DETERMINATION OF INCOME AND EMPLOYMENT

Q1. What determines the level of income, output and Employment.

Ans. Aggregate demand and Aggregate Supply determines the the level of income, output and Employment.

Q2. What is Aggregate demand?

Ans. Aggregate demand is the total demand for final goods and services in the Economy, that all the sectors of the economy are planning to buy at a given level of income, during a period of time.

Q3. What are the main Components of aggregate demand (AD)?

Ans. The main Components of AD are:

(1) Household Consumption Expenditure (C)
(2) Investment Expenditure (I)
(3) Government Consumption Expenditure (G)
(4) Net Exports $(X - M)$

or

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

Q4. What is Aggregate Supply?

Ans. It refers to the value of total final output available in an economy during a given period, say one year. Aggregate Supply, in

Q5 Give the meaning of ex-ante Savings and ex-ante investment.

Ans. Savings intended to be made during the year, where as Investment intended to be made during the year.

Q6. Can the value of APS be Negative? If yes when?

Ans. Yes, the value of APS can be negative, at very low level of income when consumption expenditure exceeds income, eg, at an income level of ₹200 when the consumption expenditure is ₹240, the saving is (−) 40.

So, $APS = \frac{S}{Y} = -\frac{40}{200} = 0.2$

Q7. Can the value of APC be greater than unity? If yes, when?

Ans. Yes, the value of APC can be greater than unity. It is so possible when the level of income is very low and consumption expenditure cannot fall below a minimum level, eg, suppose the income level ₹200 and the minimum level of consumption is ₹240, the value of $APC = \frac{C}{Y} = \frac{240}{200} = 1$

Q8. Give the formula of investment multiplier in terms of MPS

Ans. $\text{Multiplier } (k) = \frac{1}{1-MPC}$

Since, $MPS = 1 - MPC$

$\therefore \text{Multiplier} = (k) = \frac{1}{MPS}$

Q10. What is meant by voluntary unemployment?

Ans. It refers to that part of the population, which prefers not to work, even though suitable work is available for them.

Q11. What is meant by full Employment?

Ans11. Full employment refers to a situation where there is no involuntary unemployment, i.e., those who are willing to work at the current wage rate get work.

Q12. Define Underemployment Equilibrium.

Ans. Refers to a situation of equilibrium when all resources are not fully used, as some resources lie idle or unutilised.

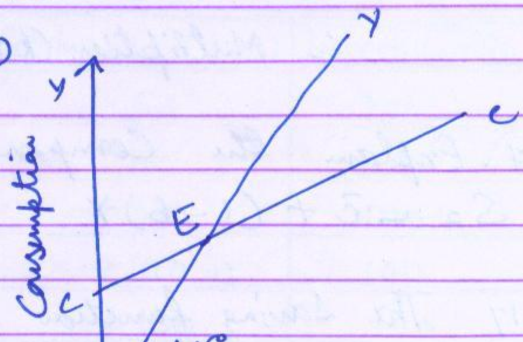
Q13 Explain the consumption function with the help of schedule and diagram.

Ans. Consumption function states or shows the relationship between consumption and income

$C = f(Y)$

This equation states that there is a direct relation between consumption and the level of income. As the level of income increases, consumption also increases but the increase in consumption is less than the increase in income

INCOME	CONSUMPTION (₹ Cr)
0	50
100	100
200	150
300	200
400	250
500	300



Q14. What measures does the Central bank adop to regulate the availability of Credit?

Ans14. (i) Bank rate
(ii) Open Market operation
(iii) Legal reserve ratio (CRR and SLR)
(iv) Margin requirements
(v) Repo rate

Q15. If planned Savings are greater than planned investment, What will be the effect on inventories?

Ans15. When Planned savings are greater than Planned investments, then the inventories start rising.

Q16. If the value of MPS is 0.25, Calculate the value of multiplier.

Ans16 Given MPS = 0.25, k = ?

