

ISC Solved Paper Semester-2 2022

Economics

Class-XII

(Maximum Marks : 40)

(Time allowed : One and a half hours)

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

Section A consists of objective / very short answer questions.

Section B consists of short answer questions.

Section C consists of long answer questions.

The intended marks for questions or parts of questions are given in brackets [].

SECTION A

[8 Marks]

1. (i) RBI has adopted four measures of money supply. In this, M_3 comprises: [1]

- (a) M_1 + Saving deposits of post office
- (b) M_1 + Net time deposits with banks
- (c) M_2 + Total deposits with post office saving
- (d) Cash + Demand deposits + other deposits

(ii) If at present \$1 = ₹ 95 and later \$1 = ₹ 80, it is a case of: [1]

- (a) appreciation of currency
- (b) devaluation of currency
- (c) depreciation of currency
- (d) supply of currency

(iii) The central bank provides, direct or indirect, financial assistance to the commercial bank when the latter is facing severe liquidity problem. Hence, central bank: [1]

- (a) has a monopoly of note issue
- (b) acts as banker to the government
- (c) acts as controller of credit
- (d) acts as lender of the last resort

(iv) Which one of the following is NOT an example of leakage in the circular flow of income? [1]

- (a) Taxation
- (b) Import
- (c) Investment
- (d) Saving

(v) The type of investment which is affected by a change in the level of output or income is called [1]

(vi) $NNP_{FC} = NDP_{FC} + \dots\dots\dots$ [1]

(vii) Fiscal deficit – Primary deficit = [1]

(viii) State one difference between progressive tax and regressive tax. [1]

Ans.(i) Option (b) is correct

Explanation: Money supply refers to the total quantity of money held by public in various forms at any point of time in an economy. The main components of money supply are currency held by the public and net-demand deposits held by the commercial banks. $M_3 = M_1 +$ Time deposits of all commercial banks and co-operative banks (excluding interbank time deposits).

(ii) Option (a) is correct.

Explanation: Appreciation of domestic currency is a situation of a fall in the exchange rate and fewer rupees are needed to buy one dollar. It leads to a rise in imports as imports are a component of the demand for foreign exchange.

(iii) Option (d) is correct.

Explanation: As banker to the banks, the Central Bank acts as the lender of the last resort. It means, in case the commercial banks fail to meet their financial requirements from other sources, they can, as a last resort, approach to the Central Bank for loans and advances. The Central Bank assists such banks through discounting of approved securities and bills of exchange.

(iv) Option (c) is correct.

Explanation: Leakage occurs when there is a withdrawal of money from the economy that results in a reduction of the national income.

Sources of leakages include taxes, savings and imports. But investment is an example of injections in circular flow of income.

(v) Induced Investment.

Explanation: Induced investment refers to the investment which is made with the motive of earning profit as it is done in private sector. Induced investment depends directly upon profit expectations.

(vi) NFIA or (factor income from abroad - factor income to abroad)

(vii) Interest payments

(viii) **Progressive tax:** A tax that takes a larger percentage of income from high-income groups than from low-income groups.

Regressive tax: A tax that takes a larger percentage of income from low-income groups than from high-income groups.

SECTION B

[12 Marks]

Answer the following questions briefly.

2. Discuss any two export promotion measures undertaken to correct the disequilibrium in the Balance of Payments. [2]

Ans. (a) Exchange Rate Depreciation: By reducing the value of the domestic currency, government can correct the disequilibrium in the BOP of the economy. Exchange rate depreciation reduces the value of domestic currency in relation to foreign currency. As a result, import becomes costlier and export becomes cheaper. It also leads to inflationary trends in the country.

(b) Devaluation: Devaluation is lowering the exchange value of the official currency. When a country devalues its currency, exports become cheaper and imports become expensive which causes a reduction in the BOP deficit.

3. State the components of compensation of employees. Give one example of any one of the components. [2]

Ans. Compensation of Employees (COES): COE refers to amount paid to employees by employer for rendering productive services. It includes all payments and benefits, which the employees receive, directly or indirectly from the employer. Compensation of employees consists of the following components:

(a) Wages and salaries in cash: It includes all monetary benefits, like wages, salaries, bonus, dearness allowances, commission, etc.

(b) Wages and salaries in kind: It includes all non-monetary benefits, like rent-free home, free car, free medical and educational facilities, etc.

(c) Employer's contribution to social security schemes: It includes contributions made by employer for the social security scheme of employees. For example, contribution to provident fund, gratuity, labour welfare funds, retirement pension, etc.

