



# *Introductory Macroeconomics*

**Textbook in Economics for Class XII**



12105

विद्यया ऽ मृतमश्नुते



एन सी ई आर टी  
NCERT

राष्ट्रीय शैक्षिक अनुसंधान और प्रशिक्षण परिषद्  
NATIONAL COUNCIL OF EDUCATIONAL RESEARCH AND TRAINING

**First Edition**

March 2007 Phalguna 1928

**Reprinted**

February 2008 Magha 1929  
 February 2009 Magha 1930  
 January 2010 Magha 1931  
 January 2011 Magha 1932  
 January 2012 Magha 1933  
 January 2013 Pausa 1934  
 January 2014 Pausa 1935  
 December 2014 Pausa 1936  
 December 2015 Pausa 1937  
 February 2017 Magha 1938  
 January 2018 Magha 1939  
 January 2019 Pausa 1940  
 September 2019 Bhadrapada 1941  
 January 2021 Pausa 1942

**PD 57T RSP**

© **National Council of Educational  
 Research and Training, 2007**

₹ .....

Printed on 80 GSM paper with NCERT  
 watermark

Published at the Publication Division by  
 the Secretary, National Council of  
 Educational Research and Training, Sri  
 Aurobindo Marg, New Delhi 110 016  
 and printed at .....  
 .....  
 .....

**ALL RIGHTS RESERVED**

- ❑ No part of this publication may be reproduced, stored in a retrieval system or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without the prior permission of the publisher.
- ❑ This book is sold subject to the condition that it shall not, by way of trade, be lent, re-sold, hired out or otherwise disposed of without the publisher's consent, in any form of binding or cover other than that in which it is published.
- ❑ The correct price of this publication is the price printed on this page. Any revised price indicated by a rubber stamp or by a sticker or by any other means is incorrect and should be unacceptable.

**OFFICES OF THE PUBLICATION  
 DIVISION, NCERT**

NCERT Campus  
 Sri Aurobindo Marg  
**New Delhi 110 016** Phone : 011-26562708

108, 100 Feet Road  
 Hosdakere Halli Extension  
 Banashankari III Stage  
**Bengaluru 560 085** Phone : 080-26725740

Navjivan Trust Building  
 P.O. Navjivan  
**Ahmedabad 380 014** Phone : 079-27541446

CWC Campus  
 Opp. Dhankal Bus Stop  
 Panihati  
**Kolkata 700 114** Phone : 033-25530454

CWC Complex  
 Maligaon  
**Guwahati 781 021** Phone : 0361-2674869

**Publication Team**

Head, Publication Division : *Anup Kumar Rajput*  
 Chief Editor : *Shveta Uppal*  
 Chief Production Officer : *Arun Chitkara*  
 Chief Business Manager (In charge) : *Vipin Dewan*  
 Editor : *R.N. Bhardwaj*  
 Production Officer : .....

**Cover, Layout and Illustrations**  
*Blue Fish*

**Cartoonist**  
*Irfan*

# Foreword

The National Curriculum Framework (NCF) 2005, recommends that children's life at school must be linked to their life outside the school. This principle marks a departure from the legacy of bookish learning which continues to shape our system and causes a gap between the school, home and community. The syllabi and textbooks developed on the basis of NCF signify an attempt to implement this basic idea. They also attempt to discourage rote learning and the maintenance of sharp boundaries between different subject areas. We hope these measures will take us significantly further in the direction of a child-centred system of education outlined in the National Policy on Education (1986).

The success of this effort depends on the steps that school principals and teachers will take to encourage children to reflect on their own learning and to pursue imaginative activities and questions. We must recognise that, given space, time and freedom, children generate new knowledge by engaging with the information passed on to them by adults. Treating the prescribed textbook as the sole basis of examination is one of the key reasons why other resources and sites of learning are ignored. Inculcating creativity and initiative is possible if we perceive and treat children as participants in learning, not as receivers of a fixed body of knowledge.

