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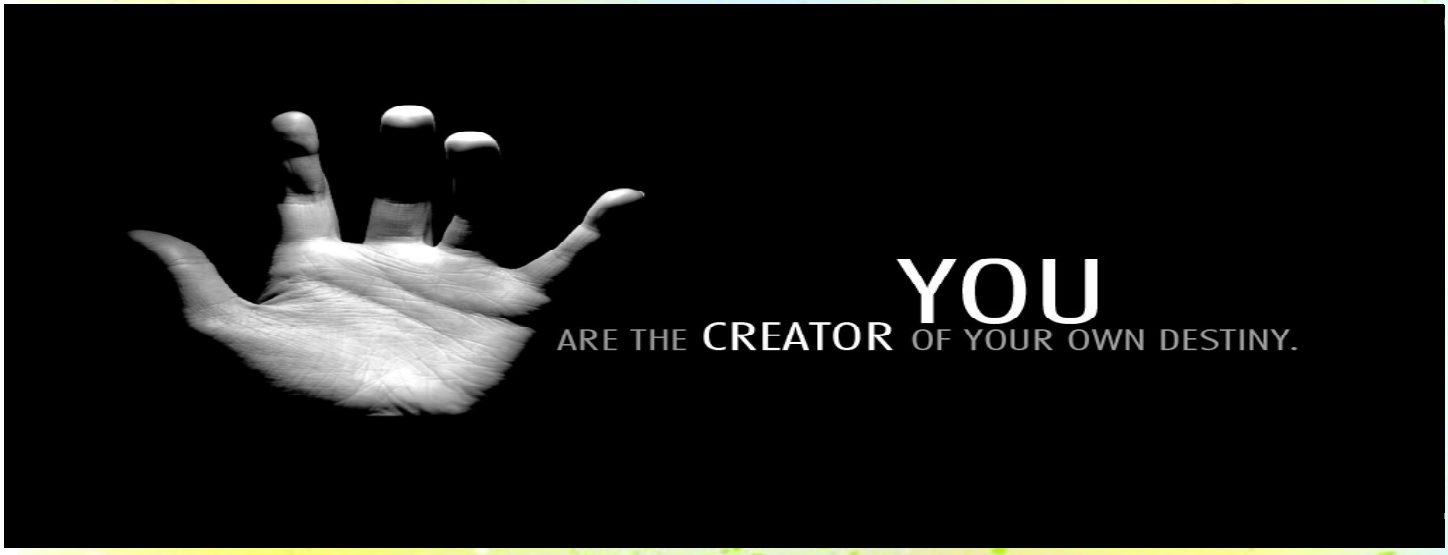

"You're the only one who can make the difference. Whatever your dream is, go for it."

CA Aaditya Jain

With Sunrise You Rise

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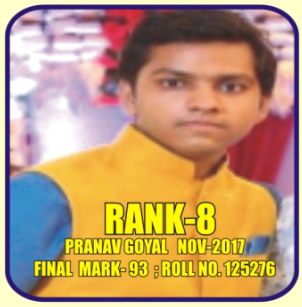

ANS MANY MORE RANKHOLDER WITH 100% MARKS IN SUBJECT

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CHAPTER 1 THEORIES OF INTERNATIONAL TRADE

QUESTION NO.1 What are the arguments in support of international trade ?
(1) economic growth and rising incomes.(2) receives inputs components internationally at competitive prices.(3) increase the scope for mechanization and specialisation. (4) enhance economic growth by creating jobs(5) enhances foreign direct investment.(6) Opening up of new markets which results in high production (7) contribute to human resource development.(8)Trade strengthens bonds between nations.

QUESTION NO.2 What are the arguments against international trade ?
(1)negative labour market outcomes for unskilled workers.(2)not equally beneficial to all nations (3) leads to exhaustion of natural resources and environmental damage.(4)have adverse effect on the development of domestic industries (5)Risky dependence of underdeveloped countries on foreign nations(6)Welfare of people may be ignored for the sake of profit. (7)may hamper the genuine investment needs of a country. (8)trade may increase severe competition.(9)lack of transparency and predictability related to international trade.

QUESTION NO.3 What is The Mercantilists' View of International Trade ?
➞Advocated maximizing exports in order to bring in more "specie" (precious metals) and minimizing imports through the state imposing very high tariffs on foreign goods.

QUESTION NO.4 What is The Theory of Absolute Advantage ?

Commodity	Country A	Country B
Wheat (bushels/hour)	6	1
Cloth (yards/hour)	4	5

➞What each country should produce:Country A would specialise completely in production of wheat and country B in cloth.➞Calculation Of Gain: Assume:If country A exchanges six bushels of wheat (6W) for six yards of country B's cloth (6C), Country A gains 2C or saves half an hour or 30 minutes of labour time.Country B gains 24C, or saves nearly(approx) five hours of work.

QUESTION NO.5 What is The Theory of Comparative Advantage ?

Output per Hour of Labour

Commodity	Country A	Country B
Wheat (bushels/hour)	6	1
Cloth (yards/hour)	4	2

➞What each country should produce: Country A specialises in the production of wheat and country B should specialise in the production of cloth.➞Calculation Of Gain: Assume that country A could exchange 6W for 6C with country B. **Country A would gain 2C (or save half an hour of labour time).Country B would gain 6C or save three hours of labour time.➞Range for mutually advantageous trade:**Range for mutually advantageous trade is **4C < 6W < 12C**.

QUESTION NO.6 What is Opportunity cost concept from Microeconomic theory ?

➡**Opportunity cost is basically the value of the forgone option.**

Output per Hour of Labour

Commodity	Country A	Country B
Wheat (bushels/hour)	6	1
Cloth (yards/hour)	4	2

➡**Calculation Of Opportunity Cost : Country A : 1W = 2/3C and Country B : 1W = 2C,**
➡**What each country should produce: Opportunity cost of wheat is lower in country A than in country B.Therefore, country A should consider specializing in producing wheat and Country B in cloth.**

QUESTION NO.7 What is The Heckscher-Ohlin Theory of Trade ?

➡**States that two countries have different factor endowments**.➡"**Factor Endowment" like labour and capital are taken into account in this theory.**➡According to this theory, **international trade is but a special case of inter-regional trade**. ➡The theory states that a **country's exports depend on its resources endowment** i.e. whether the country is capital-abundant or labour-abundant. ➡The Heckscher-Ohlin theory of foreign trade can be stated in the form of two theorems namely, **Heckscher-Ohlin Trade Theorem and Factor-Price Equalization Theorem.-The Heckscher-Ohlin Trade Theorem:**The Heckscher-Ohlin Trade Theorem establishes that a country tends to specialize in the **export** of a commodity whose production requires **intensive use of its abundant resources** and **imports** a commodity whose production requires **intensive use of its scarce resources.**
-The Factor-Price Equalization Theorem:➡States that international trade **tends to equalize the factor prices between the trading nations.** ➡In other words, the **wages of homogeneous labour and returns to homogeneous capital will be the same** in all those nations which engage in trading.

