ICSE Paper 2012
ECONOMIC APPLICATIONS

(Two Hours)
Answers to this Paper must be written on the paper provided separately.
You will not be allowed to write during the first 15 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.
Section I is compulsory. Attempt any four questions from Section II.
The intended marks for questions or parts of questions are given in brackets [ ].

SECTION-I (40 Marks)
(Attempt all questions from this Section)

Question 1:
Explain in brief the following terms:
(a) Ceteris paribus assumption of the law of demand [2]
(b) Fiscal Policy [2]
(c) Sunk Capital [2]
(d) Product Differentiation [2]
(e) Statutory Liquidity Ratio ** [2]
** Answer has not given due to out of present syllabus.

Answer:
(a) Ceteris paribus: Other things remaining unchanged, we analyse only the effect of a change in the price of a commodity on the quantity demanded of a commodity. All other determinants of demand and the set of conditions remains unchanged.

(b) Refer Ans. 2 (e), 2015.

(c) Sunk Capital: Sunk capital is that capital, which can be used to produce only one type of commodity or service, for example, an ice factory and an oil mill uses capital only to produce ice and oil respectively and no other commodity.

(d) Product Differentiation: Under monopolistic competition, the products of different firms are not homogeneous but are close substitutes. Products are differentiated from each other in terms of brand name, colour, shape, quality etc.

Question 2:
(a) Distinguish between fixed and circulating capital. [2]
(b) Explain one exception to the law of demand. [2]
(c) Mention the impact of advanced technology on the supply of a commodity. ** [2]
(d) What is meant by running inflation? State its impact on fixed income groups. [2]
(e) Define a Degressive tax. [2]

Answer:
(a)

Fixed Capital	Circulating Capital
. It is not totally used up within a single period of production e.g. heavy machines.	It is completely exhausted after a single Use e.g raw materials.
2. It does not change its form after its use.	It changes its form after its use.
3. It gradually depreciates.	The question of depreciation does not arise.

(b) One exception to the Law of Demand can be:
Conspicuous goods: These are status symbol goods which are purchased not because of their intrinsic value but because of status or prestige value. Thus, if price decreases, demand for such goods also decreases, e.g. diamonds jewellery belong to this category, where the law of demand does not operate.

(d) When the sustained rising prices gain a full momentum of their own (say 8% to 10% per annum) they begin to move up at a fast speed. It is called running inflation. It is a warning signal for controlling it. Fixed income groups are worst affected by inflation because the purchasing power of fixed income goes on decreasing with rising prices.

(e) Taxes which are mildly progressive, hence not very steep, so that high-income earners do not make a due sacrifice on the basis of equity are called degressive tax. In degressive taxation a tax may be progressive upto a certain limit; after that it may be charged at a flat rate.

Question 3:
(a) Capital is the result of past labour. Briefly explain. [2]
(b) Define monopsony. [2]
(c) Producers in a monopoly are price makers. Briefly explain. [2]
(d) What is bank rate? How it is altered to correct a depression in an economy? ** [2]
(e) With the help of a formula calculate the elasticity of supply from the following table: [2]

Price ₹	Quantity supplied (Units)
10	200
15	225

Answer:
(a) Capital is the result of human efforts by working on natural resources in the past. Capital goods are the products (tools) of the past labour (efforts) used for further production. It is man-made and is born out of savings done by man.

(b) Refer Ans. 2 (d), 2015.

(c) Under monopoly, producer or the single seller can directly or indirectly influence the price to a great extent. A monopolist is the price-maker and can get the price raised by manipulating the supply of the commodity; but he cannot sell more by raising the price of his commodity.
(e)

eS=Percentage change in quantity suppliedPercentage change in its price

$$e_s = \frac{\text{Percentage change in quantity supplied}}{\text{Percentage change in its price}}$$

$$= \frac{\Delta Q}{\Delta P} \times \frac{P}{Q}$$

ΔQ = Change in quantity supplied
Q = Original quantity of supply
ΔP = Change in the price of the product
P = Original price of the product

$$= \frac{25}{5} \times \frac{10}{200}$$

$$= \frac{2}{8} = \frac{1}{4} \text{ hence } e_s < 1 \text{ (Less than unity.)}$$

Question 4:
Citing reasons state the advantage of:
(a) A progressive tax over proportional tax. [2]
(b) Monopolistic competition over monopoly. [2]
(c) Private sector over public sector. [2]
(d) A direct tax over an indirect tax. [2]
(e) A credit card over currency notes. [2]

Answer:
(a)

1. Progressive taxes help in reducing the income inequality among different income groups of people in a society. The rich pays a higher average tax rate than the poor. So the gap between the rich and poor is narrowed down. But in case of proportional taxes both rich and poorer persons are to pay the tax at the same rate.
2. Progressive tax is more elastic than proportional tax.