4. If the initial increase in autonomous investment is ₹100 cr and MPC = 0.8, calculate the increase in income. [2]

Ans. $K = 1/1 - MPC$

$$= \frac{1}{1 - 0.8} = \frac{1}{0.2} = 5$$

$$K = \frac{\Delta Y}{\Delta I}$$

$$5 = \frac{\Delta Y}{100} = \Delta Y = 5 \times 100$$

$$\Delta Y = ₹ 500 \text{ Crore.}$$

5. Differentiate between demand pull and cost push inflation. [2]

Ans. Demand-pull inflation arises when there is an excess of demand for goods over their supply. When there is persistent increase in demand and supply does not increase proportionately then prices tend to rise. Cost-push inflation happens when prices, such as raw materials and wages rise because of rises in production costs. Demand for products remains constant, although the supply of goods decreases as a result of higher production costs.

6. What is meant by government budget?

OR

What is meant by deficit financing? [2]

Ans. A government budget is an annual financial statement showing item wise estimates of anticipated revenue and anticipated expenditure during a fiscal year.

OR

Deficit financing refers to a situation in the government budget where the government expenditure exceeds government revenue and the difference is made up by borrowings or minting new funds.

7. State whether the following will be included or not in the national income accounting. Give one reason for each. [2]
- (i) Interest paid on a loan taken to buy consumer durable good.
 - (ii) Food grain grown by a farmer for self consumption.

- Ans. (i) Yes, it is included in national income accounting as it is a part of consumption expenditure.
- (ii) Yes, it is included in national income accounting as goods have a market value. Grains grown by a farmer but used entirely for self-consumption is a part of the contribution by him to the value of goods produced. Therefore, this is included in national income.

SECTION C

[20 Marks]

8. Explain the steps involved in calculation of National Income by Expenditure Method. [4]

OR

Draw a well labelled diagram to explain briefly, the circular flow of income in a three-sector model.

- Ans. (i) The steps involved in calculating National Income by Expenditure Method are:

Step 1: Identify the Sectors Incurring Final Expenditure: All sectors which incur final expenditure within the domestic territory are classified into four groups: (i) Household sector; (ii) Government sector; (iii) Producing sector; (iv) Foreign sector.

Step 2: Classification of Final Expenditure: Final expenditures incurred by the above-mentioned sectors are estimated and classified under the following heads:

- (a) Private Final Consumption Expenditure (PFCE)
- (b) Government Final Consumption Expenditure (GFCE)
- (c) Gross Domestic Capital Formation (GDCF)
- (d) Net Exports (X – M).

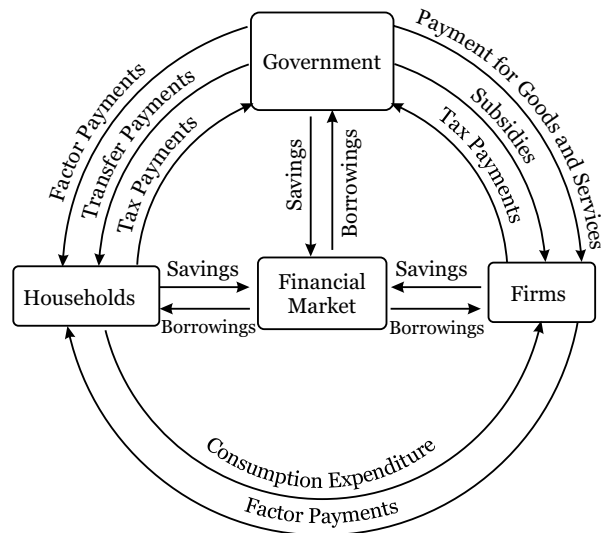
The sum of four components of final expenditure gives Gross Domestic Product at Market Price

$$(GDP_{MP}), \text{ i.e. } GDP_{MP} = PFCE + GFCE + GDCF + (X-M)$$

Step 3: Calculation of Domestic Income (NDP_{FC}): By subtracting the amount of depreciation and net indirect taxes from GDP_{MP} we get domestic income, i.e., $NDP_{FC} = GDP_{MP} - \text{Depreciation} - \text{Net Indirect Taxes}$.

Step 4: Estimate Net Factor Income from Abroad (NFIA) to arrive at National Income: In the final step, NFIA is added to domestic income to arrive at National Income. National Income $(NNP_{FC}) = NDP_{FC} + NFIA$

- (ii) Diagram of circular flow of income in three sector model:



Explanation: Three sector model includes household sector, producing sector and government sector. It will study a circular flow income in these sectors excluding rest of the world i.e., closed economy income. Here flows from household sector and producing sector to government sector are in the form of taxes. The income received from the government sector flows to producing and household sector in the form of payments for government purchases of goods and services as well as payment of subsidies and transfer payments. Every payment has a receipt in response of it by which aggregate expenditure of an economy becomes identical to aggregate income and makes this circular flow unending.

9. Discuss the components of the Balance of Payments in the current account. [4]

- Ans. **Current Account:** Current account refers to an account which records all the transactions relating to export and import of goods and services and unilateral transfers during a given period of time.