QUESTION NO.8 Difference between theory of comparitive costs and modern theory ?

Theory of Comparative Costs	Modern Theory
1.The **basis of the difference** between countries is **comparative costs.**	**1.**The **basis of the difference** in comparative costs is due to differences in **factor endowments.**
2.Based on labour theory of value.	**2.Based on money cost** which is more realistic.
3.Considered labour as the sole factor of production and **presents a one-factor (labour) model.**	**3.**Include labour and capital as important factors of production.This is **2-factor model** & can be extended to more factors.
4.Treats **international trade as quite distinct from domestic trade.**	**4.**International trade is only a **special case of inter-regional trade.**
5.Attributes the differences in comparative advantage **to differences in productive efficiency of workers.**	**5.**Attributes the differences in comparative advantage due to **differences in factor endowment.**
6.Does not take into account the **factor price differences.**	**6.Considers factor price differences** as the main cause of commodity price differences.
7.Normative; tries to demonstrate the gains from international trade.	**7.Positive**; concentrates on the basis of trade.

QUESTION NO.9 What is The New Trade Theory ?

➡NTT came about to help us understand **why developed and big countries are trade partners when they are trading similar goods and services.** These countries constitute more than 50% of world trade.➡This is **particularly true in key economic sectors such as electronics, IT, food, and automotive.** We have **cars** made in the India, yet we purchase many cars made in other countries.The **mobile phones** we use are a good example. India produces them and also imports them.➡**Two key concepts according to NTT are** :**1.Economies of Scale:**

2.Network effects: A good example will be Mobile App such as **Whats App** and software like Microsoft Windows.

QUESTION NO.10 Difference between International Trade & Domestic Trade ?

1.International trade -**between residents of different countries**.Domestic trade - **within the domestic territory of a country 2.**involves **multiple currencies. 3.**greater **complexity 4.**differences in **legal systems, 5.**more elaborate **documentation, 6.diverse restrictions** in the form of taxes, regulations, duties, tariffs, quotas, trade barriers, standards, restraints to movement of specified goods and services and issues related to shipping and transportation.

QUESTION NO.11 What is "Terms of trade" ?

➡"Terms of trade" **is ratio of the price of a country's export commodity to the price of its import commodity.**
➡When a country's **TOT is less than 100%**, more capital is leaving the country than is entering the country. When the **TOT is greater than 100%**, the country is accumulating more capital from exports than it is spending on imports.

CHAPTER 2 THE INSTRUMENTS OF TRADE POLICY

QUESTION NO. 1 What is Tariffs ? What are its objective ?

➡Tariffs means **taxes or duties** imposed on goods and services which are imported or exported.
➡**Objective:(a)** to raise **revenue for the government**, **(b)to protect the domestic** import-competing **industries.**

QUESTION NO. 2 What are the different Forms of Import Tariffs ?

(1) Specific Tariff: ➡A specific tariff is an import duty that assigns a **fixed monetary tax per physical unit** of the goods imported. ➡Thus, a specific tariff of **Rs.1000/ may be charged on each imported bicycle.**
(2) *Ad valorem* tariff: ➡An *ad valorem* tariff is levied as a **constant percentage of the monetary value** of one unit of the imported good. ➡A **20% ad valorem tariff** on any bicycle generates a Rs 1000/ payment on each imported bicycle priced at Rs 5,000/ in the world market; and if the price rises to Rs 10,000, it generates a payment of Rs 2,000/.
(3) Mixed Tariffs : ➡Mixed tariffs are expressed either on the basis of the **value of the imported goods (an ad valorem rate) or on the basis of a unit of measure of the imported goods (a specific duty)** depending on which generates the most income(or least income at times) for the nation. ➡For example, duty on cotton: **5 per cent *ad valorem* Or Rs 3000/per tonne, whichever is higher.**
(4) Compound Tariff or a Compound Duty :➡It is a **combination of an ad valorem and a specific tariff.** ➡**For example**: duty on cheese at 5 per cent *ad valorem* plus 100 per kilogram.
(5) Tariff Rate Quotas: ➡Tariff rate quotas (TRQs) **combine two policy instruments: quotas and tariffs.** ➡Imports-under the **specified quota portion are usually subject to a lower (sometimes zero), tariff rate.** ➡**Imports-above the quantitative limit** of the quota face a **much higher tariff.**
(6) Most-Favored Nation Tariffs: ➡MFN tariffs are what countries **promise to impose on imports from members who are not a part of WTO**, unless the country is part of a preferential trade agreement .
(7) Preferential Tariff:➡Nearly all countries are part of at least one preferential trade agreement, under which they promise to give another country's products **lower tariffs than their MFN rate.** ➡These **agreements are reciprocal.** ➡A **lower tariff is charged** from goods imported from a country which is given preferential treatment.
(8) Bound Tariff :➡A bound tariff is a **tariff which a WTO member binds itself with a legal commitment not to raise it above a certain level.**
(9) Escalated Tariff :➡Escalated tariff structure refers to the system wherein the **nominal tariff rates on imports of finished goods are higher than the nominal tariff rates on raw materials.**➡**For example** :less tariff on the import of raw leather, but more tariffs on the import of leather manufactures such as shoes. ➡This has special relevance to trade between developed countries and developing countries. Developing countries are thus forced to continue to be **suppliers of raw materials without much value addition.**

(10)Tariffs as Response to Trade Distortions:

(A)Anti-dumping Duties:

➡Dumping occurs **when manufacturers sell goods in a foreign country below the sales prices in their domestic market or below their full average cost of the product.** ➡Dumping may be **persistent, seasonal, or cyclical.** ➡**Predatory pricing practice** to drive out established domestic producers from the market and to **establish monopoly position.**➡Dumping is an **international price discrimination** aim to harm the domestic producers of the importing country. ➡This is **unfair and constitutes a threat to domestic producers** and therefore when dumping is found, **anti-dumping tariffs** is initiated as a safeguard instrument by imposition of additional import duties so as **to offset the foreign firm's unfair price advantage.**➡This is **justified only if the domestic industry is seriously injured by import competition, and protection is in the national interest.** ➡**for example**:In January 2017, India imposed antidumping duties on colour-coated or pre-painted flat steel products imported into the country from China and European nations and for jute and jute products from Bangladesh and Nepal.

