

12TH ECONOMICS QUARTERLY EXAM – ANSWER KEY SEP - 2022**DR.A.VENNILA****PRINCIPAL**

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I. Choose the most appropriate answer**20 x 1 = 20**

1	C	Ragnar Frisch	11	A	Lead to consumption function becoming steeper
2	D	Socialism	12	A	The APC falls and gets nearer in value to the MPC
3	B	Stock	13	C	The most liquid of all assets
4	D	Aggregates	14	C	Creeping
5	A	Progressive	15	A	Multiplication
6	A	National Income	16	D	July1, 1963
7	B	Population of a Country	17	B	Resources are not equally distributed among all trading nations
8	B	Economic Welfare	18	B	Services Account
9	A	Full Employment	19	A	Washington
10	B	Automatic Price Mechanism	20	D	Customs Union

II. Answer any 7 questions. Question No. 30 is Compulsory**7 x 2 = 14****21) Economy – Meaning:**

- ✍ An economy is referred to any system or area where economic activities are carried out.
- ✍ Each economy has its own character.
- ✍ Accordingly, the functions or activities also vary.
- ✍ An economy, the fundamental economic activities are production and consumption.

22) Four Sector Model – Meaning:

- ♣ In a Four-sector economy, in addition to household, firms and government, a fourth sector namely, external sector is included.
- ♣ In real life, only four-sector economy exists.
- ♣ This model composed of four sectors namely,
 - (i) Households
 - (ii) Firms
 - (iii) Government,
 - (iv) External Sector

23) National Income – Definition:

- ♣ National Income means the total money value of all final goods and services produced in a country during a particular period of time (one year).

24) Short note on Frictional Unemployment

- ✍ Frictional unemployment arises due to imbalance between supply of labour and demand for labour.
- ✍ This is because of immobility of labour, lack of necessary skills, break down of machinery, shortage of raw materials etc.

25) Consumption Function:

- ✎ Consumption function is a “Functional relationship between two aggregates viz., total consumption and gross national income”.
- ✎ It is represented as $C = f(Y)$ where,

C = Consumption

Y = Income

f = Function

26) Plastic money – Meaning:

- ✓ The latest type of money is plastic money.
- ✓ Plastic money is one of the most evolved forms of financial products.
- ✓ Plastic money is an alternative to the cash or the standard “money”.
- ✓ Plastic money is a term that is used predominantly in reference to the hard plastic cards used every day in place of actual bank notes.

Examples: Cash cards, Credit cards, Debit cards, Pre-paid Cash cards, Store cards, Forex cards and Smart cards.

27) Central bank - Definition

- ✎ A central bank, reserve bank, or monetary authority is an institution that
- ✎ manages a state’s currency, money supply, and interest rates.
- ✎ Central banks also usually oversee the commercial banking system of their respective countries.

28) Merits of International Trade

- ✎ Efficient Production
- ✎ Equalization of Prices between Countries

29) SAARC Secretariat Established:

- The SAARC Secretariat was established in Kathmandu (Nepal) on 16th January 1987.

30) Classification of the economics based on Status of Development:

- a) Developed,
- b) Underdeveloped,
- c) Undeveloped and developing economies.

III. Answer any 7 questions. Question No. 40 is Compulsory 7 x 3 = 21

31) Features of Mixed Economy

Ownership of property and means of production:

- ♣ Both the public and private have rights over property and means of production.

Co-existence of public and Private sector:

- ♣ public sector aims at social welfare whereas private sectors aims at for profits.

Economic plan:

- ♣ National plans are drawn up by the government and both public and private sectors abide.

32) Two sector Circular Flow Model:

- There are only two sectors namely, **household sector** and **firm sector**.
- In a two-sector economy; production and sales are equal and there will be a circular flow of income and good.
- The **outer circle** represents real flow (factors and goods) and
- The **inner circle** represents the monetary flow (factor prices and commodity prices).
- **Real flow** indicates the factor services flow from household sector to the business sector, and goods and services flow from business sector to the household.

