

ISC SEMESTER 2 EXAMINATION
SAMPLE PAPER - 2
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.

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

Section-A

Question 1.

- (i) If change in stock is ₹40 cr, then opening and closing stock will be:
- (a) ₹80 cr and 40 cr (c) ₹10 cr and ₹50 cr
(b) ₹120 cr and ₹80 cr (d) None of these
- (ii) In order to correct the situation of deflation, finance minister uses the policy of:
- (a) Selling securities to commercial banks
(b) Increasing expenditure on infrastructure development
(c) Raising taxes on rich people
(d) Reduces expenditure on various social security schemes
- (iii) Which one of the following is correct about APC?
- (a) APC of rich is more than that of poor (c) APC can never be zero
(b) APC can never be greater than 1 (d) APC rises with rise in income
- (iv) Which amount of the following is not the part of GDP at MP?
- (a) Depreciation (c) NIT
(b) NFIA (d) Value of final goods
- (v) The value of _____ (APC/APS) can be negative.
- (vi) If borrowings and other liabilities are added to the budgetary deficit, we get _____ deficit.
- (vii) $NVA_{mp} = GVA_{fc} - \text{_____} + \text{_____}$
- (viii) Giving one difference between Entertainment tax and Wealth tax

Section-B

Answer the following questions briefly.

Question 2.

Differentiate between quantitative and qualitative tools to control credit.

Question 3.

In which sub- account and on which side of BOP account will following be recorded? Give reasons.

- (i) Interest paid on loan received from Nepal
- (ii) Increase of MNCs investment in India

Question 4.

Meals given to a beggar will not be counted under national income accounts but will increase the welfare of the economy. Defend or refute the given statement with valid reason.

Question 5.

In economy equilibrium level of income is ₹12,000 crore. The ratio of MPC to MPS is 3:1. Calculate the additional investment needed to reach a new equilibrium of ₹20,000.

Question 6.

- (i) Distinguish between cash credit and overdraft.

OR

- (ii) How does rise in demand for a foreign currency affects the foreign exchange rate under flexible exchange rate system?

Question 7.

What do you mean by the following terms:

- (i) LRR
- (ii) Bank Rate

Section-C

Question 8.

- (i) What is meant by the 'Effective Demand Principle' in Keynesian theory of employment? Discuss by using a schedule.

OR

- (ii) Define consumption function? What are the two technical attributes consumption function?

Question 9.

According to recent media reports:

'USA has accused China of currency devaluation to promote its exports'.

In the light of the given media report comment, how exports can be promoted through the currency devaluation?

Question 10.

What is National Income? Why is it necessary for a country to calculate National Income?

Question 11.

- (i) Giving reasons, categories the following into revenue and capital expenditure:
- (a) Construction of school building by the government.
 - (b) Payment of interest
- (ii) As it has been stated that Demonetisation of ₹500 and ₹1,000 rupees notes would help the government in lowering its fiscal deficit. Defend or refute the statement with the reason.

Question 12.

Read the given extract carefully and answer the following questions.

"RBI slashed the policy repo rate by 25 basis points in the latest review." – The Economics Times.

- (i) How will this decision taken by the RBI affects credit creation by commercial banks?
- (ii) Define repo rate.
- (iii) Under what circumstances, the decision to slash the repo rate is undertaken by RBI?



Section-A

Answer 1.

- (i) (c) ₹10 cr and ₹50 cr

Explanation:

Change in stock = Closing stock – Opening stock

Closing stock = 50cr, Opening stock = 10cr

Hence,

Closing stock = 50 – 10 = ₹40cr

- (ii) (b) Increasing expenditure on infrastructure development

Explanation:

In order to correct the situation of deflation the government should increase expenditure on infrastructure development.

- (iii) (c) APC can never be zero

Explanation:

APC can never be zero. The only possible way for APC to be zero is when consumption becomes zero. However, this is impossible because the consumption function includes autonomous consumption, which is always positive.

- (iv) (b) NFIA

Explanation:

Gross Domestic Product at market price refers to the market value of final goods and services produced within the domestic territory of a country during the period of an accounting year, inclusive of depreciation. So NFIA should not be a part of GDPmp.

