Hence, there will be less production and thereby less payments to the factors. So, the savings would also fall. Again, the consumption expenditure will fall and the same process will be repeated. In each step, the consumer will save more part of his income but his total savings will remain the same or it may fall simply because his income will start falling.

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