

**ISC SEMESTER 2 EXAMINATION**  
**SAMPLE PAPER - 4**  
**ECONOMICS**

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***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.***

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**Section-A**

**Question 1.**

- (i) Identify the element that is not a component of NFIA.
  - (a) Net export of goods and services
  - (b) Net income from property and entrepreneurship from abroad
  - (c) Net retained earnings of resident companies abroad
  - (d) Net compensation of employees from abroad
- (ii) Which of the following is a credit money?
  - (a) Cheque and draft
  - (b) Promissory note
  - (c) Exchange note
  - (d) All of these
- (iii) According to classical economists, there always exists \_\_\_\_ equilibrium in the economy.
  - (a) Full employment
  - (b) Under employment
  - (c) Over full employment
  - (d) None of these.
- (iv) What does negative real GDP growth for the year 2020-21 signify?
  - (a) Real GDP of the Year 2020-21 has decreased as compared to 2019-20
  - (b) Real GDP of the Year 2020-21 has become negative
  - (c) Real GDP of the Year 2020-21 is less than Nominal GDP of the same period
  - (d) None of the above
- (v) When in an economy, all the additional income is saved, then the rational change in income and in change in investment will be \_\_\_\_\_
- (vi) The government can influence the allocation of resources through the moderation in \_\_\_\_\_
- (vii)  $NNP \text{ at FC} = GDP \text{ at MP} - \text{Depreciation} + \text{_____} - \text{_____}$
- (viii) Give one difference between revenue expenditure and capital expenditure.

## **Section-B**

**Answer the following questions briefly.**

**Question 2.**

Distinguish between - Commodity money and Metallic money.

**Question 3.**

When foreign exchange rate in a country is on the rise, what is its likely impact on imports and exports?

**Question 4.**

State, giving reasons, whether the following will be included in Domestic Income of India:

- (i) Rent received by an Indian from his building in London
- (ii) Compensation of employees to the residents of Qatar working in Indian embassy in Qatar.

**Question 5.**

On the basis of consumption function:  $C = 120 + 0.6Y$

Derive the savings function.

**Question 6.**

- (i) What are the alternative measures of money supply in India?

**OR**

- (ii) The rupee slumped on Friday to a record closing low of 75.20 against the U.S. dollar as deepening concerns about the economic fallout of the COVID-19 pandemic sent global investors scurrying to dump most assets, especially emerging market holdings, and opt for cash and the relative safety of the greenback. The rupee has now depreciated by more than 5.3% in 2020, with the bulk of its losses, a 4.1% slide, having occurred in March. - The Hindu, March 22, 2020

As per the above article, state whether the rupee is appreciating or depreciating against dollar. Discuss the possible causes of this situation.

**Question 7.**

Explain discounting bills of exchange as one of the functions of the commercial banks.

**Question 8.**

- (i) What is the relationship between average propensity to consume and average propensity to save? Can the value of APS be negative? If yes, When?

**OR**

- (ii) Define aggregate demand. State its components.

**Question 9.**

Distinguish between balance of trade account and current account balance of BOP account.

**Question 10.**

Discuss briefly, the limitation of GDP as an index of welfare. Explain any two points.

**Question 11.**

Explain the following methods of redemption of public debt.

- (i) Use of Government surplus.
- (ii) Refunding

**Question 12.**

Read the given extract carefully and answer the following questions.

The Central Bank of India is an apex body in the banking and financial structure of a country which was established in 1935. The Central Bank enjoys the sole monopoly of issuing currency. It acts as a banker, agent and advisor to the government. The Central Bank has the same relation with the commercial banks as the latter has with the general public

- (i) Central Bank issues currency but commercial bank creates money. Justify the statement.
- (ii) Name the rate at which Central Bank lends money to commercial banks.
- (iii) Who is authorised to issue currency coins in India?

## **Section-A**

### **Answer 1.**

- (i) (a) Net export of goods and services

**Explanation:**

There are three main components of NFIA: 1. Net Compensation to Employees, 2. Net Income from property and entrepreneurship and 3. Net Retained Earnings.