Components of Current Account: The main components of Current Account are:

(i) **Export and Import of Goods (Merchandise Transactions or Visible Trade):** A major part of transactions in foreign trade is in the form of export and import of goods (visible items). Payment for import of goods is written on the negative side (debit items) and receipt from exports is shown on the positive side (credit items). Balance of these visible exports and imports is known as balance of trade (or trade balance).

(ii) **Export and Import of Services (Invisible Trade):** It includes a large variety of non-factor services (known as invisible items) sold and purchased by the residents of a country, to and from the rest of the world. Payments are either received or made to the other countries for use of these services. Services are generally of three kinds: (a) Shipping, (b) Banking and (c) Insurance. Payments for these services are recorded on the negative side and receipts on the positive side.

(iii) **Unilateral Transfers to and from Abroad (One sided Transactions):** Unilateral transfers include gifts, donations, personal remittances and other 'one-way' transactions. These refer to those receipts and payments, which take place without any service in return. Receipt of unilateral transfers from rest of the world is shown on the credit side and unilateral transfers to rest of the world on the debit side.

(iv) **Income receipts and payments to and from Abroad:** It includes investment income in the form of interest, rent and profits.

10. Explain any two types of deposits of commercial banks. [4]

Ans. Commercial banks accept following types of deposit:

(i) **Current Account Deposits or Demand Deposits:** This type of account is generally maintained by the business entities and money under these deposits are payable on demand of the depositor. The depositors are free to deposit or withdraw money from their account any number of times without any restrictions.

(ii) **Savings Account Deposits:** This type of account is generally maintained by the households or individuals. The depositor can deposit or withdraw money deposited under this account only for a limited number of times. This account also attracts a nominal rate of interest payable to the account holder.

(iii) **Fixed Deposit or Time Deposit or Term Deposit:** Under this account money is deposited for a fixed period and the rate of interest is relatively higher than other accounts depending on the tenure of the fixed deposit.

(iv) **Recurring Deposit Account:** This type of account is suitable for those who can save regularly and expect to earn a fair return on the deposits over a period of time. While opening the account a person has to agree to deposit a fixed amount once in a month for a certain period. The total deposit along with the interest therein is payable on maturity. However, the depositor can also be allowed to close the account before its maturity and get back the money along with the interest till that period. (Any two)

11. Discuss how public expenditure can be used as an important tool to attain:

(i) Regional equality. [2]

(ii) Economic growth. [2]

Ans. (i) **Regional Equality:** Public expenditure can correct regional disparities. By diverting resources in backward regions, government can bring about all-round development there so as to compete with the advanced regions of the country. This is what is required to maintain integration and unity among people of all the regions. Unbalanced regional growth encourages disintegrating forces to rise. Public expenditure is an antidote for these reactionary elements.

(ii) **Economic Growth:** Without government support and backing, a poor country cannot make huge investments to bring about a favourable change in the economic base of a country. That is why massive investments are made by the government in the growth and development of basic and key industries, agriculture, consumable goods, etc. Public expenditure has the expansionary effect on the growth of national income, employment opportunities, etc. Economic development also requires development of economic infrastructures.

12. Read the passage given below and answer the following questions.

The Great Depression of 1930s proved that without the government's intervention, the economy cannot create employment opportunities. In India, MGNREGA programmes are based on the Keynesian aggregate demand strategy of direct job creation by the government. MGNREGA increases the purchasing power of those individuals whose MPC is the highest.

(i) What is meant by MPC? [1]

(ii) State the components of aggregate demand. [2]

(iii) How is MPS obtained from MPC? [1]

Ans. (i) MPC is Marginal Propensity to Consume. The ratio of change in consumption (C) to change in income (Y) is known as marginal propensity to consume. MPC indicates the proportion of additional income that is being spent on consumption.

(ii) Aggregate demand is made up of four components: consumption, investment, government spending and net exports (exports–imports). These are discussed below:

(a) Household (or Private) Consumption Demand (C): It is defined as 'Value of goods and services that households are able and willing to buy.' Alternatively, it refers to ex-ante (planned) consumption expenditure to be incurred by all households on purchase of goods and services.

(b) Private Investment Demand (I): This refers to planned (ex-ante) expenditure on creation of new capital assets like machines,

buildings and raw materials by private entrepreneurs.

(c) Government Demand for Goods and Services (G): It refers to government planned (ex-ante) expenditure on purchase of consumer and capital goods to fulfil common needs of the society. Government demand may be for satisfying public needs for roads, schools, hospitals, water works, railway transport or for infrastructure (like roads, bridges, airports), maintenance of law and order and defence from external aggression.

(d) Net Exports (Exports - Imports) Demand: Net export is the difference between export of goods and services and import of goods and services during a given period. Net exports reflect the demand of foreign countries for our goods and services over our demand for foreign countries' goods and services. Thus, net exports show expected (ex-ante) net foreign demand.

(iii) The sum of MPC and MPS is equal to one. Thus, $MPS = 1 - MPC$.

