ISC SEMESTER 2 EXAMINATION
SAMPLE PAPER - 1
ECONOMICS

Maximum Marks: 40

Time allowed: One and a half hour

*Candidates are allowed an additional **10 minutes** for **only** reading the paper.*

*They must **NOT** start writing during this time.*

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*Answer **all** questions in **Section A, Section B** and **Section C**.*

Section-A

Question 1.

(i) If GDP_{mp} is ₹500 cr and NIT is – ₹40 cr, what is the value of GDP_{fc}?

    (a) ₹460 cr   (b) ₹420 cr   (c) ₹540 cr   (d) ₹580 cr

(ii) Currency issued by Central Bank is:

    (a) High powered money   (c) Fiat money

    (b) Legal tender money   (d) All of these

(iii) Following are the features of aggregate demand curve except:

    (a) AD curve is upward sloping

    (b) AD curve is a 45 degree line

    (c) AD starts from Y-axis

    (d) AD curve is combination of consumption and investment curve

(iv) NFIA is equal to zero when:

    (a) Indirect tax is equal to subsidies

    (b) GDP is equal to GNP

    (c) Factor income from abroad is equal to factor income to abroad

    (d) Both (b) and (c)

(v) The level of AD at the equilibrium level is _____ demand.

(vi) _____ deficit represents the borrowing requirements of the government.

(vii) $NDP_{mp} - GDP_{mp} =$ _____

(viii) Give one difference between revenue receipts and capital receipts.

Section-B

Answer the following questions briefly.

Question 2.

Give any two limitations of barter system.

Question 3.

Briefly explain two measures to correct the situation of BOP in an economy.

Question 4.

The value of flour used to make a cake is not included in national income while the value of the cake is included. Both are produced in a secondary sector. Explain the reason for the difference in the treatment of two items.

Question 5.

Complete the data below:

Equilibrium level of income = ₹500 Cr.

MPC = 0.8

Investment = ₹70

Autonomous consumption = ?

Question 6.

(i) Differentiate between current account and saving account. Give any two differences.

OR

(ii) Differentiate between current account and capital account of BOP. Give two points.

Question 7.

Explain the following tools of Central Bank to control credit:

(i) Rationing of credit

(ii) Moral suasion

Section-C

Question 8.

(i) Draw a linear consumption curve and show the points where:

APC = 1

APC > 1

APC < 1

OR

(ii) What is ex-ante consumption? Distinguish between autonomous consumption and induced consumption.

Question 9.

Enlist any four sources of demand for foreign exchange. Why the demand curve of foreign exchange under flexible exchange rate system is downward sloping?

Question 10.

Define NDP_{fc}. Explain the three components of NDP_{fc}.

Question 11.

Explain the following objective of Government budget:

(i) Economic stability

(ii) Redistribution of income and wealth

Question 12.

Read the given extract carefully and answer the following questions.

Mr. X wants a loan amount of ₹2.5 lakh. He approached a commercial bank. Mr. X was asked for a collateral amount of ₹2.75 lakh. He presented the documents of his own car to the bank.

(i) Why bank asks for higher value of collateral than the loan amount from the borrowers?

(ii) The difference between collateral amount and loan amount is known as?

(iii) What will happen if central bank changes (Increases and decreases) this difference between collateral amount and loan amount?

Answers

Section-A

Answer 1.

(i) (c) ₹540 cr

Explanation:

In the question,
So,

$$GDP_{mp} = GDP \text{ at factor cost} + \text{Net indirect taxes}$$
$$GDP_{mp} = 500 \text{ and NIT is} - 40cr$$
$$500 = GDP_{fc} + (-40)$$
$$GDP_{fc} = ₹540cr.$$

(ii) (d) All of these

Explanation:

The Central bank of India issues the following types of currency i.e., Fiat money, high powered money or monetary base and Legal tender money.

(iii) (b) AD curve is a 45 degree line

Explanation:

Features of Aggregate Demand (AD) curve includes – It is upward sloping curve (in case of giffen goods), AD curve starts from Y-axis and AD curve is combination of consumption and investment curve.

(iv) (d) Both (b) and (c)

Explanation:

NFIA is equal to zero when GDP is equal to GNP and income earned from abroad is equal to income paid to abroad.

