

ICSE SEMESTER 2 EXAMINATION

SAMPLE PAPER - 1

ECONOMIC APPLICATIONS

Maximum Marks: 50

Time allowed: One and a half hours

Answers to this Paper must be written on the paper provided separately.

You will not be allowed to write during the first 10 minutes.

This time is to be spent in reading the question paper.

The time given at the head of this Paper is the time allowed for writing the answers.

*Attempt **all** questions from **Section A** and **any four** questions from **Section B**.*

SECTION A

*(Attempt **all** questions)*

Section-A (Attempt all questions)

Question 1.

Choose the correct answers to the questions from the given options. (Do not copy the question, write the correct answer only)

- (i) The main objective of fiscal policy does not include:
- | | |
|-------------------------------------|-----------------------------------|
| (a) Price stability | (c) Capital formation and growth |
| (b) Optimum allocation of resources | (d) Influencing supply and demand |
- (ii) The process whereby the real per capita income of a country increases over a long period of time is termed as:
- | | |
|---------------------|------------------------|
| (a) Economic growth | (c) Exchange stability |
| (b) Price stability | (d) Full employment |
- (iii) Economic equality, increase in employment, welfare activities. These are some of the main objectives of:
- | | |
|-------------------------------|------------------------|
| (a) Private sector enterprise | (c) Mixed economy |
| (b) Public sector enterprise | (d) Capitalist economy |
- (iv) Currency notes are form of:
- | | |
|----------------------|--------------------|
| (a) Paper money | (c) Metallic money |
| (b) Electronic money | (d) Credit money |
- (v) Primary function of commercial banks involves:
- | | |
|------------------------------|--|
| (a) Acceptance of deposits | (c) Giving advice on financial matters |
| (b) Collection of statistics | (d) Safe custody of valuable goods |
- (vi) Sales tax, VAT are form of which type of tax:
- | | |
|------------------|----------------------|
| (a) Direct tax | (c) Proportional tax |
| (b) Indirect tax | (d) Regressive tax |

- (vii) The measure which central bank adopt to encourage investment in the economy:-
- | | |
|------------------|------------------------|
| (a) Decrease CRR | (c) Privatization |
| (b) Increase CRR | (d) Increase bank rate |
- (viii) Rate of tax remaining same regardless of income such type of tax is called as:-
- | | |
|----------------------|--------------------|
| (a) Progressive tax | (c) Regressive tax |
| (b) Proportional tax | (d) Degressive tax |
- (ix) Fiscal policy = Policy related to government expenditure and budget
 _____ = Policy related to credit and supply of money
- | | |
|---------------------------|---------------------------------|
| (a) Monetary policy | (c) Credit creation policy |
| (b) Credit control policy | (d) Economic development policy |
- (x) The full form of ATM is:-
- | | |
|------------------------------|--------------------|
| (a) Any time machine | (c) All time money |
| (b) Automatic teller machine | (d) any time money |

Section-B (Attempt any four questions from this Section)

Question 2.

- (i) Define SLR.
- (ii) Write any two services rendered by commercial banks.
- (iii) Elaborate any three contingent functions of money.
- (iv) Why developing nation like India follow privatization? Give three reasons.

Question 3.

- (i) Write short note on the term open market operations.
- (ii) What is the difference between direct and indirect tax? Write two points.
- (iii) What do we mean by credit control? Write any two objectives of credit control.
- (iv) Explain the phrase "Lender of last resort".

Question 4.

- (i) Define mixed economy.
- (ii) Describe two objectives of public sector enterprise.
- (iii) Explain any three qualitative methods adopted under monetary policy.
- (iv) Write three differences between Tax and Price.

Question 5.

- (i) What do we mean by Hyperinflation?
- (ii) Discuss the term "Rationing of credit".
- (iii) Elaborate the role of CRR in credit creation process.
- (iv) How paper money is different from Electronic money? Write three points.

Question 6.

- (i) Define monetary policy.
- (ii) What are the objectives of taxation? Give two points.
- (iii) Define commercial banks. Elaborate any two functions of commercial banks.
- (iv) "Commercial banks do not have unlimited capacity to control credit". Explain with three points.

Question 7.

- (i) Write two disadvantage of Indirect Tax.
- (ii) What do we mean by walking inflation?
- (iii) Explain any three social, political and moral consequences of Inflation in society.
- (iv) Give three reasons behind setting up an apex body above all the public and private banks in India.

Section-A

Answer 1.