These aims imply considerable change in school routines and mode of functioning. Flexibility in the daily time-tables is as necessary as rigour in implementing the annual calendar so that the required number of teaching days are actually devoted to teaching. The methods used for teaching and evaluation will also determine how effective this textbook proves for making children's life at school a happy experience, rather than a source of stress or problem. Syllabus designers have tried to address the problem of curricular burden by restructuring and reorienting knowledge at different stages with greater consideration for child psychology and the time available for teaching. The textbook attempts to enhance this endeavour by giving higher priority and space to opportunities for contemplation and wondering, discussion in small groups, and activities requiring hands-on experience.

The National Council of Educational Research and Training (NCERT) appreciates the hardwork done by the textbook development committee responsible for this textbook. We wish to thank the Chairperson of the advisory group in Social Sciences, Professor Hari Vasudevan, and the *Chief Advisor* for this textbook, Professor Tapas Majumdar, for guiding the work of this committee. Several teachers

contributed to the development of this textbook; we are grateful to their principals for making this possible. We are indebted to the institutions and organisations which have generously permitted us to draw upon their resources, material and personnel. We are especially grateful to the members of the National Monitoring Committee, appointed by the Department of Secondary and Higher Education, Ministry of Human Resource Development under the Chairpersonship of Professor Mrinal Miri and Professor G.P. Deshpande, for their valuable time and contribution. As an organisation committed to systemic reform and continuous improvement in the quality of its products, NCERT welcomes comments and suggestions which will enable us to undertake further revision and refinement.

New Delhi  
16 February 2007

*Director*  
National Council of Educational  
Research and Training

# Textbook Development Committee

## CHAIRPERSON, ADVISORY COMMITTEE FOR SOCIAL SCIENCE TEXTBOOKS AT THE HIGHER SECONDARY LEVEL

Hari Vasudevan, *Professor*, Department of History, University of Calcutta, Kolkata

## CHIEF ADVISOR

Tapas Majumdar, *Professor Emeritus of Economics*, Jawaharlal Nehru University, New Delhi.

## ADVISOR

Satish Jain, *Professor*, Centre for Economics Studies and Planning, School of Social Sciences, Jawaharlal Nehru University, New Delhi

## MEMBERS

Debarshi Das, *Lecturer*, Department of Economics, Punjab University, Chandigarh

Saumyajit Bhattacharya, *Senior Lecturer*, Department of Economics, Kirorimal College, University of Delhi, New Delhi

Sanmitra Ghosh, *Lecturer*, Department of Economics, Jadavpur University, Kolkata

Malbika Pal, *Senior Lecturer*, Department of Economics, Miranda House, University of Delhi, New Delhi

## MEMBER-COORDINATOR

Jaya Singh, *Lecturer*, Economics, Department of Education in Social Sciences, NCERT, New Delhi

# Acknowledgements

The National Council of Educational Research and Training acknowledges the invaluable contribution of academicians and practising school teachers for bringing out this textbook. We are grateful to Subrato Guha, *Assistant Professor*, Jawaharlal Nehru University, for going through our manuscript and suggesting relevant changes. We thank Sunil Ashra, *Associate Professor*, Management Development Institute, Gurgaon, for his contribution. We also thank our colleagues Neeraja Rashmi, *Reader*, Curriculum Group; M.V. Srinivasan, Ashita Raveendran, Pratima Kumari, *Lecturers*, Department of Education in Social Sciences and Humanities, (DESSH), for their feedback and suggestions.

We would like to place on record the precious advice of (Late) Dipak Banerjee, *Professor* (Retd.), Presidency College, Kolkata. We could have benefited much more of his expertise had his health permitted.

The practising school teachers have helped in many ways. The council expresses its gratitude to S.K. Mishra, *PGT* (Economics), Kendriya Vidyalaya, Uttarkashi, Uttarakhand; Ambika Gulati, *Head*, Department of Economics, Sanskriti School; B.C. Thakur, *PGT* (Economics), Government Pratibha Vikas Vidyalaya, Surajmal Vihar; Ritu Gupta, *Principal*, Sneh International School, Rashmi Sharma, *PGT* (Economics), Kendriya Vidyalaya, JNU Campus, New Delhi.