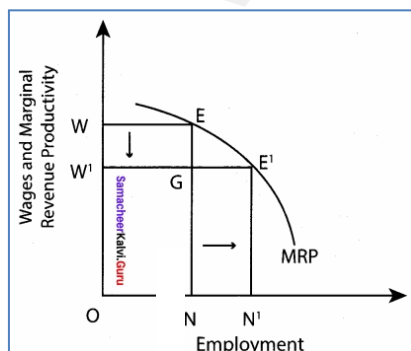
**33) Uses of national income:**

- To know the relative importance of the various sectors of the economy and their contribution towards national income
- To formulate the national policies such as monetary policy, fiscal policy and other policies
- To formulate planning and evaluate plan progress

34) Explanation of classical theory of employment, how wage reduction solves the problem of unemployment with Diagrammatically:

- The classical theory of employment assumes that the economy operates at the level of full employment without inflation in the long period.
- It also assumes that wages and prices of goods are flexible and the competitive market exists in the economy (laissez – faire economy).
- According to the classical theory of employment, full employment condition can be achieved by cutting down the wage rate.
- Unemployment would be eliminated when wages are determined by the mechanism of economy itself.

e) The following figure shows the relationship between wage rate and employment:



- In the figure, when the wage rate is OW, then the employment is ON.
- As the wage rate is reduced to OW^1 , then the employment has increased to ON^1 .
- Prof. Pigou has taken this theory as base for developing the solution of unemployment problem.

35) The propositions of keynes's psychological Law of consumption

- ✎ When **income** increases, consumption also increases but by a smaller amount.
- ✎ The increased income will be divided in some proportion between **consumption expenditure** and **saving**
- ✎ Increase in income always leads to an increase in both consumption and saving.

36) Short note on Metallic Money:

- ♣ Under metallic standard, some kind of metal either gold or silver is used to determine the standard value of the money and currency.
- ♣ Standard coins made out of the metal are the principal coins used under the metallic standard.
- ♣ These standard coins are full bodied or full weighted legal tender. Their face value is equal to their intrinsic metal value.

37) Differences between money market and capital market

- ✎ Money market deals with short-term loans. It designated financial institutions which handle the purchase, sale and transfer of short-term credit instrument.
- ✎ Capital market deals in raising capital by dealing in shares, bonds, equities and mortgages.

38) Comparison of the Classical Theory of international trade with Modern Theory of International trade

Sl.No.	Classical Theory of International Trade	Modern Theory of International Trade
1	The classical theory explains the phenomenon of international trade on the basis of labour theory of value.	The modern theory explains the phenomenon of international trade on the basis of general theory of value.
2	It presents a one factor (labour) model.	In presents a multi- factor (labour and capital) model.
3	It attributes the differences in the comparative costs to difference in the productive efficiency of workers in the two countries.	It attributes the differences in comparative Costs to the differences in factor endowments in the two countries.

39) Various forms of economic integration:

- ✎ Economic integration takes the form of Free Trade Area, Customs Union, Common Market and Economic Union.
- ✎ A free trade area is the region encompassing a trade bloc whose member countries have signed a free trade agreement (FTA). e.g. SAFTA, EFTA.
- ✎ A customs union is defined as a type of trade block which is composed of a free trade area with no tariff among members and with a common external tariff. e.g. BENELUX.

40) Economic Models – Meaning:

- ♣ A model is a simplified representation of real situation.
- ♣ Economists use models to describe economic activities, their relationships and their behaviour.
- ♣ A model is an explanation of how the economy, or part of the economy, works.
- ♣ Most economic models are built with mathematics, graphs and equations, and attempt to explain relationships between economic variables.
- ♣ The commonly used economic models are the
 - (i) Supply-demand models and
 - (ii) Circular flow models and
 - (iii) Smith models.