- (i) (d) Influencing supply and demand

Explanation :

Price stability, optimum allocation of resources, capital formation and growth are main objective of fiscal policy. As fiscal policy is a change in government expenditure and taxation designed to influence the pattern and level of activity. Influencing supply and demand is not the main objective of fiscal policy.

- (ii) (a) Economic growth

Explanation :

The process whereby the real per capita income of a country increases over a long period of time is termed as economic growth. A constant economic growth is one of the progressive indicator of the country.

- (iii) (b) Public sector enterprise

Explanation :

Public sector enterprise works for the welfare of the society. They mainly focus towards economic equality, increase in employment other than public sector private sector always works for their personal profit and growth.

- (iv) (a) Paper money

Explanation :

Paper money is a country's official paper currency that is circulated for the transactions involved in acquiring goods and services. Paper money like ₹ 50, 100, 200 notes are called as currency notes.

- (v) (a) Acceptance of deposits

Explanation :

Acceptance of deposits is primary function of commercial banks and other functions like collection of statistics, giving advice on financial matters, safe custody of valuable goods are subsidiary functions of commercial banks.

- (vi) (b) Indirect tax

Explanation :

Sales tax, VAT are indirect form of tax as indirect tax is a type of tax where the incidence and impact of taxation does not fall on the same entity.

- (vii) (a) Decrease CRR

Explanation :

By decreasing CRR central bank can encourage investment in the economy as lesser amounts of reserves banks have to keep with themselves and rest they can use for loan purpose.

- (viii) Proportional tax

Explanation :

Proportional tax is the kind of tax in which rate of tax remains same regardless of income.

Explanation :

Monetary policy is the policy related to the credit and supply of money. It includes the control of quantity of money available in the economy and the channels by which new money is supplied.

- (x) (b) Automatic teller machine

Explanation :

The full form of ATM is automated teller machine.

Section-B

Answer 2.

- (i) SLR (Statutory liquidity ratio) is the minimum percentage of deposit that a commercial bank has to maintain in the form of liquid cash, gold or other securities. The SLR is fixed by RBI.
- (ii) Two services rendered by commercial bank are:
1. **Accepting deposits:** The commercial banks accepts deposit from people, businesses and other entities in form of saving deposits, time deposits, and current deposits.
 2. **Lending of funds:** the second important function of commercial bank is lending funds to customers in form of loans, advances, cash credits, overdrafts and discounting of bills.
- (iii) The contingent functions of money are discussed below:
1. **Basis of credit:** credit creation function by commercial banks is not possible without money. Money as a store of value has encouraged savings by people in form of demand deposits in the banks which are used by banks for credit creation.
 2. **Distribution of national income:** Money helps in optimum distribution of income among different factors of production by generating factor income as rent, interest, wages and profits.
 3. **Increase productivity of assets:** Money increases the productivity of capital as it is the most liquid asset and can be put to alternative uses. Due to liquidity of money, capital can be easily transferred from less productive uses to more productive uses.
- (iv) Developing nations like India should adopt privatization as it improves performance in long term and create positive environment for economic growth. Certain Arguments in favour of Privatization are as shown:
1. **Reduction of Budgetary Deficits:** The government can control its staggering (reducing) budgetary deficit by using the sale process on the shares in PSU's (Public sector undertakings).
 2. **Creation of New jobs:** If PSU's start earning rich profits, several new projects will come up which in turn will help to generate more employment opportunities in the country.
 3. **Less political intervention:** The PSU can perform their function in a more precise manner without much interference of political groups. which will help them in working more efficiently and effectively.

Answer 3.

- (i) Open market operations refer to the selling and purchasing of the treasury bills and government securities by the central bank of any country in order to regulate money supply in the economy. It is one of the most important ways of monetary control that is exercised by the central bank.
- (ii)

Direct tax	Indirect tax
A direct tax is paid by the person on whom it is legally imposed or paid directly by the person concerned and because of which burden of tax cannot be shifted to another person.	An indirect tax is imposed on one person but paid partly or wholly by another. It is paid by one person but he recovers the same from another person i.e. person who actually bears the tax ultimate consumer.
Example- Income tax, Wealth tax	Example- GST, Excise duty

(iii) Credit control is the most significant function of central bank by which it maintains the stability of monetary unit. It regulates the supply of currency and credit to ensure economic stability. Credit control deals with the regulation of credit by central bank for achieving some definite objectives.

The main objectives of credit control are as follows:

1. **Stabilization of money market:** Stabilization of money market is the foremost objective of central banks credit control policy so as to reduce the fluctuations in the interest rates.
2. **Exchange rate stability:** Instability in the exchange rates is harmful for the foreign trade of the country. Thus the central bank, in the countries which are largely dependent upon foreign trade, should attempt to eliminate the fluctuations in the foreign exchange rates through its credit control policy.