(v) effective

Explanation:

Effective Demand Principle is a situation in which the equilibrium output is determined solely by the level of aggregate demand.

(vi) Fiscal

Explanation:

The difference between total revenue and total expenditure of the government is termed as fiscal deficit. It is an indication of the total borrowings needed by the government.

(vii) Depreciation

Explanation:

Net Domestic Product (NDP) is equal to GDP minus deprecation.

(viii) Revenue receipts are recurring in nature while capital receipts are non-recurring in nature.

Answer 2.

Two limitations of barter system are:

1. **Lack of double coincidence of wants :** Barter system can work only when both buyer and seller are ready to exchange each other's goods. There must be a simultaneous fulfillment of wants of the buyers and the seller in the form of commodities exchanged.

2. **Lack of common unit of value :** A common unit of value would be when one single good is used to express the exchange rate of all other commodities that are being offered for sale. There is no common measure of value in the barter system. All commodities do not possess equal values.

Answer 3.

Two measures to correct the situation of BOP in an economy are:

1. **Export promotion :** Exports should be encouraged by granting various benefits to manufactures and exporters. At the same time, imports should be discouraged by undertaking import substitution.
2. **Reducing inflation :** Inflation discourages exports and encourages imports. Therefore, Government, should check inflation and lower the prices in the country.

Answer 4.

The value of the flour is not included in the national income as it is a raw material to produce the final good *i.e.* cake. Raw material is an intermediate good which is used for making final good and losses its identity in the process of making final good (cake). Its value is already included in the final good. Hence, it is not included separately in the calculation of national income.

If the value of intermediates are included in the national income, it will lead to the PROBLEM OF DOUBLE COUNTING.

Answer 5.

At equilibrium level,

AD = AS   ...(1)

$AD = C_0 + bY + I$

$AS = Y$

C_0 = Autonomous consumption

Y = Income

b = MPC

Substituting in 1

AD = AS

$C_0 + bY + I = Y$

$C_0 + 0.8 (500) + 70 = 500$

$C_0 + 400 + 70 = 500$

$C_0 = 500 - 470$

$C_0 = ₹30$ cr

Autonomous consumption = ₹30 cr

Answer 6.

(i)

S.No.	Current account	Saving account
1.	It is mostly managed by businessmen and industrialists.	It is mainly managed by small savers like farmers etc.
2.	It provides overdraft facility.	It does not provide overdraft facility.

OR

(ii)

| S.No.	Current account	Capital account
1.	It records economic transactions which includes imports and exports of goods, services and unilateral transfers between countries.	It records all such transactions between residents of a country and rest of the world which cause a change in the asset or liability status of the residents of a country or its government.
2.	The main components are export and import of good's services and unilateral transfers.	The main components are private capital transaction, official capital transaction, and banking capital transaction.

Answer 7.

(i) **Rationing of credit :** Under this method, reserve bank fixes credit limit for different business activities in the economy. If the member bank seeks more loans than their fixed quota, they will have to pay higher interest.

(ii) Moral suasion : It refers to oral or written appeal made by the RBI to the banks to increase or decrease money supply in the economy.

Answer 8.

(i) C is the consumption curve and Y is the income line.

Consumption curve starts from Y axis due to the component of autonomous consumption.
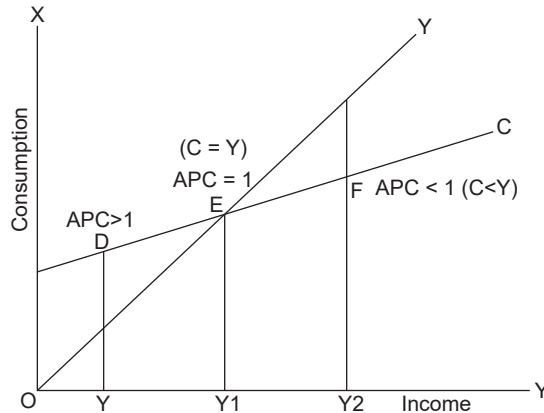
1. At OY level of income, the consumption is more than income. Since, APC = C / Y and here C > Y, that is why APC > 1.