(B) Countervailing Duties: ➡CVDs are meant to level, the playing field between domestic producers of a product and foreign producers of the same product who **can afford to sell it at a lower price because of the subsidy they receive from their government.** ➡Countervailing duties are tariffs that **aim to offset the artificially low prices charged by exporters who enjoy export subsidies and tax concessions** offered by their governments. ➡**Subsidy generates a distortion(disbalance) from the free-trade allocation of resources.**➡In such cases, **CVD is charged in an importing country to negate(remove) the advantage that exporters get from subsidies** to ensure fair and market oriented pricing of imported products and thereby protecting domestic industries and firms. ➡If left unchecked, such subsidized imports can have a **severe effect on domestic industry, forcing factory closures and causing huge job losses.** ➡For example, in 2016, in order to protect its domestic industry, **India imposed 12.5% countervailing duty on Gold jewellery imports from ASEAN.**

(11)Technical/Other Tariff: ➡These are calculated on the basis of the specific contents of the imported goods i.e **the duties are payable by its components or related items.** ➡For example: **Rs 3000/ on each solar panel plus Rs 50/ per kg on the battery.**

(12) Prohibitive tariff: ➡A prohibitive tariff is one that is **set so high that no imports will enter.**

(13) Import subsidies : ➡An import subsidy is **simply a payment per unit or as a percent of value** for the importation of a good.

(14) Variable Tariff: ➡A duty typically fixed to bring the price of an imported commodity **up to the domestic support price** for the commodity.

(15) Applied Tariffs: ➡An 'applied tariff ' is the duty that is **actually charged on imports .**

QUESTION NO. 3 What are the Effects of Tariffs ?

(1) decrease the volume of imports and exports . (2)tariffs discourage domestic consumers from consuming imported foreign goods. (3) protect domestic industries.(4) Producers in the domestic country can charge higher prices because of reduced foreign competition.(5) The **price increase** also **increase output** and consequently an **increase in employment in the industry.(6)** Tariffs **disregard comparative advantage** .It **discourage efficient production** in the rest of the world and **encourage inefficient production** in the home country.**(7)** Tariffs **increase government revenues.**

QUESTION NO. 4 What is Non Tariff Measures (NTMs) ?

➡Tariffs constitute the visible barriers to trade .Non- tariff constitute the hidden or **'invisible' barriers to trade.**

➡NTMs are categorized as:

Technical Measures: ➡These measures are intended for ensuring **(a)product quality, (b)food safety, (c)environmental protection, (d)national security and (e)protection of animal and plant health.**

Non Technical Measures:➡Non-technical measures **relate to trade requirements;** for example; shipping requirements, custom formalities, trade rules, taxation policies, etc.

➡**These are further distinguished as:(a) Hard measures** (e.g. Price and quantity control measures),**(b) Threat**

measures (e.g. Anti-dumping and safeguards) and **(c) Other measures** (related to finance and investment) ➡**Furthermore, the Non Technical Measures also distinguishes between:(i) Import-related measures** which relate to measures imposed by the importing country, and **(ii) Export-related measures** which relate to measures imposed by the exporting country. **(iii)** In addition, to these, there are **procedural obstacles (PO)** which includes problems in **(a)**administration, **(b)**transportation, **(c)**delays in testing, **(d)**certification that may make it difficult for businesses to pursue international trade.

QUESTION NO. 5 What are the examples of Technical measures ?

(a)Sanitary and Phytosanitary (SPS) Measures: ➡SPS measures are applied **to protect human, animal or plant life** from risks arising from **(a)additives, (b)pests, (c)contaminants, (d)toxins or (e)disease-causing organisms and (f)to protect biodiversity**➡These **include ban or prohibition of import of certain goods**➡**For example;** prohibition of import of poultry from countries affected by avian flu, meat and poultry processing standards to reduce pathogens, **limits for pesticides in foods** etc.

(b) Technical Barriers To Trade (TBT): ➡Technical Barriers to Trade (TBT) which cover both food and non-food traded products **refer to mandatory 'Standards and Technical Regulations' that define the specific characteristics that a product should have,** such as its **(a)size,(b)shape,(c) design, (d)labelling (e)marking (f)packaging, (g)functionality or (h)performance and (i)production methods, excluding measures covered by the SPS Agreement.** ➡This involves **testing, inspection and certification**.➡It also involves **compulsory quality, quantity and price control of goods** before shipment from the exporting country. ➡**Some examples of TBT are: (a)**food laws, **(b)**quality standards, **(c)**industrial standards, **(d)**organic certification, **(e)**eco-labeling,**(f)** marketing and **(g)**label requirements.

QUESTION NO. 6 What are the examples of Non-technical Measures ?

(i) Import Quotas: ➡An import quota is a **direct restriction which specifies that only a certain physical amount of the good will be allowed** into the country during a given time period, usually one year. ➡Import quotas may be **binding quota and non-binding quota**.➡Import quotas are mainly of two types: **absolute quotas and tariff-rate quotas.** ➡In addition, there are **seasonal quotas and temporary quotas.**

➡ **'Quota Rents':**-The **profits received by the holders of such import licenses** are known as 'quota rents'. -The license holders are able to **buy imports and resell them at a higher price in the domestic market** and they will be able to earn a 'rent' on their operations over and above the profit they would have made in a free market.

➡**Welfare Effects of quotas(a)**the amount of **imports will be reduced**. **(b)raise the domestic price. (c)reduces consumer surplus(d)increases producer surplus (e)**The price increase also **increases output of existing firms (and perhaps the addition of new firms), an increase in employment, and an increase in profit.**

(ii) Rules of origin: ➡Rules of origin are the criteria needed by governments of importing countries to **determine the national source of a product.**

(iii) Embargos:➡An embargo is a **total ban imposed by government** on import or export of some or all commodities to particular country or regions for a specified or indefinite period.

(iv)Trade-Related Investment Measures: ➡It Includes **(a) that a specified fraction of a final good should be produced domestically.(b) restricting the level of imported components** , and **(c)limiting the purchase or use of imported products** to an amount related **to the quantity or value of local products that it exports**. (A firm may import only up to 75 % of its export earnings of the previous year)

(v) Government Procurement Policies: ➡Government purchases **should be from domestic firms rather than foreign firms,** despite higher prices than similar foreign suppliers. ➡In accepting public tenders, a **government may give preference to the local tenders rather than foreign tenders**.

(vi) Distribution Restrictions:➡Distribution restrictions are limitations imposed on the distribution of goods in the importing country **involving additional license or certification requirements.**

(vii) Restriction on Post-sales Services:➡Producers may be **restricted from providing after- sales services** for exported goods ➡Such services **may be reserved to local service companies** .

(viii)Price Control Measures:➡Price control measures **(including additional taxes and charges)** are steps taken to control or influence the prices of imported goods in order to support the domestic price of certain products **when the import prices of these goods are lower.**

(ix) Non-automatic Licensing and Prohibitions: ➡These measures **may take the form of non-automatic licensing, or through complete prohibitions.** ➡**For example,** textiles may be allowed only on the basis of license by the importing country. **India prohibits import/export of arms and related material from/to Iraq**.

(x) Financial Measures: ➡It includes measures such as **advance payment requirements and foreign exchange controls** .