(iv) The phrase ‘Lender of the last resort’ is used in the context of central bank. As banker to the banks, the central bank performs function of “lender of last resort”. A lender of last resort is the institution in a financial system that acts as the provider of liquidity to a financial institution which finds itself unable to obtain sufficient liquidity in the interbank lending market when other facilities or such sources have been exhausted. It means that if commercial banks fail to meet their financial requirement from other sources, they can approach the central bank for help (loans and advances). Therefore central bank provides financial assistance to commercial bank through discounting of approved securities and bills of exchange. It increases the elasticity and liquidity of the entire structure. In short central bank is ‘Lender of last resort’.

Answer 4.

(i) A Mixed economy is an economic system that combines elements of a capitalist, market based system and Socialist economic system. India follows mixed economic system as it is the best option for the democratic nation like India to adopt working which fulfills public and private motives.

(ii) The main objectives of public sector undertakings are as follows:-

1. **Balanced Regional Development:** Public sector undertakings locate their plants in backward parts of the country. These areas lack basic industrial and civic facilities like electricity, water supply, township and manpower. Public enterprises then develop these facilities, thereby bringing about a complete transformation. Transformation in the socio-economic life of the people in these regions.
2. **Employment Generation:** Public sector creates millions of jobs to fight the obvious problem of unemployment in India. Furthermore, the public sector contributes a lot towards the improvement of working and living conditions of workers.

(iii) Following are the qualitative methods adopted under monetary policy.

1. **Regulation of Consumer Credit:** In this instrument, consumers’ credit supply is regulated through the instalment of sale and hire purchase of consumer goods. Here, features like instalment amount, down payment, loan duration, etc., are all fixed in advance, which helps to check the credit and inflation in the country.
2. **Moral suasion:** Moral suasion refers to the suggestions to commercial banks from the RBI that helps in restraining credits in the inflationary period. RBI implies pressure on the Indian banking system without taking any strict action for compliance with rules.
3. **Rationing of Credit:** RBI fixes a credit amount to be granted for commercial banks. Credit is given by limiting the amount available for each commercial bank. For certain purposes, the upper credit limit can be fixed, and banks have to stick to that limit. This helps in lowering the bank’s credit exposure to unwanted sectors. This instrument also controls the bill rediscounting.

(iv)

Tax	Price
Tax is compulsory contribution to be paid by every citizen on whom it is imposed. People are not guaranteed with any benefit for the tax paid by them	Price is paid by the person who purchases goods and services. Price is direct payment for goods and services purchased

Taxes are imposed only by the government.	Prices are fixed by producer and sellers of goods and services.
Amount collected by taxation is used for public welfare activities or for development process	Benefits from pricing is mainly taken by the producer and seller of goods and services.

Answer 5.

- (i) Hyperinflation is a term to describe rapid, excessive and out of control general price increases in an economy. Hyperinflation is rapidly rising inflation. This type of inflation is caused by the issue of too much currency to finance government expenditure.
- (ii) This is the qualitative method adopted under monetary policy. Under this method, the central bank fixes a limit for the credit facilities to commercial banks. Being the lender of last resort, central bank rations the available credit among the applicants. By adopting few ways, like Reducing the amount of loan, fixing quota of the credit, refusing the loan to any bank etc.
- (iii) CRR refers to the minimum proportion of the total deposits that the commercial banks has to maintain with the central bank in the form of reserves. An increase in CRR would mean that banks would be required to keep a greater portion in form of deposits with the central bank. This implies that the commercial banks are left with lesser amount of funds to lend out. Hence the lending capacity of the banks reduces, leading to fall in the money supply. On the contrary a fall in CRR will lead to an increase supply in the money.

(iv)

Paper money	Electronic money
The currency notes issued by the reserve bank of India except on rupee note issued by the government of India are examples of paper money.	Electronic money is currency that is stored in banking computer system.
It is risky to carry paper money in huge quantity from one place to another.	Electronic money is often considered safer and more transparent than physical currency; it is not without its risks.
It is tangible as we can touch paper money i.e; notes.	It is intangible. we can see it but can't touch it and feel it.

Answer 6.