- (ii) (d) All of these

**Explanation:**

Any future monetary claim against an individual that can be used is called credit money. Cheque, draft, token coins, circulating promissory notes issued by the government, are the forms of credit money.

- (iii) (a) Full employment.

**Explanation:**

According to classical economists, there always exists full employment equilibrium in the economy.

- (iv) (a) Real GDP of the Year 2020-21 has decreased as compared to 2019-20

**Explanation:**

The Reserve Bank of India (RBI) said India's Gross Domestic Product (GDP) growth will be in negative territory in 2020-21 compared to 2019-20 as the outbreak of coronavirus has disrupted economic activities.

- (v) one

**Explanation:**

When in an economy, all the additional income is saved, then the rational change in income and in change in investment will be one.

- (vi) fiscal policy

**Explanation:**

Government can influence allocation of resources through taxes, subsidies and expenditure which is a part of fiscal policy.

(vii) NIA – NIT

**Explanation:**

NNP at FC= GDP at MP – Consumption of Fixed Capital + Net Factor income from abroad - Indirect Taxes

(viii) Revenue expenditure is the expenditure of government which neither cause increase in government assets nor cause any reduction in government liabilities. Whereas, capital expenditure is the expenditure of government which leads to increase in government assets or reduction in government liabilities.

**Answer 2.**

S.No.	Basis	Commodity money	Metallic money
1.	Definition	Any commodity chosen to serve as money is called commodity money.	Precious metals or any other metal having high intrinsic value used as money are called metallic money.
2.	Stage of development	It was developed in the initial stages of evolution of money.	It was developed after the development of commodity money.
3.	Durability	Commodity money is less durable	Metallic money is highly durable.

**Answer 3.**

With the rise in foreign exchange rate in India, the demand for foreign currency increases. This rise in exchange rate implies depreciation in domestic currency. It encourages exports from a country and discourages imports from rest of the world.

**Answer 4.**

- (i) It will not be included because, rent is received from London. The services of the house has been rendered outside India. This factor income is received from abroad. Hence, it is not included in domestic income.

- (ii) It will be included as income generated in Indian embassy is a part of domestic territory of India. Hence the income generated within the domestic territory will be included in domestic income.

**Answer 5.**

Consumption function is

$$C = 120 + 0.6Y \quad \dots(1)$$

$$Y = C + S \quad \dots(2)$$

Substituting 1 in 2

$$Y = 120 + 0.6Y + S$$

$$Y - 0.6Y - 120 = S$$

$$S = -120 + 0.4Y$$

**Answer 6.**

- (i) The various measures of money supply in India as prescribed by RBI are M1, M2, M3 and M4. These are arranged in the descending order of liquidity.

$M1 = C + DD + OD$ , Where C = Currency held by public, DD = Net demand deposits of the bank, OD = Other deposits held by RBI.

$M2 = M1 + \text{Savings of the people with Post offices}$ . M2 includes the components of M1 as well as the savings of people with Post office.

$M3 = M1 + \text{Net time deposits with commercial banks}$ . M3 is the most commonly used measure of money supply. It includes the components of M1 and Net time deposits of commercial banks.

$M4 = M3 + \text{Total deposits with post offices excluding National Saving Certificate}$ .

**OR**

- (ii) The rupee is depreciating against dollar as per the given article. The possible causes of this situation are as follows :

1. Lower demand of Indian goods and services in foreign countries.
2. Lower foreign investment in India.
3. Higher exports by Indian exporters.
4. Less remittance received by foreign nations.

All the above mentioned causes may either reduce the demand of Indian rupee or causes a higher demand of dollars that lead to the situation of depreciation in Indian currency.

**Answer 7.**

**Discounting bills of exchange:** Discounting bills of exchange is an important function of commercial banks. A bill of exchange represents a promise to pay a fixed amount of money at specific point of time in future. It can also be en-cashed earlier through the discounting process of commercial bank. In this facility, the bank pays the amount of bill presented by the customer, after deducting the usual bank charges.