(iv) Measures Affecting Competition: ➡It may include **government imposed special import channels or enterprises, and compulsory use of national services.** ➡**For example,** a statutory marketing board may be granted exclusive rights to import wheat: or a canalizing agency (**like State Trading Corporation) may be given monopoly right to distribute palm oil.**

(v) Administrative Procedures:➡Another potential obstruction to free trade is the **costly and time consuming administrative procedures** which are mandatory for import of foreign goods. ➡**Examples** include specifying particular procedures and formalities, requiring licenses, administrative delay, red-tape and corruption in customs clearing frustrating the potential importers , procedural obstacles linked to prove compliance etc.

(vi) Safeguard Measures:➡They are initiated by countries to restrict imports of a product temporarily if its domestic industry **is injured or threatened with serious injury caused by a surge in imports.**

QUESTION NO. 7 What are Export Related Measures ?

(1) Ban on exports:➡**For example** ,during **periods of shortages,** export of agricultural products **such as onion** , wheat etc may be prohibited to make them available for domestic consumption.

(2) Export Taxes :➡An export tax is a tax collected on exported goods and may be **either specific or ad valorem.**

(3) Export Subsidies and Incentives : ➡Governments or government bodies **provides Export subsidies ,duty drawback, duty-free access .**

(4) Voluntary Export Restraints: ➡Voluntary Export Restraints (VERs) refer to a type of **informal quota** administered by an exporting country voluntarily **preventing the quantity of goods that can be exported out** of that country during a specified period of time. ➡Exporter agree to VER mostly **to appease the importing country** and to **avoid the effects of possible retaliatory trade restraints** that may be imposed by the importer.➡VERs may arise when the domestic industries **seeks protection from a surge of imports** from particular countries.

CHAPTER 3 TRADE NEGOTIATIONS

QUESTION NO. 1 What are different types of trade agreements/negotiations?

(1) Unilateral trade agreements :**offers trade incentives** that will improve the exporting country's economy.**Example:Generalized System of Preferences.(2) Bilateral Agreements** are agreements which **set rules of trade between two countries, two blocs or a bloc and a country**. **Example: EU-South Africa Free Trade**

Agreement; ASEAN-India Free Trade Area(3) Regional Preferential Trade Agreements among a group of countries to **reduce trade barriers on a reciprocal and preferential basis** for only the members of the group. **Example: Global System of Trade Preferences among Developing Countries (GSTP)(4) Trading Bloc** has a group of countries that have a **free trade agreement between themselves and may apply a common external tariff** to other countries. **Example: Arab League (AL), European Free Trade Association (EFTA).(5) Free-trade area** is a group of countries that **eliminate all tariff barriers on trade with each other and retains independence in determining their tariffs with non members**. **Example: NAFTA(6)** A **customs union** is a group of countries that **eliminate all tariffs on trade among themselves but maintain a common external tariff** on trade with countries outside the union. **Example: EC, MERCOSUR.(7) Common Market**: A Common Market which helps a customs union by providing for the **free flow of factors of production (labor and capital)** in addition to the free flow of outputs.There are also common barriers against non-members.**Example: EU, ASEAN(8)** In an **Economic and Monetary Union**, members **share a common currency and macroeconomic policies**. **For Example, the European Union countries implement and adopt a single currency.**

QUESTION NO. 2 Why General Agreement on Tariffs and Trade (GATT) lost its relevance ?

(1) it was obsolete (2) international investments had expanded to a large degree.(3) intellectual property rights and trade in services were not covered by GATT.**(4) world business increased** to a large degree and was beyond its scope.**(5)the ambiguities(loopholes) in the multilateral system could be heavily exploited.(6) efforts to reform agricultural trade were not successful.(7)inadequacies in institutional structure and dispute settlement system.(8)terms of GATT were binding .**

QUESTION NO. 3 Define objectives of World Trade Organization ?

(1)to set and enforce rules for international trade.(2)to provide a forum (3)to resolve trade disputes.(4)to increase the transparency(5)to cooperate with other major international economic institutions(6)to help developing countries (7)raising standards of living.(8)ensuring full employment .(9)growing volume of real income and effective demand.(10)expanding the production and trade of goods and services .(11)to facilitate the flow of international trade smoothly, freely, fairly and predictably.

QUESTION NO. 4 Explain THE STRUCTURE OF THE WTO ?

➡It has a **three-tier system of decision making.** ➡The **WTO's top level decision-making body is the Ministerial Conference** which can take **decisions on all matters** .The Ministerial Conference meets **at least once every two years.** ➡The **next level is the General Council which meets several times a year at the Geneva headquarters**. The General Council **also manage Trade Policy Review Body and the Dispute Settlement Body.**➡At the next level, the **Goods Council, Services Council and Intellectual Property (TRIPS) Council** report to the General Council.These councils are **responsible for overseeing the implementation of the WTO agreements** in their respective areas of specialisation.

QUESTION NO. 5 Explain The Guiding Principles of World Trade Organization (WTO) ? OR Explain Trade without discrimination or The National Treatment Principle (NTP) in detail ?

(1)Trade without discrimination (2)The National Treatment Principle (NTP) (3) Freer trade c(4) Predictability (5) Principle of general prohibition of quantitative restrictions (6) Greater competitiveness (7)Tariffs as legitimate measures for the protection of domestic industries (8) Transparency in Decision Making (9) Progressive Liberalization(Freedom/Reform) (10)Market Access (11) Special privileges to less developed countries (12) Protection of Health & Environment (13) A transparent, effective and true dispute settlement mechanism:

QUESTION NO. 6 What are the major issues/concern before WTO ?

(1) The **progress of multilateral negotiations is very slow** and the requirement of **consensus among all members**

acts as a constraint and creates rigidity in the system. (2) The **complex network** of regional agreements **introduces uncertainties and murkiness** in the global trade system.**(3)** The **achievement** in liberalizing(reform) trade in **agriculture, textiles, and apparel etc** has been **negligible.(4)** The latest negotiations, such as the **Doha Development Round**, have **run into problems, and their definitive success is doubtful.(5)** Most countries, **particularly developing countries are dissatisfied** with the WTO because, in practice, **most of the promises** of the Uruguay Round agreement to expand global trade **has not been materialized.**

(6) Concerns regarding developing countries:(i) The developing countries contend that the **real expansion of trade in the three key areas of agriculture, textiles and services has been dismal(very low).(ii) Protectionism(Restriction) and lack of willingness** among developed countries to provide market access **(iii)** The developing countries have raised a number of issues in the **Doha Agenda** in respect of the **difficulties that they face in implementing the present agreements.(iv)** The **North-South divide apparent in the WTO ministerial** meets.**(v)** Developing countries **complain that they face exceptionally(too much) high tariffs**.**(vi)** Another major issue concerns **'tariff escalation'**.**(vii)**There is also **possible erosion of preferences i.e. the special tariff concessions** granted by developed countries on imports**(viii)**The least-developed countries find themselves in disadvantage position due to **lack of human as well as physical capital, poor infrastructure, inadequate institutions, political instabilities etc.**

CHAPTER 4 EXCHANGE RATE AND ITS ECONOMIC EFFECTS

QUESTION NO. 1 Define Following terms:

Direct quote and Indirect quote:➡*A direct quote* is the number of units of a local currency exchangeable for **one unit of a foreign currency**. ➡For example, **1 Dollar = Rs. 66** is a direct *quote for India.*➡*An indirect quote* is the number of units of a foreign currency exchangeable **for one unit of local currency;** ➡For example: **1 Rupee = 1/66 = $ 0.0151** is a indirect *quote for India.*

'Base Currency' and a 'Counter Currency':

➡**In a direct quotation**, the foreign currency is the base currency and the domestic currency is the counter currency. ➡For example, **1 Dollar = Rs. 66** is a direct quote for India.Here Dollar is base currency and Rupee is the counter currency. ➡**In an indirect quotation**, the domestic currency is the base currency and the foreign currency is the counter currency. ➡For example: **1 Rupee = $ 0.0151** is a indirect *quote for India.*Here Rupee is base currency and Dollar is the counter currency.

QUESTION NO. 2 What are different types of exchange rate regimes ?

Floating exchange rate regime (also called a flexible exchange rate) :(1)exchange rate **is market-determined** i.e the demand and supply forces determine the exchange rate. **(2)**There is **no predetermined target rate(3)**There is **no interference on the part of the government or the central bank of the country(4)**Followed by nearly **all advanced economies** (for example, New Zealand, Sweden, the United States)**(5)greater flexibility; but less stability.**

Fixed exchange rate(1)it is not market-determined. (2) There is a **predetermined target rate .central bank intervenes** in the foreign exchange market.**(4)**It is **preferred by developing economies**.[Bulgaria;Cuba;Denmark]**(5)**A fixed rate **lacks flexibility but provides more stability.**

QUESTION NO.3 What are the main advantages of a fixed rate regime ?

(1) avoids currency fluctuations and eliminates exchange rate risks and transaction costs /greatly enhance international trade and investment.(2) imposes discipline on a country's monetary authority / generate lower levels of inflation.(3) can encourage greater trade and **investment as stability encourages investment. (4)enhance the credibility of the country's monetary policy.(5)** The central bank **maintains an adequate amount of foreign exchange reserves**

QUESTION NO.4 What are the main advantages of a floating exchange rate ?

(1) allowing a Central bank and /or government to pursue its own independent monetary policy.(2) increase the competitiveness of the tradeable goods sector.(3) the central bank is not required to maintain a huge foreign exchange reserves.

QUESTION NO.5 Explain the Relation between "Nominal Exchange Rate" & "Real Exchange Rate (RER)"

$$\text{Real exchange rate} = \text{Normal exchange rate} \times \frac{\text{Domestic Price Index}}{\text{Foreign price Index}}$$

QUESTION NO.6 On What Factors Determination of Nominal Exchange Rate depends?

➡Determination of Nominal Exchange Rate **is based on demand and supply.**

➡On the demand side, people desire foreign currency to:**(1) purchase goods and services** from another country.**(2)** for **unilateral transfers** such as gifts, awards, grants, donations or endowments.**(3)** to make **investment income payments** abroad.**(4)** to purchase **financial assets, stocks or bonds** abroad.**(5)** to open a **foreign bank account.(6)** to acquire **direct ownership of real capital***, and **(7)** for **speculation and hedging activities** related to risk-taking or risk-avoidance activity.

➡The participants on the supply side operate for similar reasons.Some of which are :**(1)**purchases of **home exports, (2)unilateral transfers** to home country, **(3)**investment **income payments, (4)foreign direct investments and portfolio investments, (5)**placement of **bank deposits and speculation.**

QUESTION NO.7 Explain "currency appreciation" and "currency depreciation" ?

➡Currency appreciates when **its value increases with respect to the value of another currency** or a basket of other currencies. ➡On the contrary, currency depreciates when its **value falls with respect to the value of another currency** or a basket of other currencies.

QUESTION NO.8 What is Devaluation(Revaluation) V/S Depreciation (Appreciation)

Devaluation/Revaluation :➡Devaluation is a **deliberate downward adjustment** in the value of a country's currency.Revaluation refers to a **deliberate raising** of a nation's currency. ➡It is used by the countries that have a **fixed exchange rate.**➡ It is **due to government or central bank** policy actions. ➡There is **no fixed time** for it and it doesn't occur regularly.

Depreciation/Appreciation ➡In contrast, depreciation is a **decrease in a currency's value due to demand supply forces**(market forces).Appreciation is a **increase in a currency's value due to due to demand supply forces. (market forces).**➡ It is under a **floating exchange rate .**➡It is **not due to any government or central bank** policy actions.➡It occurs on a **daily basis** as per market condition.

QUESTION NO.9 What is the Impact of Exchange Rate Fluctuations on Domestic Economy ?

Impact Of Depreciation of domestic currency:(1) Windfall gains for export oriented sectors(2) More Benefit On Remittances to homeland (3) Depreciation would enhance government revenues(4) higher amount of local currency for a given amount of foreign currency borrowings of government.(5) positive impact on country's trade deficit as it makes imports more expensive and exports more cheaper.(6) positive impact on controlling increasing gold imports (mostly wasteful) and thereby improve trade balance.

Impact Of Appreciation of domestic currency:(1) raises the price of exports/ the quantity of exports would fall. /increase in the quantity of imports. /economic growth is likely to be negatively impacted.(2) fall in aggregate demand and higher levels of unemployment. (3) competitiveness of domestic industry is adversely affected (4) larger deficits and worsen the current account. (5) reduction in the levels of inflation because imports are cheaper. (6) Loss of competitiveness(business) will be insignificant if currency appreciation is because of strong fundamentals of the economy.

QUESTION NO. 10 Who are the major participants in the exchange market ?

(1)central banks,(2)commercial banks,(3) governments,(4) foreign exchange Dealers,(5) brokers,(6)arbitrageurs (7) speculators(8)multinational corporations that engage in international trade and investments,(9) nonbank financial institutions such as asset- management firms, insurance companies.

QUESTION NO. 11 Explain Gain or Loss for exporter and importer in case of currency fluctuations ?

For Exporter :	**When Foreign Currency Rise (Home Currency Falls):**	**Gain**
	When Foreign Currency Fall (Home Currency Rise):	**Loss**
For Importer :	**When Foreign Currency Rise (Home Currency Falls):**	**Loss**
	When Foreign Currency Fall (Home Currency Rise):	**Gain**

QUESTION NO. 12 Explain Role Of Demand & Suppy /Buying Pressure & Selling Pressure/Investment & Borrowing on Currency

Role Of Demand/Buying Pressure/Investment/Inflow:	Currency will increase
Role Of Suppy /Selling Pressure/Borrowing/Outflow:	Currency will decrease

CHAPTER 5 INTERNATIONAL CAPITAL MOVEMENTS

QUESTION NO. 1 What are some of the important components of foreign capital flows?