We also thank Savita Sinha, *Professor* and *Head*, DESSH for her support.

Special thanks are due to Vandana R. Singh, *Consultant Editor*, for going through the manuscript.

The council gratefully acknowledges the contributions of Dinesh Kumar, *In-charge*, Computer Station; Amar Kumar Prusty, *Copy Editor*, in shaping this book. The contribution of the Publication Department in bringing out this book is duly acknowledged.

This textbook has been reviewed with the support of Archana Aggarwal, *Assistant Professor*, Hindu College; Malabika Pal, *Associate Professor*, Miranda House; Lokendra Kumawat, *Assistant Professor*, Ramjas College; T. M. Thomas, *Associate Professor*, Deshbandhu College, Delhi School of Arts and Commerce and Rashmi Sharma, *Assistant Professor*, (DCAC). Their contributions are duly acknowledged.

The council is also thankful to Tampakmayum Alan Mustofa, *JPF*; Farheen Fatima, and Amjad Husain, *DTP Operators*, in shaping this textbook.

# Contents

<b>FOREWORD</b>	iii
<b>1. INTRODUCTION</b>	1
1.1 Emergence of Macroeconomics	5
1.2 Context of the Present Book of Macroeconomics	6
<b>2. NATIONAL INCOME ACCOUNTING</b>	9
2.1 Some Basic Concepts of Macroeconomics	9
2.2 Circular Flow of Income and Methods of Calculating National Income	14
2.2.1 The Product or Value Added Method	17
2.2.2 Expenditure Method	21
2.2.3 Income Method	22
2.2.4 Factor Cost, Basic Prices and Market Prices	24
2.3 Some Macroeconomic Identities	25
2.4 Nominal and Real GDP	29
2.5 GDP and Welfare	30
<b>3. MONEY AND BANKING</b>	36
3.1 Functions of Money	36
3.2 Demand for Money and Supply of Money	37
3.2.1 Demand for Money	37
3.2.2 Supply of Money	38
3.3 Money Creation by Banking System	39
3.3.1 Balance Sheet of a Fictional Bank	40
3.3.2 Limits to Credit Creation and Money Multiplier	40
3.4 Policy Tools to Control Money Supply	42
<b>4. DETERMINATION OF INCOME AND EMPLOYMENT</b>	53
4.1 Aggregate Demand and its Components	53
4.1.1 Consumption	54
4.1.2 Investment	56
4.2 Determination of Income in Two-sector Model	56
4.3 Determination of Equilibrium Income in the Short Run	57
4.3.1 Macroeconomic equilibrium with price level fixed	57
4.3.2 Effect of an autonomous change in aggregate demand on income and output	60



4.3.3 The Multiplier Mechanism	61
4.4 Some More Concepts	64
<b>5. GOVERNMENT BUDGET AND THE ECONOMY</b>	66
5.1 Government Budget – Meaning and its Components	66
5.1.1 Objectives of Government Budget	67
5.1.2 Classification of Receipts	68
5.1.3 Classification of Expenditure	69
5.2 Balanced, Surplus and Deficit Budget	70
5.2.1 Measures of Government Deficit	71
<b>6. OPEN ECONOMY MACROECONOMICS</b>	85
6.1 The Balance of Payments	86
6.1.1 Current Account	86
6.1.2 Capital Account	88
6.1.3 Balance of Payments Surplus and Deficit	88
6.2 The Foreign Exchange Market	91
6.2.1 Foreign Exchange Rate	91
6.2.2 Determination of the Exchange Rate	92
6.2.3 Merits and Demerits of Flexible and Fixed Exchange Rate Systems	95
6.2.4 Managed Floating	95
GLOSSARY	105