2. At OY_1 level of income the consumption is equal to income. Since, APC = C / Y and here C = Y, that is why APC = 1.

3. At OY_2 level of income the consumption is less than income. Since, APC = C / Y and here C < Y that is why APC < 1.

OR

(ii) Ex-ante consumption refers to desired consumption (or planned consumption) at different levels of income in the economy.

Autonomous consumption refers to minimum level of consumption, even when income is zero. It remains fixed and independent of the level of income.

Induced consumption changes as the level of income changes in the economy. It is dependent on the level of income and it is directly related to income. It is determined by the marginal propensity to consume.

Consumption function comprises of both autonomous and induced consumption. It can be explained mathematically.

Consumption function: C = c + bY.

c = Autonomous Consumption

bY = Induced Consumption

Answer 9.

Four sources of demand for foreign exchange are:

1. For making payments for the imports of goods and services *i.e.* imports. E.g. purchase of plant and machinery by domestic firms from United States.

2. For unilateral transfer such as sending gifts abroad.

3. For making investment and lending abroad by the domestic residents e.g. shares, debentures, loans etc.

4. To speculate on the value of foreign currencies *i.e.* buying and selling foreign currency with intentions of making profits.

The demand curve of foreign exchange is downward sloping because there is an inverse relationship between foreign exchange rate and foreign exchange.

Higher the exchange rate, lower the demand for imported commodities and hence the demand for foreign currency is lower. Similarly, lower the exchange rate higher the demand for imported commodities and hence the demand for foreign currency is higher.

Answer 10.

Net Domestic Product at factor cost can be defined as total factor income earned by the factor of production while working within the domestic territory of the country in an accounting year.

Three components of NDP$_{fc}$ are:

1. **Compensation of employees:** Compensation of employees refers to all the payments and transfers made by employers to their employees (both in cash and kind) in lieu of their productive services.

   It includes the following:

   (a) Wages and salaries

   (b) Employer's contribution to the social security schemes

2. **Operating surplus:** It is the total income earned by the firm during the process of production from property and entrepreneurship.

   (a) Income from property: Income from property refers to the income arising from the ownership of the financial assets (bonds, debentures) real assets (land, mines, forest etc.) and intangible assets (patents, copyright). Therefore, income from property is classified as:

   (1) Rent: It is the income earned by the owner of the land, building, machinery and other properties.

   (2) Interest: Interest is a payment for providing capital to the production unit.

   (3) Royalty: Royalty is the payment made for the use of natural resources (i.e. mining) or granting the right for using patents, copyrights and trademarks, etc.

   (b) Income from entrepreneurship: The income earned by the entrepreneurs from the entrepreneurship is called profits. However, profit is divided in 3 parts:

   (1) Dividend/Distributed profits.

   (2) Reserves/retained earnings/undistributed profits/savings of private corporate sector.

   (3) Corporate tax (tax on company's profit).

3. **Mixed income of the self-employed :** It is the third component of the domestic factor income. It is the income which has the features of both compensation of employees and operating surplus e.g. lawyer's fees or doctor's fees.

Answer 11.

(i) **Economic stability:** Economic stability means stability in fluctuations of prices in the economy. Government can control these fluctuations through taxes and expenditure. For example: Government can reduce the expenditure in the situation of inflation and increase the expenditure in depression conditions.

(ii) **Redistribution of income and wealth:** Through its budget, government uses fiscal instruments of taxation and subsidies with a view of improving the distribution of income and wealth in the economy. A government reduces the inequality in the distribution of income and wealth by imposing taxes on the rich and giving subsidies to the poor and spending more on the welfare of the poor. It will reduce income of the rich and raises the living standard of the poor. Thus, it leads to equitable distribution of income.

Answer 12.

(i) Bank asks for higher value of collateral because in case of failure to repay the loan, the principal amount and loan amount can be recovered with the help of security kept by the borrower.

(ii) The difference between collateral amount and loan amount is called margin requirement.

(iii) If central bank changes (Increases and decreases) this difference between collateral amount and loan amount *i.e.*, Margin requirement, it changes the money supply in the economy. Increase in the margin requirement, reduces the money supply as less amount of loans is made available with the same amount of security.

   Decrease in margin requirement increases the money supply as more amount of loans are distributed with same amount of security kept.

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