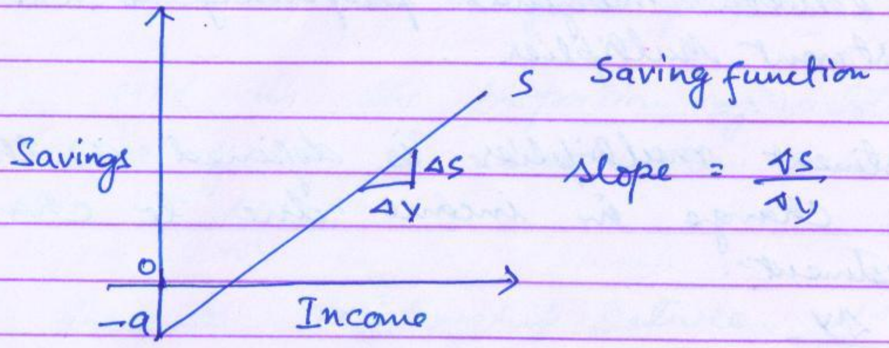
$\therefore k = \frac{1}{MPS} = \frac{\cancel{100}\,4}{0.\cancel{25}} = 4$.

$\therefore$ Multiplier (k) = 4

Q17. Explain the Components of saving function:
$S = -\bar{c} + (1-b)Y$

Ans17 The saving function is $S = -\bar{c} + (1-b)Y$
Here $-\bar{c}$ is called the intercept and it represents the amount of savings done when there is zero level of income. Savings is negative at zero level of income because at zero level of income, Consumption (a) is positive. Negative (-) savings means that at zero level

of income there is dissaving of amount $-a$

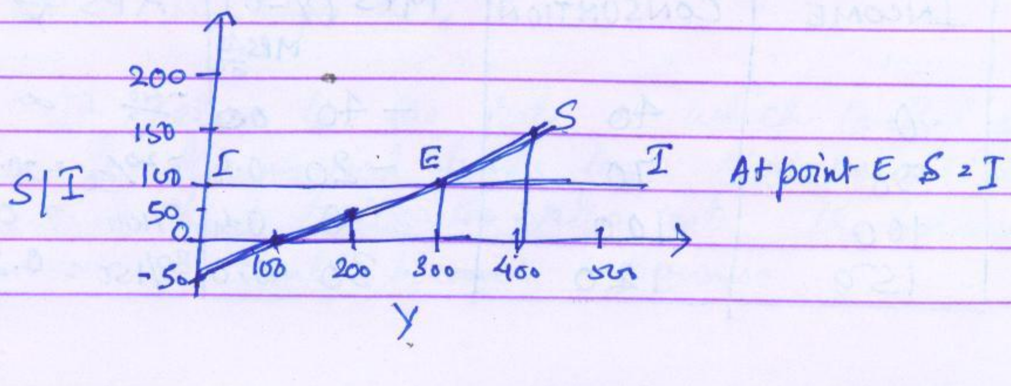


Savings increases as income increases. This is known as Marginal propensity to save (MPS). Since b i.e, MPC is less than one, it follows that $(1-b)$, i.e MPS is positive.

Q18. Explain the determination of Equilibrium level of income using S-I approach.

Ans18. $AD = AS$.
$\cancel{C}+I = \cancel{C}+S$
$I = S$ or $S = I$

Income (Y)	Consumption (C)	Saving (S) = (Y-C)	INVESTMENT (in crs)
0	50	−50	100
100	100	0	100
200	150	+50	100
=I 300	200	+100	100
400	250	+150	100



Q19. Define Investment Multiplier. Explain the relationship between marginal propensity to save and investment Multiplier.

Ans 19. Investment multiplier is defined as the ratio of change in income due to change in investment.

$$K = \frac{\Delta Y}{\Delta I}$$

Relationship between Multiplier and MPS:
The value of the multiplier varies inversely with MPS. Higher the MPS, the lower will be the size of Multiplier and lower the MPS, the larger will be the value of the multiplier.

$$K = \frac{1}{MPS}$$

For Exp: If MPS = 0.4, then

$$K = \frac{1}{MPS} = \frac{1}{0.4} = 2.5$$

If MPS = 0.1 then $K = \frac{1}{MPS} = \frac{1}{0.1} = 10$.

Q20. Complete the table.
Income: 0, 50, 100, 15.
Consumption 40, 70, 100, 120.

Ans.