(b) Under monopolistic competition there are many sellers in the market which sells differentiated products. Whereas in monopoly there is a single seller selling homogeneous or non-homogeneous product.

(c) Private sector helps in rapid economic growth. It is more productive than public sector and has more competitive ability and hence earns more profit in less time.

(d) A direct tax is an equitable, economical, certain, elastic and productive and also increases the civic sense. Whereas indirect tax is unequitable, uneconomic, uncertain, and does not create civic sense.

(e) A credit card gives the facility to the cardholder to purchase goods and services from various shops without paying the currency notes (cash) at that time. The card issuing banks pay the seller immediately after the transaction and charge the buyer after one month or so, as the condition specified. Moreover, risk of carrying currency notes is also overcome by a credit card.

SECTION-II (60 Marks)

(Answer any four questions from this section)

Question 5:

(a) Explain with the help of an example the horizontal and vertical division of labour.

Mention any three merits of division of labour. [7]

(b) Define composite demand. Clearly explain any three determinants of demand in a market. [8]

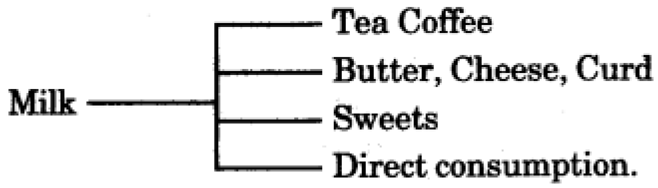
Answer:

(a) Horizontal: The different parts of an automobile can be manufactured simultaneously. The parts can be assembled together at the end. Hence the division of labour between the workers engaged in producing engines and those engaged in producing bodies is an example of horizontal division of labour.

Vertical: Whereas in order to produce cotton textile products, raw cotton has to be transformed into yam by spinning. Only then can the yarn be woven into cloth. Spinning and weaving cannot be done simultaneously on the same bag of raw cotton. Hence the division of labour between workers in spinning department and those in weaving department of a cotton textile factory is an example of a vertical division. The three merits of division of labour are as follows:

1. Division of labour increases the efficiency of worker. The worker is assigned one type of work, according to his aptitude and skill. Thus, he will do the work with more zeal and devotion which improves the efficiency of the worker.
2. Division of labour helps in increasing the profits of the producer. The greater quantity and the better quality of output bring greater profits to the producers.
3. With specialization, workers become more skilled and efficient. This results in more production quantitatively as well as qualitatively. Thus over all production increases.

(b) Composite demand: A commodity can be used for several purposes and its demand is directly linked to its various uses. Such a demand is known as composite demand.
e.g.



The three determinants of demand in a market are:

1. Price of the commodity: An increase in the price level reduces the purchasing power of consumers and the demand will be less. A fall in the price level increases the purchasing power of the consumers and the demand will be more.
2. Population: An increase in population of a region will result in an increased demand of various goods. Also the composition of papulation determines the demand of certain goods proportionately. For example, an increased number of females in the region will generate more demand for sarees, ornaments etc.
3. Pattern of income: With a rise in income, the purchasing power of people also increases which in turn encourages the people to demand more of luxuries and comforts.

Questions 6:
(a) What is meant by privatisation? Explain in brief three arguments against privatization of public sector units in India. [7]
(b) Explain four characteristics of a perfectly competitive market. [8]

Answer:
(a) Privatization: Privatization means the transfer of managerial control of any public sector units to any private entrepreneur or to any private corporate body is called privatization.
Arguments against Privatization in India are:

1. Social welfare aspect is neglected: Main motive of the private sector enterprises is to earn maximum profits. Thus, the social welfare aspect is being neglected.
2. Growth of monopoly power: Privatization may lead to the growth of monopoly power in the industry and services sectors. The weak Indian companies may either be closed down or taken over by some big companies. Ultimately the monopoly power of multi-national companies will grow more and more which would not be in the interest of economic development.

3. Misutilization of resources: The private sector in India has been wasting away valuable resources in the name of securing profits by opting for obsolete technology and producing shoddy products. It depends entirely on Government technologies or imported know-how.

(b) Refer Ans. 9(a), 2015.