IV. Answer all the questions**7 x 5 = 35****41) a. The functioning of an economy based on its activities.**

Economic System refers to the manner in which individuals and institutions are connected together to carry out economic activities in a particular area.

- In an economy, the fundamental economic activities are production and consumption. These two activities are supported by several other activities.
- The ultimate aim of these activities is to achieve growth.
- The 'exchange activity' supports the production and consumption activities. These activities are influenced by several economic and non-economic activities.
- The major economic activities include transportation, banking, advertising, planning, government policy and others.
- The major non-economic activities are environment, health, education, entertainment, governance, regulations etc.
- In addition to these supporting activities, external activities from other economies such as import, export.

41).B.**Comparison of the feature among Capitalism, Secularism and Mixedism**

S. No.	Features	Capitalism	Socialism	Mixedism
1	Ownership of Means of Production	Private Ownership	Public Ownership	Private Ownership and Public Ownership
2	Economic Motive	Profit	Social Welfare	Social Welfare and Profit Motive
3	Government Role	Internal Regulation only	Complete Involvement	Limited Role
4	Income Distribution	Unequal	Equal	Less unequal
5	Nature of Enterprise	Private Enterprise	Government Enterprise	Both Private and State Enterprises

42) a.Importance of National Income:

National income is of great importance for the economy of a country. Nowadays the national income is regarded as accounts of the economy, which are known as social accounts.

It enables us,

- ♣ To know the relative importance of the various sectors of the economy and their contribution towards national income; from the calculation of national income.
- ♣ To formulate the national policies such as monetary policy, fiscal policy and other policies; the proper measures can be adopted to bring the economy to the right path with the help of collecting national income data.
- ♣ To formulate planning and evaluate plan progress; it is essential that the data pertaining to a country's gross income, output, saving and consumption from different sources should be available for economic planning.
- ♣ To build economic models both in short - run and long - run.
- ♣ To know a country's per capita income which reflects the economic welfare of the country.
- ♣ To know the distribution of income for various factors of production in the country.

42).b. Difficulties involved in the measurement of national income:**1. Transfer payments**

- Government makes payments in the form of pensions, unemployment allowance, subsidies, etc.
- These are government expenditure. But they are not included in the national income.

2. Difficulties in assessing depreciation allowance

- The deduction of depreciation allowances, accidental damages, repair and replacement charges from the national income is not an easy task.

3. Unpaid services

- A housewife renders a number of useful services like preparation of meals, serving, tailoring, mending, washing, cleaning, bringing up children, etc.

4. Income from illegal activities

- Income earned through illegal activities like gambling, smuggling, illicit extraction of liquor, etc., is not included in national income.

5. Production for self-consumption and changing price

- Farmers keep a large portion of food and other goods produced on the farm for self consumption.

43) a.The following are the types of unemployment:**1. Cyclical Unemployment:-**

- In a business cycle during the period of recession and depression, income and output fall leading to widespread unemployment.
- It is caused by deficiency of effective demand.

2. Seasonal Unemployment:-

- This type of unemployment occurs during certain seasons of the year.

3. Frictional Unemployment:-

- Frictional unemployment arises due to imbalance between supply of labour and demand for labour.
- The persons who lose jobs and in search of jobs are also included under frictional unemployment.

4. Educated Unemployment:-

- Sometimes educated people are underemployed or unemployed when qualification does not match the job.

5. Technical Unemployment:-

- Modern technology being capital intensive requires less labourers and contributes to technological unemployment.