INCOME	CONSUMTION	MPS (Y-C)	MPS $\frac{\Delta S}{\Delta Y}$	APS $\frac{S}{Y}$
0	40	−40	00	$\frac{-40}{0} = \infty$
50	70	−20	0.4	$-20/50 = -0.4$
100	100	0	0.4	$0/100 = 0$
150	120	30	0.6	$30/150 = 0.2$

'KEYNES INCOME AND EMPLOYMENT'

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

Ans1. MPC is the proportion of additional income going to consumption expenditure.

$$MPC = \frac{\Delta C}{\Delta Y}$$

Q2. Show the relationship between MPC and MPS.

Ans2. $MPC + MPS = 1$

$$Y = C + S$$

$$\Delta Y = \Delta C + \Delta S$$

Now dividing both sides of the equation by ΔY, we have.

$$\frac{\Delta Y}{\Delta Y} = \frac{\Delta C}{\Delta Y} + \frac{\Delta S}{\Delta Y}$$

$$1 = MPC + MPS.$$

$$MPC + MPS = 1$$

$$MPC = 1 - MPS$$

$$MPS = 1 - MPC$$

Q3. What is Inflationary gap?

Ans3. The Excess of AD over AS at full employment level of income is known as inflationary gap.

Q4. What is Repo Rate?

Ans4. It refers to the rate at which Central bank lends to Commercial banks for a short period. When the Central bank raise the repo rate, the borrowings by commercial banks becomes expensive.

This in turn compels the Commercial banks to raise their lending rates.

Q5. What is Reverse Repo-Rate?

Ans5. Rate at which Central bank borrow money from Commercial banks. During excess demand, Central banks increases Reverse Repo rate. Due to high rate of interest more and more banks supply to Central bank because of more earnings. This decrease the supply of money in the market and thus, decrease the excess demand.

Q6. What are Margin Requirement?

Ans6. Margin Requirements are the discounts determined by Central bank on the security mortgaged by the borrowers to the Commercial bank. To Correct excess demand situation, the Central bank can raise the minimum margin in selected Commodities.

Q7. What is an open Economy?

Ans 7. $AD = C + I + G + (X - M)$

Q8. What are the remedies adopted during Inflation?

Ans. (i) Reduction in government Expenditure.

(ii) Increase in the bank rate

(iii) Sale of government securities in the open

market by the Central bank.
(iv) Raising CRR and SLR.
(v) Raising Repo Rate.
(vi) Raising Reverse Repo Rate.
(vii) Raising of margin requirements.

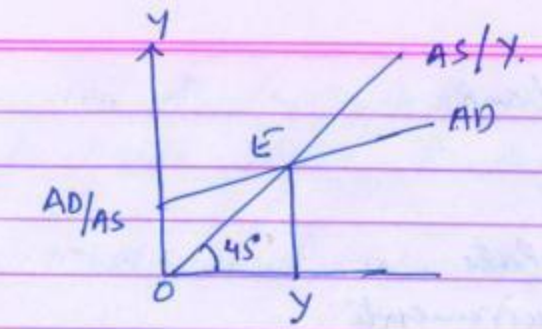
Q9. What are the remedies for deficient-demand?

Ans 9. (1) Increasing the level of government expenditure.
(2) Reduction in bank rate.
(3) Purchase of government securities in the open market by the Central bank.
(4) Reduction in CRR, SLR, Repo rate.
(5) Lowering margin requirements.

Q10. What can be the minimum value of investment multiplier?
Ans. Minimum value of the investment multiplier is 1 and maximum value is infinity.

Q11. Explain the determination of equilibrium level of income using AD = AS approach.

Ans 11. AD: Represents the total expenditure on final goods and services in an economy.
(a) Consumption expenditure (C) (b) Investment expenditure (I)
$AD = C + I$
Aggregate Supply: Refers to the total production of final goods and services in an economy.
$AS = Y$
The Equilibrium level of income is determined at a point where AD = AS.



E is the point of Equilibrium.

Q12. How open market operations be helpful in Correcting deficient demand.

Ans12. For controlling deficient demand, the Central bank should resort to buying of government securities. By buying government securities the Central bank injects the additional purchasing power into the system which results in the expansion of credit. As a result, AD increases and the problem of deficient demand can be solved.

Q13. Explain the steps taken in derivation of the CC from the saving curve.

Ans13. The steps involved in the derivation of the ~~derivation~~ Consumption curve (CC) from the saving curve are: