

ISC SEMESTER 2 EXAMINATION
SAMPLE PAPER - 3
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) Which among the following is incorrect about real GDP?
 - (a) GDP calculated at base year prices.
 - (b) GDP which can be compared over different years.
 - (c) It is a true indicator of economic growth.
 - (d) It is affected by the fluctuation in the prices over different years.
- (ii) Suppose initial deposit in a bank is ₹1000 and LRR is 20%. What will be the value of credit multiplier and total credit created?
 - (a) 4, ₹4000
 - (b) 5, ₹4000
 - (c) 5, ₹5000
 - (d) 4, ₹5000
- (iii) What will be the value of APC, when $\text{Income} = \text{Consumption}$?
 - (a) $\text{APC} = 0.5$
 - (b) $\text{APC} = 1$
 - (c) $\text{APC} > 1$
 - (d) $\text{APC} = 0$
- (iv) Which among the following will not be included in the domestic income?
 - (a) Income earned by an Indian while working in an American embassy.
 - (b) Income earned on the sale of shares.
 - (c) Brokerage paid on the sale of second hand car.
 - (d) Imports of goods.
- (v) _____ is defined as the total willingness of all the sectors of an economy who demand goods and services in an economy in a given period.
- (vi) Repayment of loans is a _____ expenditure of the government.
- (vii) Domestic income – National Income = _____
- (viii) What is the difference between fiscal deficit and primary deficit known as?

Section-B

Answer the following questions briefly.

Question 2.

Differentiate between commercial bank and Central Bank.

Question 3.

What are the two reasons behind downward sloping demand curve of foreign exchange?

Question 4.

Under what circumstances the following will be true? Give reasons:

- (i) NIT is Zero
- (ii) NFIA is Negative

Question 5.

Complete the following schedule and mention the break even point from the following, when MPC is 0.8

Income	Consumption	APC	APS
0	40		
100			
200			
300			
400			

Question 6.

- (i) Differentiate between Repo rate and Reverse repo rate.

OR

- (ii) Due to “Make in India” project, there has been a flow of foreign currency in the country. What will be the impact on foreign exchange rate under flexible exchange rate system?

Question 7.

Explain the role of the Reserve Bank of India with respect to :

- (i) Custodian of foreign exchange.
- (ii) Promotional and developmental functions.

Section-C

Question 8.

- (i) Explain saving and investment approach of achieving equilibrium level of income in an economy.

OR

- (ii) Define: (a) Ex-Post Savings (b) Involuntary unemployment

Question 9.

Distinguish between fixed and flexible exchange rate system on the basis of:

- | | |
|---------------------------|-----------------------|
| (i) Determining authority | (iii) Scope to change |
| (ii) Role of Central Bank | (iv) Speculation |

Question 10.

What do you mean by value added method? Explain the steps involved in this method for calculating national income.

Question 11.

Discuss four methods of repayment of public debt.

Question 12.

Read the given extract carefully and answer the following questions.

Suresh wants to start a business and for the repeated digital transactions, he wants to open an account with the bank. He also requested for an overdraft facility upto a limit of ₹20,000.

- (i) Which kind of deposit is best suited for Suresh?
(ii) Enlist any two features of the account opened by Suresh?
(iii) What is overdraft?



Section-A

Answer 1.

- (i) (d) It is affected by the fluctuation in the prices over different years.

Explanation:

Real GDP is the GDP evaluated at the market prices of some base year. Real GDP is an inflation – adjusted measure that reflects the value of all goods and services produced by an economy in a given year (expressed in base year prices).

(ii) (c) 5, ₹5000

Explanation:

Given, LRR is 20% or 0.2

$$\text{Money Multiplier} = 1/\text{LRR} = 1/0.2 = 5$$

If initial deposit is of ₹1000, then

$$\begin{aligned}\text{Total deposit} &= \text{Initial deposit} \times \text{Money Multiplier} \\ &= 1000 \times 5 = ₹5000\end{aligned}$$

(iii) (b) $\text{APC} = 1$

Explanation:

According to Keynes's consumption and saving (S) functions and their relation to disposable income, income consists of consumption expenditure and saved income: $Y = C + S$, where s represents marginal propensity to save (MPS). By dividing the equation by income we get that $1 = \text{APC} + \text{APS}$. Thus $\text{APC} = 1 - \text{APS}$.

(iv) (a) Income earned by an Indian while working in an American embassy.

Explanation:

Income earned by an Indian while working in an American embassy. It will not be included because salary has been earned in American embassy which is considered a part of American territory (not of Indian territory).

(v) Aggregate demand

Explanation:

Aggregate demand measures the total amount of demand for all finished goods and services produced in an economy.

(vi) capital

Explanation:

Repayment of loan is a capital expenditure of the government, as it reduces liability.

(vii) Depreciation

Explanation:

$$\text{Domestic income} - \text{National Income} = \text{Depreciation}$$

(viii) Interest payments.

Section-B

Answer 2.

Difference between Central Bank and Commercial Bank

S.No.	Central Bank	Commercial Bank
1.	It is an apex institute which regulates the entire monetary system of the country.	It is a type of financial institution that is concerned with providing banking services to the general public and businesses by facilitating deposit, offering loan facilities.
2.	Its objective is to promote social welfare.	Its objective is earning profits.

Answer 3.

There is an inverse relationship between foreign exchange rate and demand for foreign exchange. It is because of the following:

1. When price of foreign currency falls imports from that country become cheaper, hence the demand for foreign currency rises.
2. It promotes tourism to that country. More and more local people wish to make a travel to that country which increases the demand for foreign exchange.

Answer 4.

- (i) When indirect taxes charged by the government from citizens is equal to the subsidies paid by the government to the general public, NIT is equal to zero.

(NIT = Indirect tax – subsidies).

- (ii) When the factor income earned by the normal residents of our country by rendering their services abroad is less than the factor income earned by the foreign nationals by rendering their services within our country, then NFIA is negative.

(NFIA = Factor income from abroad – factor income to abroad)

Answer 5.

Income	Consumption	APC	APS
0	40	–	–
100	120	1.2	– 0.2
200	200	1	0
300	280	0.93	0.17
400	360	0.8	0.2

Breakeven point is where income is equal to consumption, so it is at the income level of ₹ 200.

Answer 6.

(ii)

Basis for Comparison	Repo Rate	Reverse Repo Rate
1. Meaning	Repo rate is a benchmark interest rate, at which money is lent to commercial bank by the Central Bank, for shorter period, against collateral.	Reverse repo rate is the interest rate offered by the RBI, to the commercial banks on the deposits, who park their surplus funds with RBI.
2. Purpose	To fulfill the deficiency of funds.	To manage liquidity in the economy.
3. Rate	High	Comparatively less
4. Impact	It will make commercial bank borrow less from the Central Bank, due to high-interest rate.	It encourages commercial banks to transfer more money to the Central Bank and earn interest.

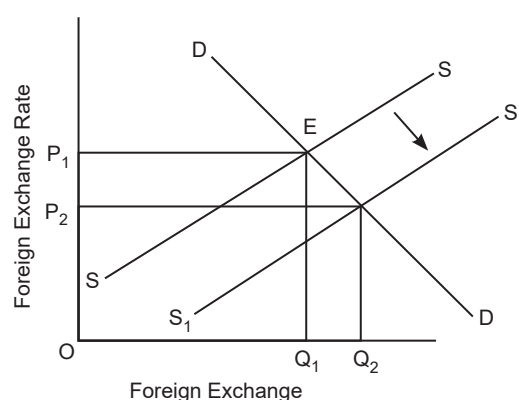
OR

Due to “Make in India” project, foreign companies were invited to manufacture goods within the domestic territory. This has led to an inflow of foreign exchange in the country.

Due to rise in foreign capital, the supply of foreign exchange increased, leading to rightward shift in the supply curve. Due to excess supply of foreign exchange, the foreign exchange rate begins to fall.

This is known as “Appreciation of domestic currency”.

In the diagram, the supply curve shifts from SS to S_1S_1' , that led to resultant change in the prices from OP_1 to OP_2 . This fall in price is Appreciation of domestic currency.



Answer 7.

Role of RBI with respect to :

- (i) **Custodian of foreign exchange:** Reserve Bank keeps a close watch on external value of its currency and undertakes exchange management control. All the foreign currency received by the citizens has to be deposited with the Reserve Bank and if citizens want to make payment in foreign currency, they have to approach to Reserve Bank. It also keeps gold reserves.
- (ii) **Promotional and developmental functions:** The RBI has been a promoter since its inception.

Various promotional and developmental functions of RBI are:

1. Encouraging commercial banks to expand their branches in semi urban and rural areas.
2. Establishing the Deposit Insurance Corporations.
3. Through the institutions like Unit Trust of India, the Reserve Bank helps to mobilise savings in the country.
4. Since its inception, Reserve Bank is making efforts to promote institutional agricultural credit by developing cooperative credit institutions.
5. It also helps to promote the process of industrialisation in the country by setting up specialised institutions for industrial finance.