- (v) APS

Explanation:

APS can have a negative value if income is zero and consumption has a positive value.

- (vi) fiscal deficit

Explanation:

Fiscal deficit occurs when the government's total expenditure exceeds the revenue that it generates which excludes money from the borrowings. When expenditure exceeds revenues it is called as budget deficit. Hence, when borrowings and liabilities are added to the budget deficit we get fiscal deficit.

- (vii) – Depreciation + NIT

Explanation:

NVAmP includes GVAfc – Depreciation + NIT

- (viii) Entertainment tax is an indirect tax, as the burden of this tax can be shifted to others whereas Wealth tax is a direct tax, as the burden of this tax cannot be shifted to someone else.

Section-B

Answer 2.

S.No.	Quantitative Methods	Qualitative Methods
1.	It refers to those methods of credit control which are used by the central bank to influence the total volume of credit/money supply in the economy.	These are the selective methods which are used by the central bank to regulate the credit into the particular direction of the economy.
2.	These are general in nature.	These are specific in nature.

Answer 3.

(i) Interest paid on loan received from Nepal:

It will be included in the current account, debit side of BOP. Because it leads to outflow of foreign currency and the payment of the interest does not affect the assets and liabilities.

(ii) Increase of MNCs investment in India:

It will be included on the credit side of capital account as it leads to inflow of foreign currency and it increases the assets of the country in the form of investments.

Answer 4.

The given statement is correct. Meals to beggar is a unilateral transfer because beggars do not give anything in return to get meals. Such transactions are not included in national income accounts but these transactions help in fulfilment of basic requirements of those who cannot afford it. Therefore, these transactions will cause an increase in the welfare of the nation.

Answer 5.

Equilibrium level of income = ₹12,000 ... (1)

New equilibrium level of income = ₹20,000 ... (2)

Change in income = ₹8,000 (2 - 1)

MPC : MPS = 3 : 1

MPC = $3/4 = 0.75$

MPS = $1/4 = 0.25$

Value of investment multiplier (K) = $1/\text{MPS} = 1/0.25 = 4$

$K = \text{Change in income} / \text{Change in investment}$

$4 = 8000 / \text{Change in investment}$

Change in investment = ₹2,000

Answer 6.

(i) Cash credit is a short term loan approved by banks for businesses, financial institutions and companies to meet their working capital requirements. The borrowing company can take money, even without having credit balance, but limited to the extent of borrowing limit.

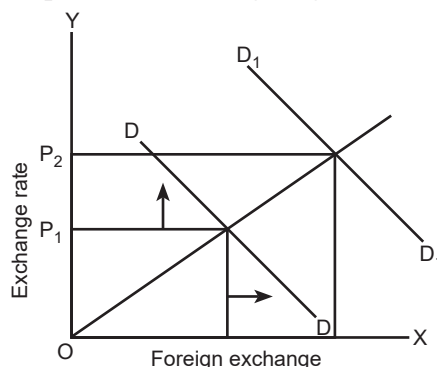
Whereas, Overdraft refers to the facility made available to the current account holders to overdraw their account upto the limit sanctioned. The interest is charged over the amount overdrawn.

OR

(ii) Rise in demand for a foreign currency affects the foreign exchange rate under flexible exchange rate system in the following manner:

Due to rise in demand for foreign currency, the demand curve shifts towards right. Due to excess demand of foreign currency the price of foreign currency (also called foreign exchange rate) starts rising. This rise in foreign exchange rate is called "Depreciation of domestic currency".

It can be explained with the help of the following diagram:



In the diagram, the new demand curve is D_1 and increase in demand has led to rise in foreign exchange rate from OP_1 to OP_2 . The result is depreciation of domestic currency.

Answer 7.

(i) **LRR (Legal Reserve Ratio)** : It is the part or fraction of the demand deposits which the banks has to keep in this form of cash with itself. It has two components- CRR and SLR. It is a quantitative tool that affects the credit creation function of commercial bank.