**Answer 8.**

- (i) Average propensity to consume (APC) is the ratio of total consumption to total income.

Symbolically,

$$APC = C/Y$$

Where, C = Total consumption

Y = Total income

Average propensity to save (APS) is the ratio of total savings to total income. Symbolically, it is expressed as

$$APS = S/Y$$

Where, S = Total saving

Y = Total income

Yes, the value of APS can be negative when consumption expenditure exceeds income. At lower level of income  $C > Y$  where C = consumption and Y = income and hence saving is negative.

OR

(ii) Aggregate demand (AD) is the total demand for goods and services in the economy. Aggregate demand infact represents the total expenditure on goods and services in the economy. There are four components of AD:

1. **Private consumption expenditure:** It refers to the total amount of expenditure incurred by the households on the purchase of goods and services to satisfy their wants. There is a positive relationship between the consumption expenditure and the level of disposable income.
2. **Investment expenditure :** It refers to the expenditure incurred by the private investors or firms on the purchase of capital goods such as plant and machinery etc. Rate of interest affects the investment demands the most. There is a negative relationship between the rate of interest and investment demand.
3. **Government expenditure:** It is the third component of AD. It refers to the expenditure incurred by the government on the purchase of goods and services, on satisfaction of collective wants etc.
4. **Net exports:** Net exports is the difference between exports and imports. It shows the effect of domestic spending on foreign goods and foreign spending on domestic goods and services on the AD level.

Answer 9.

S.No.	Basis	Balance of Trade Account	Balance of Current Account
1.	Meaning	It includes only visible items. It is the difference between exports and imports of the country.	It is the difference between sum of credit items and sum of debit items on current account.
2.	Coverage	It does not record any transactions of invisible items and transfers.	It includes balance of visible items, invisible items and balance of unilateral transfer.
3.	Concept	It is a narrow concept and it is only a part of the balance of payment account.	It is a very wide concept. Balance of current account includes the balance of trade.
4.	Financing of deficit	A deficit in balance of trade can be meet out by surplus of current account.	Deficit of current account cannot be meet out by using surplus of balance of trade.

Answer 10.

1. **Changes in distribution:** All the people do not earn the same amount of income. Some earn more and some earn less. There is unequal distribution of income. It means that inequality in the distribution of income may increase or decrease, if it increases, it implies that rich become richer and the poor become poorer. Utility of a rupee of income to the poor is more than to the rich. Suppose the income of the poor declines by one rupee and that of the rich increases by one rupee. In such a case, decline in welfare of the poor will be more than the increase in welfare of the rich. Therefore, if the rise in the per capita real GDP income, it may lead to a decline in welfare.
2. **Non-monetary exchange:** Many activities in an economy are not evaluated in monetary terms. For ex-non-market transactions like services of housewife, kitchen gardening, leisure time activities etc. are not included in GDP, due to non availability of data. However, such activities influence the economic welfare.

**Answer 11.**

- (i) **Use of Government surplus:** Quite often, surplus budgets (i.e., by spending less than the public revenue obtained) may be utilised for clearing off public debts. But in recent years due to ever-increasing public expenditures, surplus budget is a rare phenomenon. Moreover, heavy taxes have to be imposed for realising a surplus budget, which may have direct consequences. Or, when public expenditure is reduced for creating a surplus budget, a deflationary bias may develop in the economy.
- (ii) **Refunding:** Refunding of debt implies the issue of new bonds and securities by the government in order to repay the matured loans. In the refunding process, usually short-term securities are replaced by issuing long-term securities. Under this method, the money burden of public debt is not relinquished but it is accumulated owing to the postponement of debt redemption.

**Answer 12.**

- (i) Central Bank has a sole monopoly to issue the currency notes. But the power to create money through the process of credit creation lies with commercial banks. Commercial banks create bank money in the process of accepting deposits and lending. Central Bank issues the currency notes but at the same time it controls the credit creation power of commercial banks.
- (ii) Bank rate, Interest Rate.
- (iii) The Government of India.