Section-C

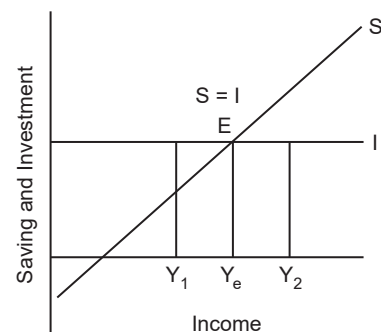
Answer 8.

- (i) An economy attains equilibrium level of income only when planned savings are equal to the planned investment. Investment is assumed to be autonomous. It can be understood with the help of following :

1. When planned saving are less than planned investment:

At the income level below the equilibrium level of income the planned savings is less than planned investment. This means that households are consuming more than what the firms are expecting. The firms will witness shortfall in their inventory shock. This is termed as unplanned investment. To reach the desired level of inventory, firms will increase the production, leading to increase in output, income and employment.

- 2. When planned savings are more than planned investment:** At the income level above the equilibrium level of income, the planned saving is more than the planned investment. This means that households are consuming less than what the firms are expecting. The firms will witness a rise in their inventory stocks. Thus there is an additional investment or unplanned investment. To have a desired level of inventory, firms will stop or reduce the production, leading to low output, income and employment. Investment



OR

- (ii) (a) **Ex-ante savings :** Ex-ante savings refers to the desired savings or planned savings during the period of one year. This is the savings which is intended to be made in the economy during the period of one year. The amount of ex-ante or planned saving is given by the saving function (or propensity to save).
- (b) **Involuntary unemployment :** Involuntary unemployment refers to the situation where people who are able to work and are willing to work at the existing wage rate are not getting the job. This kind of situation is eradicated in the case of full employment. As in full employment, willing and capable people get work without any undue difficulty and there is no involuntary unemployment.

Answer 9.

S.No.	Basis	Fixed Exchange Rate	Flexible Exchange Rate
(i)	Determining authority	It is the rate officially determined by the government and remains fixed.	It is determined by the forces of demand and supply of currency in the market.
(ii)	Role of Central Bank	In this system, Central Bank is ready to buy or sell its currencies at a fixed price.	In this system, Central Bank does not interfere with the foreign exchange rate.
(iii)	Scope to change	A very small variation from the fixed value is possible.	Exchange rate keeps on changing.
(iv)	Speculation	Speculation activities are not possible under fixed exchange rate system.	Speculation activities are possible under flexible exchange rate system.

Answer 10.

Value added method is also known as product method or output method and it is used for calculating national income involves adding value to the product at each stage of production.

It includes the following steps:

Step-I : Identification and classification of producing enterprises

- (a) Primary sector (b) Secondary sector (c) Tertiary sector

Step II: Calculation of NVA_{EC} of each producing enterprises

Following are the steps involved

- (a) Value of Output = Sales + Change in stock
(b) GVA at MP = Value of output – Intermediate consumption
(c) NVA at FC = GVA at MP – Depreciation – NIT

Step III: Compute Domestic Income (NDP_{FC})

Sum of NVA at fc from all the producing enterprises gives the value of NDP at fc.

Step IV: Estimate NNP_{fc} (National Income)

$$\text{NNP at fc} = \text{NDP at fc} + \text{NFIA}$$

Answer 11.

The four methods of redemption of public debt are:

1. **Budgetary surplus:** Sometimes the government is able to generate a surplus in its budget. It can use its budget surplus to pay off its debt to the lenders. A policy of surplus budget may be followed annually for paying off public debt.
2. **Sinking fund:** The government establishes a separate fund known as 'sinking fund' for the purpose of repaying its debt. Sinking fund account is made by crediting every year a certain amount of revenue generated by the government.
3. **Capital levy:** It refers to a very heavy tax on property and wealth. It is once-for-all tax imposed on capital assets above a certain value. It is imposed on the rich individuals on a progressive basis. This system is suggested to pay off the war time debts by taxing the rich sections of the community.
4. **Statutory reduction in the rate of interest:** Sometimes the government takes a statutory decision to reduce the rate of interest payable on public debt. The creditors are forced to accept the reduced rate of interest in the view of statutory powers of the government. However, the government may adopt this policy during the period of financial crisis.

Answer 12.

- (i) Best suited deposits for Suresh is Current account or demand deposits.
- (ii) Two features of Current account are:
 1. It has no restrictions on the number of withdrawal and deposits.
 2. It provides overdraft facility
- (iii) Overdraft refers to the facility available to the current account holders to overdraw their account upto a limit sanctioned.