(ii) **Bank Rate** : It is the rate at which central bank lends money to the commercial bank for a long period. It is a quantitative tool used by the central bank to influence the lending capacity of commercial banks.

Answer 8.

(i) Effective demand is that level of income where the Aggregate Demand (AD) is equal to the Aggregate Supply (AS).

Schedule : (all figures in ₹ crore)

Income	Consumption (C)	Savings (S)	Investments (I)	Aggregate Demand (C + I)	Aggregate Supply (C + S)
0	50	- 50	100	150	0
100	100	0	100	200	100
200	150	50	100	250	200
300	200	100	100	300	300
400	250	150	100	350	400
500	300	200	100	400	500

In the schedule, the level of effective demand is ₹300 Crore as $AD = AS$.

At the income level below ₹300 cr, $AD > AS$, which indicates planned availability of goods and services is less than the planned aggregate expenditure. This will reduce the inventories.

At the income level above ₹300, $AD < AS$ which indicates that planned availability of goods and services is more than the planned aggregate expenditure. This will pile up the stock levels.

Hence, the effective demand is at the point of equality between AD and AS.

OR

(ii) A propensity to consume or the consumption function states the relationship between the aggregate consumption expenditure and aggregate income. This concept was introduced by Lord Keynes under his psychological law of consumption which states that as income increases, consumption also increases but at a lesser rate than the increase in income.

Two attributes are:

- 1. The average propensity to consume:** It may be defined as the ratio of consumption expenditure to any particular level of income.
- 2. The marginal propensity to consume:** It may be defined as the ratio of the change in consumption to the change in income.

Answer 9.

USA has accused China of currency devaluation to promote its exports.

Currency devaluation refers to reduction in price of domestic currency in terms of all foreign currencies under fixed exchange rate regime. It makes domestic goods cheaper in foreign country as more of such goods can now be purchased with same amount of foreign currency. So, it leads to increase in exports. It is observed that this practice has been adopted by China to make its goods cheaper in the global market to capture the market of other countries.

It has increases the exports of China due to the alteration towards cheaper commodities.

Answer 10.

National income is the sum of the value of all final goods and services produced in the country in a given period of time usually a year. National Income includes the net factor income from abroad but does not include the cost of depreciation nor does it include any income which accrues to the government.

It is very important for a country to calculate its National Income as it expresses the growth rate of the economy of that country. Besides it is important to measure the National Income for the following reasons:

- 1. Functioning of the economy:** National income data helps us to understand the functioning of the economy. For instance, it enables us to know whether the level of economic activity, level of

production, consumption, saving and investment are high or low. It also provides us an insight into the interdependence of different parts and sectors of the economy.

2. **Reflects the structure of the economy:** National income statistics gives us a correct picture about the structure of the economy, For instance, they indicate the importance of different sectors of the economy. This statistics also show us the pattern of distribution of the economy throwing light on the inequalities in the distribution of income if there is any.

Answer 11.

- (i) **(a) Capital expenditure:** As it increases the assets of the government.
(b) Revenue expenditure: As it neither increases the assets nor reduces the liabilities of the government.
- (ii) Yes, Demonetisation of ₹500 and 1000 rupees notes would help the government in lowering its fiscal deficit. Demonetisation will help in a way that black money economy will shrink. Unaccounted income will now be counted as a part of national income. This will increase the revenue receipt of the government by way of taxes. Rise in the taxes will reduce the fiscal deficit of the government.

Answer 12.

Slash in the repo rate mean fall in the value of the repo rate which is the rate at which the commercial banks borrows funds from RBI for a short period of time.

- (i) As the rate decreases, the rate of interest on the loans granted to general public also decreases. Due to dearer monetary policy, the investment levels falls in the economy. As the lending powers of the commercial banks will reduce, the credit creation will also fall.
- (ii) It is the rate at which the central bank of a country lends money to the commercial bank in the case of any shortfall of funds. It is a short term funding.
- (iii) The decision to slash the repo rate is undertaken by RBI in order to control the excess money supply or inflationary pressures in the economy.

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