43).b. Differences between classical theory and Keynes theory:

S. NO	BASIS OF DIFFERENCES	CLASSICAL THEORY	KEYNES THEORY
1	Equilibrium	Long-run equilibrium	Short-run equilibrium
2	Savings and Investment	Saving and investment equilibrium through interest rate	Saving and investment equilibrium through income levels
3	Money	The function of money is to act as a medium of exchange	The function of money is a medium of exchange on the one side and a store of value on the other side.
4	Approach	Micro foundation to macro problems	Macro approach to national problems
5	Intervention	No government intervention	Government intervention is necessary for stabilization of economy

44) .a. Definition of Multiplier

- The multiplier is defined as the ratio of the change in national income to change in investment.
- If ΔI stands for increase in investment and ΔY stands for resultant increase in income, the multiplier
 $K = \Delta Y / \Delta I$.
 The value of multiplier depends on MPC
 Multiplier $K = 1/1-MPC$

Illustrate the Working of Multiplier.**Working of Multiplier – Illustration**

- Suppose the Government undertakes investment expenditure equal to Rs.100 crore on some public works, by way of wages, price of materials etc.
- Thus income of labourers and suppliers of materials increases by Rs.100 crore. Suppose the MPC is 0.8 that is 80 %. A sum of Rs.80 crores is spent on consumption (Rs.20 Crores is saved).
- As a result, suppliers of goods get an income of Rs.80 crores. They in turn spend Rs.64 crores (80% of Rs.80cr).
- In this manner consumption expenditure and increase in income act in a chain like manner.
- The final result is $\Delta Y = 100 + 100 \times 4/5 + 100 \times [4/5]^2 + 100 \times [4/5]^3 + \dots$

44.b.

Differences between MEC and MEI

No	Marginal Efficiency of Capital (MEC)	Marginal efficiency of investment (MEI)
1	Based on a given supply price of Capital	Based on the induced change in the price due to changes in demand for Capital
2	It represents the rate of return on the successive units of Capital without regard to existing Capital	It shows the rate of return on just those units of Capital over and above the existing Capital stock.
3	It is a stock concept	It is flow concept
4	It determines the optimum capital stock in an Economy at each level of interest rate	It determines the net investment of the economy at each interest rate given the Capital Stock.

45) .a.Functions of money are in four forms

- 1) Primary functions
- 2) Secondary functions
- 3) Contingent functions
- 4) Other functions.

1. Primary functions

1. Medium of Exchange
2. Measure of Value

- **Money as a Medium of Exchange:** Money acts as the medium of Exchange (intermediary) in Sales and purchases.
- **Money as a measure of Value:** The value (price) of goods and services are in terms of money.

2. Secondary functions

1. Money as store of value
2. Standard of deferred payments.

- **Money as a Store of Value** - Value (or savings) can be stored in the form of money. The value of money is more or less stable.
- **Money acts as a standard of deferred payment** Future transaction can be carried on in terms of money. The loans which are taken at present can be repaid in money in future.

3. Contingent functions

- Basis of the Credit system
- Money facilitates distribution of National income
- Money helps to equalize marginal utilities and marginal productivities
- Money increases productivity of Capital.

4. Other functions

- Money helps to maintain repayment capacity
- Money represents General purchasing power money gives liquidity to Capital.

45).b.Phases of Trade cycle

- ✓ A Trade cycle refers to oscillations in aggregate economic activity particularly in employment, output, income, etc.

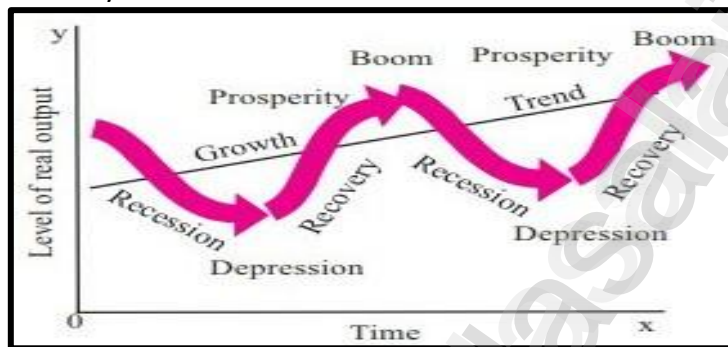
Definition:

- ✓ “A trade cycle is composed of periods of good trade characterised by rising prices and low unemployment percentages altering with periods of bad trade characterised by falling prices and high unemployment percentages’:

Phases of Trade Cycle:

The four different phases of trade cycle is referred to as

1. Boom
2. Recession
3. Depression
4. Recovery

**(1) Boom (or) Prosperity Phase:**

1. The full employment and the movement of the economy beyond full employment.
2. Money wages rise, profits increase and interest rates go up.
3. It is characterized as boom period.