Question 7:
(a) Explain the terms impact, shifting and incidence of a tax. Explain in brief two merits of direct tax. [7]
(b) Define price elasticity of supply. With the help of suitable diagrams explain the following degrees of elasticity:

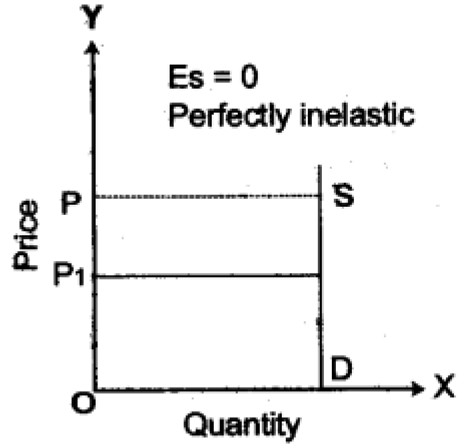
1. Perfectly inelastic supply.
2. Perfectly elastic supply. [8]

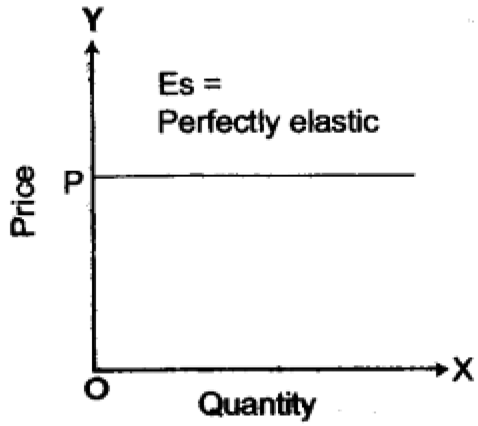
Answer:
(a) Impact: The person or institution who has to bear the burden of tax at first instance (e.g. ‘seller’ in case of a sales tax).
Shifting: When the burden of tax is shifted from impact to incidence, it is known as shifting.
Incidence: The resting point of burden of tax, i.e. the person or institution who ultimately bears the burden of a tax (e.g. ‘consumers’ in case of a ‘sales tax’).
The person from whom the tax is first collected bears the ‘impact’ of the tax. But he does not bear the burden of taxation. Rather, he shifts it to another person. We say incidence of tax is on this person.
e.g. In income tax the impact and incidence is on the same person. Shifting cannot be done.
But in sales tax the impact is on the seller and incidence is on the consumer. Two merits of direct tax are:

1. Certainty: Canon of certainty is satisfied by direct taxes for instance an income tax payer knows when and at what rate he has to pay income tax. The Government also knows for sure how much it would earn from income tax.
2. Economical: The cost of collection of direct taxes is relatively low as it is deducted at source.

(b) Price elasticity of supply: The price elasticity of supply indicates the responsiveness in quantity supplied of a commodity due to percentage change in the price of that commodity. It is expressed as follows:
$$e_S = \frac{\text{Percentage change in quantity supplied}}{\text{Percentage change in its price}}$$

1. Perfectly inelastic supply: If there is no change in quantity supplied with changes in the price of the product, then the supply of that





2. Perfectly elastic supply: If there is an infinite change in quantity supplied in response to a small change in price, the supply of that commodity is said to be completely price elastic (i.e., $E_S = \infty$).

Question 8:
(a) Define production. Explain three factors which determine land productivity. [7]
(b) Explain an important characteristic of each of the following factors of production:

1. Land
2. Labour
3. Capital
4. Entrepreneur. [8]

Answer:
(a) Production: The process of creating various utilities which are consumed by the people of the country is called production. It includes the production of material goods only. “An act of creating utility is known as production”. There are five factors of production—land, labour, capital, enterprise, and organization.
The three factors which determines land productivity are as follows:

1. Natural fertility of land: Some plots of land are more fertile than others. Fertile land yields greater amount of output than the less fertile land. Land is a free gift of nature.
2. Proper use of land: Productivity of land also depends upon the use of land which the land is put to, e.g. some land may be more suitable for the cultivation of rice than for the cultivation of wheat. Supply of land is fixed.

3. Security of tenancy: Productivity of land often depends on the security of the tenant. If the tenant is not certain about the tenancy for the next year, he will not be enthusiastic in working over it and investing money on it, because by the time the investment would start giving results he may no longer remain the tenant.

(b)

1. Land: Basically, land is available from the nature as free of cost. In the initial stages, man paid no price for the land acquired by him. However to improve the usefulness or fertility of land or to make some improvements over land, some expenditure is to be incurred. But as such, it is available at no cost from nature. Its supply is fixed but it is indestructible and passive factor of production.
2. Labour: Labour is an active factor of production as labour can easily produce anything on its own without the help of land or capital because it is a living entity. The labourer and his labour are inseparable. The labour sells his services only not himself. Labour is perishable.
    1. Capital: It is a passive factor of production because it remains ineffective without co-operation of labour. Capital is man-made and is bom out of savings done by man. It has the highest mobility. The supply of capital is elastic and can be adjusted easily and quickly according to demand. On the other hand supply of land is fixed, and supply of labour can neither be increased nor decreased quickly.
3. Entrepreneur: Entrepreneur is a person or group of persons controlling the policy of a firm. He conceives the idea of business, arranges various resources, combines different factors of production and makes every effort to convert his business idea into reality. Moreover, he is the one who bears the risk of the business.