1. Foreign aid or assistance which may be:(a) Bilateral or direct inter government grants.(b) Multilateral aid (c) Tied aid or **untied aid (d) Foreign grants**

2. Borrowings which may take different forms such as:(a) Direct inter government loans (b) Loans from international institutions (c) Soft loans (d) External commercial borrowing, and (e) Trade credit facilities

3. Deposits from non-resident Indians (NRI)

4. Investments in the form of:(a) Foreign portfolio investment (FPI) and **(b) Foreign direct investment(FDI)**

QUEESTION NO. 2 Define Foreign Direct Investment (FDI)

➦The **acquisition of at least ten percent** of the ordinary shares or voting power by non-resident investors makes it eligible to be categorized as foreign direct investment (FDI).

QUEESTION NO. 3 What are the categorized of Foreign Direct Investment (FDI) ?

(i) A **horizontal direct investment** :**same type of business** , **for example**, a cell phone service provider based in the United States moving to India to provide the same service.

(ii) A **vertical investment**:different from the investor's main business activity yet in some way supplements its major activity. **For example**; an automobile manufacturing company may acquire an interest in a foreign company that supplies parts or raw materials required for the company.

iii) A **conglomerate type of foreign direct investment** : unrelated to its existing business.

➦Yet another category of investments is **'two- way direct foreign investments'** which are reciprocal investments **between countries** that occur when **some industries are more advanced in one nation** (for example, the computer industry in the United States), **while other industries are more efficient in other nations** (such as the automobile industry in Japan).

QUESTION NO. 4 Define Foreign Portfolio Investment (FPI) ?

➦Following international standards, portfolio investments are characterised by lower stake in companies with their **total stake in a firm at below 10 percent.**

QUESTION NO. 5 Difference Between FDI and FPI ?

Foreign Direct Investment (FDI)	Foreign Portfolio Investment (FPI)
1.Investment involves **creation of**	Investment is **only in financial assets.**

	physical assets.	
2.	Has a **long term interest** and therefore remain invested for long	Only **short term interest** and generally remain invested for short periods.
3.	Relatively **difficult to withdraw** invested amount.	Relatively **easy to withdraw** invested amount.
4.	**Not inclined to be speculative.**	**Speculative in nature .**
5.	Often **accompanied by technology transfer.**	**Not accompanied by technology transfer.**
6.	**Direct impact on employment of labour and wages .**	**No direct impact** on employment labour and wages.
7.	**Interest in management and control.**	**No Interest in management and control.**
8.	Securities are held with **significant degree of influence** by the investor on the management of the enterprise.	Securities are held purely as a financial investment and **no significant degree of influence** on the management of the enterprise.

QUESTION NO. 6 What are the Reasons for Foreign Direct Investment ?

(1)increasing interdependence of national economies (2) internationalisation of production and investment(3) desire to reap economies of large-scale operation (4) tax policies of the host country which support direct investment.-(5) direct control of production knowledge or managerial skill (6) desire to procure a promising foreign firm (7) risk diversification(minimization) (8) possible saving in time and transport costs (9) for creating monopolies in a global context.(10) promoting optimal utilization of physical, human, financial and other resources.**(11) desire to capture emerging markets (12) ease of penetration (13) lower environmental standards (14) favourable investment climate(15)control of strategic raw material(16) low relative wages(17) high rate of growth in country where investment is done.**

QUESTION NO. 7 What are the factors in the host country that discourage inflow of foreign investments ?or What are deterrent to FDI ?

(1)infrastructure lags(problem),(2)high rates of inflation, (3)poor literacy and(4)high rates of industrial disputes,(5)low labour skills, (6)rigidity in the labour market, (7)bureaucracy and corruption, (8)unfavourable tax regime, (9)lack of security to life & property (10)political instability, (11)exchange rate volatility, (12)poor track-record of investments,(13)Tough regulations, (14)lack of openness, (15)language barriers, (16)double taxation(17)complicated legal formalities & delays, (18)absence of well-defined property rights,(19)small size of market and lack of potential for its growth,(20)lack of facilities for immigration & employment of foreign technical & administrative personnel,(21)lack of a general spirit of friendliness towards foreign investors.

QUESTION NO. 8 What are the Modes of Foreign Direct Investment (FDI) ?

(1) Opening of a **subsidiary or associate company** in a foreign country,**(2) Equity injection** into an overseas company,**(3) Acquiring a controlling interest** in an existing foreign company,**(4) Mergers and acquisitions(M&A) (5) Joint venture** with a foreign company.**(6) Green field investment**

QUESTION NO. 9 What are the Benefits of Foreign Direct Investment ?

(1) increases competition and generates a competitive environment in the host country. (2)allows countries to finance more investment (3) FDI can increase growth and economic development (4) generates **direct employment (5) generate indirect employment opportunities.(6)higher wages for skilled jobs. (7) promote the exports of developing countries. (8) source of new tax revenue(9) consumer prices might be lowered. (10)weakening of the market power of domestic monopolies (11) favourable impact on the host country's balance of payment position(12) Better work culture and higher productivity (13) promoter of bilateral and international relations. (14) promotion of ancillary* units resulting in job creation and skill development**

for workers.

QUESTION NO.10 What Potential Problems associated with Foreign Direct Investment(FDI) ?

(1)concentrate on **capital-intensive methods** hence it **does not support generation of jobs (2) creates regional disparity. (3)host country loses tax revenues.(4) lead to a decline in domestic investments.(5) host country is left with routine management jobs (6) could get concentrated on items of elite** and popular consumption **and on non-essential items.(7)** accused of **being anti-ethical** (aggressive advertising and anticompetitive practices)**(8) may even drive out domestic firms** which may **result in serious problems of displacement of labour. (9) national security considerations(10) ruthless exploitation of natural resources and the possible environmental damage.(11) corruption issues, unduly influencing policy making and evasion of corporate social responsibility.(12)large scale repatriation of profits(13)**cause of **increasing income inequalities in the host country.(14) emergence of a dual economy with a developed foreign sector and an underdeveloped domestic sector.(15)can lead to increased imports.**

QUESTION NO.11 In India, foreign investment is prohibited in which sectors ?