- (i) Monetary policy is the control of the quantity of money available in an economy and the channels by which new money is supplied. By managing the money supply, a central bank aims to influence macroeconomic factors including inflation, the rate of consumption, economic growth, and overall liquidity.
- (ii) The main objectives of taxation are as shown:
 1. **To raise revenue:** The principal objective of taxation is to raise revenue for the government, which is needed for the provision of essential services and execution of other activities of the government.
 2. **Growth and development:** Growth and improvement of a country depend on tax structure of that country. The tax money is used by the government for the process of development of the nation.
- (iii) A Commercial bank is a financial institution which accepts deposits from the public and gives loans for the purpose of consumption and investment to make profit. Commercial banks include private sector banks and public sector banks.

The two functions of commercial banks are a shown:

1. **Accept deposit:** The bank takes deposits in the form of saving, current and fixed deposits. The surplus balances collected from the firm and individuals are lent to the temporary requirements of the commercial transactions.

2. **Provides loans and advances:** It offers loans and advances to the entrepreneurs and business people and collect interest. Loans are advances that a bank extends to his customers with or without security for a specified time and at an agreed rate of interest. Further, the bank credits the loan amount in the customers' account which he withdraws as per his needs.
- (iv) As we know that central bank work as an apex body to regulate and supervise the working of commercial banks. So there are certain limitation to the power of commercial bank .Limitations of the power to control credit are as follows:
1. **Policy of central bank:** The central bank can influence the powers of banks to create money. Commercial banks maintain CLR and SLR rate decided by central bank and have to follow rules and regulations made by central bank in relation with that.
 2. **CRR (cash reserve ratio):** RBI decides the CRR and the need for maintaining adequate cash reserves sets a limit on the power of banks to create credit.Cash reserve ratio (CRR) is the percentage of a bank's total deposits that it needs to maintain as liquid cash. This is an RBI requirement, and the cash reserve is kept with the RBI.
 3. **Amount of cash:** The total amount of cash in the country sets another limitation on the power of the commercial banking system to create credit.

Answer 7.

- (i) Demerits of indirect taxes are discussed below:
1. **Unfair/Regressive:** Both rich and poor people have to pay same amount of tax because taxes are included in the price of the products and services. So, poor people have to pay more amount of their income as tax. So, indirect taxes are regressive and unfair in nature.
 2. **Inflationary:** The indirect taxation proves to be highly inflationary when excessively relied upon. Higher tax rate increases the price of the products which may lead to inflation.
- (ii) When rise in prices becomes more marked as compared with the situation obtaining under creeping inflation. Inflation of this rate is a warning signal for the government to control it before it turns into running inflation.
- (iv) Inflation may cause many consequences some of them are as follows:
1. **Inequality in Income Distribution Increases (Social effect):** During inflation, businessmen and entrepreneurs experience an increase in profits. On the other hand, people belonging to the fixed-income groups experience a decline in their real income. Hence, the inequality in income distribution becomes acute during this period. It is said that inflation is socially unjust and inequitable for society. It is because it redistributed income and wealth in favour of those who are already well off.
 2. **Moral and ethical effects:** Inflation breeds moral degeneration among people in general and business and official in particular.moral and economic problem with inflation is that it thrusts more and more people into higher-income tax-brackets while simultaneously decreasing their money's spending power.
 3. **Upsets the Planning Process (Political effect):** During inflation, the prices of goods, raw materials, and factor services increase. Therefore, the Government has to spend more money to complete any investment project taken up during the planning period.If the Government fails to raise more financial resources through savings or taxation, then it upsets the entire planning process.The lower social, moral and ethical values generate dissatisfaction among the common masses.
- (v) In India Central bank work as an apex institution for all the public and private banks. As an apex institution it organizes, supervises, regulates and develops the monetary system by performing shown functions:
1. **Banker's bank:** The central bank provides financial assistance to the scheduled commercial banks. RBI supervise and controls the activities of various scheduled commercial bank.It lays down various policies for the working of the bank and revises them as and when necessary. It also releases a set of operational instructions. RBI records all the information related to credit.

Rules and regulations for the functioning of a bank are also clearly defined. If RBI feels that any transaction is unethical, doubtful or any suspicious activity is undertaken, they can interrogate the bank.

2. **Control of credit:** In order to ensure the internal price stability and economic growth the central bank undertakes the responsibility of controlling credit. The RBI decides the rates, and that is mandatory for every bank to follow. The rates can be the policy rates which include bank rate, the repo rate, the reverse repo rate, and marginal standing facility rate. The percentage of reserves that every bank has to maintain with the RBI is also decided by the RBI. It includes the cash reserve ratio (CRR) and the statutory liquidity ratio (SLR). RBI also decides the foreign exchange rates.
3. **Monopoly of note issue:** central bank has the monopoly rights of issuing notes of all denominations. This is called as currency authority function of central banks.

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