Question 9:
(a) Name the hank which has sole authority to issue currency in India. Mention three ways by which it differs from a commercial bank. [7]
(b) Define money. Explain how money performs the following functions:

1. As a measure of value.
2. As a standard of deferred payment.
3. As a store of value. [8]

Answer:
(a) The bank which has sole authority to issue currency in India is central

bank, in India (RBI as central bank). The three ways by which it differs from a commercial bank are as follows:

Central Bank	Commercial Banks
1. Central bank is an apex institution in the money market.	Commercial bank is merely a unit in the banking structure of the country operating under the control of central bank.
2. A country has only one central bank.	A country has a large number of commercial banks.
3. It enjoys the monopoly power to issue currency and it is generally owned and governed by the Government.	These banks do not have power to issue currency and can be owned by the Government or by the private entrepreneurs.
4. Central bank controls credit.	Commercial banks create credit.
5. It acts as an agent and a banker to the Government. It functions as a custodian of the Government's funds, and gives advise	These banks have no advisory responsibility towards the state.

on monetary and fiscal measures.	

(b) Money is defined as “Anything which is commonly used as generally accepted, as a medium of exchange or as a standard of value, like metallic coins, paper money, and deposit money.
It functions as:

1. As a measure of value: Money is accepted as a measure of value or unit of account. Under the barter system, the price of a commodity were expressed in terms of other commodity.
2. As a standard of deferred payments: Money acts as a standard of deferred payments. It means payment to be made in future can be expressed in terms of money.
3. Refer Ans. 8 (a) (ii), 2016.

Question 10:
(a) What is a public sector undertaking? Explain three problems faced by public sector undertakings in India. [7]
(b) Read the extract given below and answer the questions that follow:
The Hindu, 11th July, 2011.
“We need to remember that we should work towards bringing nearly 100 million citizens, to the formal fold of the banking sector” said RBI Deputy Governor, K.C. Chakraborty.
In rural areas, where accessibility is a problem, banks are using the Micro finance network business correspondents and facilitators to bring more people under the ambit of banking services.

1. Why is it necessary to bring more people under the formal fold of the banking sector? Give one reason. [1]
2. Mention one way by which people would benefit from banking services. [1]
3. Which stage of capital formation is the above extract referring to? Explain the stage in brief. [2]
4. Explain two ways in which banks accept deposits. [2]
5. What is meant by cash credit? [2]

Answer:
(a) Public sector undertakings are state/central Government owned enterprises. The term is used to refer to companies in which the

Government (either the union govt, or state govt, or both) owned a majority (51% or more) of the company equity. These are companies which are funded by Government of India, e.g. GAIL, SAIL, ONGC, BHEL, HAL, BSNL, H.P., B.P. etc.
The three problems faced by public sector undertakings are as follows:

1. Poor planning: Public sector undertakings are often established in a hurry without clear cut objectives. There is always lack of proper evaluation of demand and supply.
2. Ineffective financial control: Several public sector undertakings suffer from over capitalization due to insufficient planning. This is totally wastage of financial resources. Even investment worth thousands of crores of rupees in the public sector undertakings is not utilized fully.
3. Inefficient Management: The management of the public sector undertakings are inefficient due to centralized decision-making, frequent transfer of top executives. Some persons are appointed with the approach of politicians. This results inefficient management. Moreover PSU faces the problem of sick units due to time and cost over runs.
4. Wasteful expenditure: Wasteful expenditure is also one of the problems faced by public enterprises. The Government funds and property are used carelessly by the Government officials and other servants leading to an increase in the cost of production.
5. Autonomy: Theoretically, public enterprises are provided, autonomy in their working. In practice, the Government, the ministers, the politicians and other Government agencies constantly interfere in their day-to-day activities.

(b)

1. It is necessary to bring more people under the formal fold of the banking sector so that people’s financial requirements can be fulfilled easily and quickly without any hindrances. Moreover people’s savings can easily be mobilised and act of investment can easily be made through banks for capital formation.
2. People will save more and will invest their savings in the banks and will earn interest on their investments.
3. Second stage (effective mobilization of savings) The capital formation cannot occur unless the savings of the people are actually utilized (i.e. invested) for producing capital goods. For that effective mobilization of saving has to be done (to the banks).
4. Banks accepts deposits in two ways. They are as follows:
    1. Fixed deposits account: In such deposits, the deposited amount can be withdrawn only after the period of time agreed upon by

the bank and the depositor. The interest rates are higher in case of such deposits.

2. Recurring Account: In case of such deposits, an account holder has to deposit certain fixed amount every month for a specified period. The amount accumulated with interest (cumulative deposits) is paid to the depositor after the specified period.

5. Cash credit: In cash credit, the bank advances a ‘cash loan’ upto a specified limit to the customer against a bond or other security. A borrower is required to open a account and bank allows the borrower to withdraw upto the full amount of the loan. The interest is charged only on the amount actually utilized by the borrower and not on the loan sanctioned.