(1) Lottery business including Government / private lottery, online lotteries, etc.**(2) Gambling and betting** including casinos etc.**(3) Chit funds (4) Nidhi company(5)** Trading in **Transferable Development Rights (TDRs) (6) Real Estate Business or Construction of Farm Houses(7)** Manufacturing of **cigars, cheroots , cigarillos and cigarettes, of tobacco or of tobacco substitutes(8)**Activities / sectors not open to private sector investment e.g. **atomic energy and railway operations (other than permitted activities).**

CHAPTER 6 FISCAL FUNCTIONS AN OVERVIEW

QUESTION NO.1 What is the role of Government in an Economic System ? or What is Richard Musgrave view on functions of government ?

➦Richard Musgrave, in his classic book " The Theory of Public Finance"(1959), believed that the **functions of government are to be separated into three**, namely, **(a)**resource allocation, (efficiency), **(b)**income redistribution (fairness) and **(c)**macroeconomic stabilization.

QUESTION NO.2 Why do markets generate misallocation of resources? or What is reason of Market failures which hold back the efficient allocation of resources?

(a) Imperfect competition and presence of monopoly power (b) Markets typically **fail to provide collective goods (c) Externalities like pollution (d) Factor immobility** which causes unemployment and inefficiency.**(e) Imperfect information**, and **(f) Inequalities in the distribution of income and wealth.**

QUESTION NO.3 What are variety of allocation instruments by which governments can influence resource allocation in the economy ?

(i) government **may directly produce the economic good**(for example, electricity and public transportation services).**(ii)** government **may influence private allocation through incentives and disincentives (iii)**government **may influence allocation through its competition policies,merger policies(iv) governments' regulatory activities such as licensing, controls, minimum wages, and directives on location** of industry**(v)** government sets **legal and administrative frameworks**, and **(vi) any of a mixture of above** intermediate techniques may be adopted by governments.

QUESTION NO.4 What is the aim of Redistribution Function ?

(i) equitable distribution of societal output among households**(ii) advancing the well-being** of those members of the society who suffer from deprivations(negligence) of different types.**(iii)** providing **equality in income, wealth and opportunities.(iv)** providing **security for people who have hardships**, and **(v)** ensuring that everyone

enjoys a minimal standard of living.

QUESTION NO.5 What are the few examples of the redistribution function performed by governments ?

(i) taxation policies of the government whereby progressive taxation of the rich is combined with provision of subsidy to the poor households.**(ii) proceeds from progressive taxes** used for financing public services, especially those that benefit low-income households (example, supply of essential food grains at highly subsidized prices to BPL households) **(iii) employment reservations and preferences** to protect certain segments of the population, **(iv) regulation of the manufacture and sale of certain products** to ensure the health and well-being of consumers, **(v) special schemes for backward regions** and for the vulnerable sections of the population

QUESTION NO.6 What is Stabilization Function or What is the aim of Stabilization Function ?

➦The stabilization function is one of the **key functions of fiscal policy** and **aims at eliminating macroeconomic fluctuations** arising from suboptimal allocation. ➦The stabilization function is **concerned with the performance of** :• **labour employment and capital utilization,**• **overall output and income,**• **general price levels,**• **balance of international payments, and** • **the rate of economic growth.**

QUESTION NO.7 Government's fiscal policy has two major components which are important in stabilizing the economy.What are they?

(i) an **overall balance between** the resources the government puts into the economy through **expenditures** and the resources it takes out through **taxation**, charges, borrowing etc.**(ii)** a **microeconomic effect** generated by the specific policies adopted for stabilizing the economy.

CHAPTER 7 MARKET FAILURE

QUESTION NO. 1 What is MARKET FAILURE ?

➦Market failure is a situation in which the free market leads to **misallocation of society's scarce resources** in the sense that there is either **overproduction or underproduction** of particular goods and services leading to a **less than optimal outcome.** ➦There are two aspects of market failures namely, **demand-side market failures and supply side market failures.**

Demand-side market failures are said to occur -when the **demand curves do not take into account the full willingness of consumers to pay** for a product. -**For example**, **wayside fountain**

Supply-side market failures happen -when **supply curves do not incorporate the full cost of producing** the product.-**For example**, a **thermal power plant** polluting the atmosphere

QUESTION NO.2 Why do Markets Fail ?

(a) Market power, **(b)** Externalities, **(c)** Public goods, and **(d)** Incomplete information

QUESTION NO.3 What is Market Power ?

➦Market power or **monopoly power** is the ability of a firm to profitably raise the market price of a good or service **over its marginal cost.** ➦They are **price makers** and can charge a price that gives them positive economic profits. ➦ **Disadvantage of Market Power:(1)cause of market failure**./**inefficient allocation of resources.(2)keeps price and output away from the equilibrium of supply and demand. (3results in higher prices than competitive prices. (4)restrict output and leads to deadweight loss.** (5)single producer or a small number of producers to produce and sell less output**(6)loss of consumer surplus.**

QUESTION NO. 4 What is Externalities ?

➦ Such costs or benefits **which are not accounted in the market price** are called externalities because they are "external" to the market.

QUESTION NO.5 What are Types of Externalities ?

(a) Negative production externalities **(b) Positive production externalities**
(c) Negative consumption externalities **(d) Positive consumption externalities**

Detailed Explanation:

(a) Negative Production Externalities:

➡**Example Of Negative Production Externality is received in consumption:**When a **factory** which produces aluminum discharges **untreated waste water** into a nearby river and pollutes the water causing health hazards for people who use the water for **drinking and bathing.**

➡**Example Of Negative Production Externality received in Production:Pollution** of river also affects **fish output** as there will be less catch for **fishermen** due to loss of fish resources.

(b) Positive Production Externalities:

➡**Example of positive production externality is received in consumption:** When an individual raises an **attractive garden** and the persons walking by enjoy the garden.

➡**Example of Positive Production Externality received in Production:(a)**A firm which offers **training to its employees** for increasing their skills.The firm generates positive benefits on other firms when they hire such workers as they change their jobs. **(b)**Another example is the case of a **beekeeper** who locates beehives in an orange growing area enhancing the chances of greater production of oranges through increased pollination.

➡These external effects are **not taken into account** when the production decisions are made.

(c) Negative Consumption Externalities:

➡**Examples of consumption side: (a)Smoking cigarettes** in public place causing passive smoking by others, **(b)creating litter** and diminishing the aesthetic*(beauty) value of the room and **(c)playing the radio loudly** obstructing one from enjoying a concert.

➡**Examples of production side:(a)**The act of **undisciplined students talking** and creating disturbance in a class preventing teachers from making effective instruction and **(b)**the case of **excessive consumption of alcohol** causing loss in efficiency for work and production are instances of negative consumption externalities affecting production.

(d) Positive consumption externalities:

➡**Examples of consumption side:**If people **get immunized against contagious diseases**, they would confer a social benefit to others as well by preventing others from getting infected.

➡**Examples of production side:**Consumption of the **services of a health club** by the employees of a firm would result in an external benefit to the firm in the form of increased efficiency and productivity.

QUESTION NO.6 Why Problem of Negative Externalities are not Given Importance?