(2) Recession:

1. The turning point from boom condition is called recession.
2. This happens at higher rate, than what was earlier.
3. Liquidity preference of the people rises and money market becomes tight.

(3) Depression:

1. During depression the level of economic activities becomes extremely low.
2. Firms incur losses and closure of business becomes a common feature and the ultimate result is unemployment.
3. Interest prices, profits and wages are low.
4. Depression is the worst phase of the business cycle.
5. Extreme point of depression is called as 'trough'

(4) Recovery:

1. After a period of depression, recovery sets in.
2. It begins with the revival of demand for capital goods.
3. Recovery may be initiated by innovation (or) investment (or) by government expenditure

46) a. Functions of RBI :**(1) Monetary Authority :**

- It controls the supply of money.
- To stabilize exchange rate, maintain healthy balance of payment;

(2) The issue of currency:

- To maintain the currency and credit.
- It is the sole authority to issue currency.
- To control the circulation of fake currency.

(3) The issuer of banking licence:

- As per Sec 22 of Banking Regulation Act, every bank has to obtain a banking license from RBI to conduct banking business in India.

(4) Bankers to the Government:

- It acts as banker both to the Central and the State Government.

(5) Banker's Bank: RBI is the bank of all banks in India.

(6) Lender of last resort: The banks can borrow from the RBI by keeping eligible securities as collateral at the time of need or crisis.

(7) Act as clearing house : RBI manages 314 clearing houses.

(8) Custodian of foreign exchange reserves.

(9) Regulator of economy.

(10) Managing government securities.

(11) Regulator and supervisor of payment and settlement system.

(12) Developmental Role.

(13) Publisher of monetary data and other data.

(14) Exchange manager and controller.

(15) Banking Ombudsman Scheme.

(16) Banking Codes and Standards Boards of India.

46.b. The objectives of monetary policy:**1. Neutrality of Money**

- The monetary authority should aim at neutrality of money in the economy.
- Monetary changes could be the root cause of all economic fluctuations.

2. Exchange Rate Stability

- Exchange rate stability was the traditional objective of monetary authority.
- This was the main objective under Gold Standard among different countries.

3. Price Stability

- Economists like Crustave Cassel and Keynes suggested price stabilization as a main objective of monetary policy.

4. Full Employment

- During world depression, the problem of unemployment had increased rapidly.
- It was regarded as socially dangerous, economically wasteful and morally deplorable.

5. Economic Growth

- Economic growth is the process whereby the real per capita income of a country increases over a long period of time.
- It implies an increase in the total physical or real output.

47) .a. Differences between Internal Trade and International Trade.

S.No	Internal Trade	International Trade
1	Trade takes place between different individuals and firm within the same	Trade takes place between different individuals and firms in different countries.
2	Labour and capital move freely from one region to another.	Labour and capital do not move easily from one nation to another.
3	There will be free flow of goods and services.	Goods and services do not easily move from one country to another.
4	There is only one common currency.	There are different currencies.
5	Trade and financial regulations are more or less the same	Trade and financial regulations such as interest rate laws differ between countries.

47.b. Objectives of IMF

1. To promote international monetary cooperation among the member nations.
2. To facilitate faster and balanced growth of international trade.
3. To ensure exchange rate stability by curbing competitive exchange depreciations.
4. To eliminate or reduce exchange controls imposed by member nations.
5. To promote the flow of capital from developed to developing nations.
6. To solve the problem of international liquidity.

***** All the Best *****