(i) The society **does not know precisely** who are the producers of harmful externalities.**(ii)** Even if the society knows it, the **cause-effect linkages are so unclear** that the negative externality cannot be directly traced to its producer.

QUESTIONNO.7 What are social costs ?

➡**Social Cost = Private Cost + External Cost**

QUESTION NO.8 What are Characteristics (Features)of Private Goods ?

(1)yield utility to people. Anyone who wants to consume them **must purchase them.(2)can exercise private property rights (3) Consumption of private goods is 'rivalrous' (4)Private goods are 'excludable' (5)Private goods do not have the free rider problem. (6) Private goods can be parceled out(divided) (7)All private goods and services can be rejected (8) Additional resource costs are involved** for producing and supplying additional quantities of private goods.**(9)issues of fairness and justice tend to arise** with respect to private goods.**(10) market will efficiently allocate resources** for the production of private goods.

QUESTION NO.9 What are Characteristics (Features)of Public Goods ?

(1)consumption is essentially collective in nature. **No direct payment** by the consumer is involved .**(2)** Public good is **non-rival in consumption.(3)Public goods are non-excludable.(4)Public goods are characterized by indivisibility.(5)**Public goods are generally more vulnerable to **issues such as externalities, inadequate property rights, and free rider problems.**

QUESTION NO.10 What is Classification of Public Goods ?

	Excludable	Non-excludable
Rivalrous	A Private goods food, clothing, cars	B Common resources such as fish stocks, forest resources, coal
Non-rivalrous	C Club goods, cinemas, private parks, satellite television	D Pure public goods such as national defence

QUESTION NO.11 What is Pure Public Goods ?

➦**Pure public goods** are those goods or services that provides **non-excludable and non-rival** benefits to all people in the population.➦**Few example** of Pure Public Goods:Public fireworks, Lighthouses, Clean air and other environmental goods.Fresh air, National Defence,Flood control systems, and street lighting.

QUESTION NO.12 What is Impure Public Goods ?

➦**Impure Public Goods** are many hybrid goods that **possess some features of both public and private goods.** ➦They are **partially rivalrous or congestible**. ➦**Few example (a)Open- access Wi-Fi networks (b)**The **use of cable television** ➦The possibility of exclusion from the use of an impure public good **has two implications**: **(i)** Since **free riding can be eliminated**, the impure public good may be provided either by the market or by the government at a **price or fee.(ii)** The provider of an impure public good may be **able to control the degree of congestion** either by regulating the number of people who may use it, or the frequency with which it may be used or both.➦**Two broad classes** of goods have been included in the studies related to impure public goods:**(i) Club goods**; **(ii) Variable use public goods**; **Examples of club goods** are facilities such as swimming pools, fitness centres etc. **Examples of Variable public goods** are facilities such as roads, bridges etc.

QUESTION NO.13 What is Quasi Public Goods (Mixed Goods) ?

➦The quasi-public goods or services, also called a **near public good** (for e.g. education, health services) possess nearly **all of the qualities of the private goods and some of the benefits of public good.** ➦**Example No.1:**For example, if one gets **inoculated against measles**, it confers not only a private benefit to the individual, but also an external benefit because it reduces the chances getting infected of other persons who are in contact with him.You can observe here that the external effect associated with the consumption of a private good may have the characteristics of a public good.➦**Example No.2: Education will improve the individual's earning** potential and at the same time, it may facilitate basic research policy recommendations that you may be able to put forth for a better tax or budgeting system which are public goods.

QUESTION NO. 14 What is Common Access Resources ?

➦Common access resources or common pool resources are a special class of **impure public goods.**➦ These are **non-excludable** as people cannot be excluded from using them.These are **rival in nature and their consumption lessens the benefits available for others.** ➦They are generally available **free of charge.** ➦**Examples of common access resources** are fisheries, common pastures, rivers, sea, backwaters, biodiversity etc. The earth's atmosphere is perhaps the best example. Emissions of carbon dioxide and other greenhouse gases have led to the depletion of the ozone layer endangering environmental sustainability. ➦Since **price mechanism does not apply** to common

resources,they **are over used** and **cause their depletion and degradation**. ➦the availability of **common access resources for future generations decreases.**➦Economists use the term **'tragedy of the commons**' to describe the problem which occurs when rivalrous but non excludable goods are overused, to the disadvantage of the entire world.

QUESTION NO.15 What is Global Public Goods ?

➦There are several **public goods benefits** of which **accrue to everyone in the world.** ➦The **WHO stated two categories of global public goods namely, final public goods** which are 'outcomes', (e.g. the eradication of polio) and **intermediate public goods**, which contribute to the provision of final public goods.(e.g. International Health Regulations aimed at stopping the cross-border movement of communicable diseases and thus reducing cross-border health risks).➦Similarly, the World Bank identifies **five areas of global public goods which it seeks to address:** namely, **(a)**the **environmental** commons (including the prevention of climate change and biodiversity), **(b)communicable diseases** (including HIV/AIDS, tuberculosis, malaria, and avian influenza), **(c)international trade**, **(d)international financial architecture**, and **(e)global knowledge** for development.

QUESTION NO.16 What is The Free Rider Problem ?

➦Free riding is **'benefiting from the actions of others without paying'**. A free rider is a consumer or producer who does not pay for a non exclusive good in the expectation that others will pay.➦When **students are required to do a group project,** some group members tend to escape the work and make others do the entire work. Those who escape assignment 'free ride' on the efforts of others.➦ **If every individual plays the same strategy of free riding, the strategy will fail** because nobody will be willing to pay ➦On account of the free rider problem, there is **no meaningful demand curve** for public goods. ➦As such, if the free-rider problem cannot be solved, the following **two outcomes are possible:(i) No public good** will be provided in private markets.**(ii)** Private markets will seriously **under produce public goods** even though these goods provide valuable service to the society.

QUESTION NO.17 Why assumption of Complete information is not fully satisfied in real markets ?

(a) Often, the nature of products and services tends to be **highly complex** e.g. Cardiac surgery, financial products (such as pension products mutual funds etc).**(b)** In many cases consumers are **unable to quickly / cheaply find sufficient information** on the best prices as well as quality for different products.Sometimes they misunderstand the true costs or benefits of a product or are uncertain about the true costs and benefits.**(c)** People are ignorant or not aware of many matters in the market. Generally they have **inaccurate or incomplete data** and consequently make potentially 'wrong' choices / decisions.

QUESTION NO.18 What is Asymmetric Information ?

➦Asymmetric information occurs when there is an **imbalance in information between buyer and seller** i.e. when the buyer knows more than the seller or the seller knows more than the buyer. This can distort choices.
➦**For example,** the **landlords** know more about their properties than tenants, a **borrower** knows more about their ability to repay a loan than the lender, a **used-car seller** knows more about vehicle quality than a buyer and some **traders** may possess insider information in financial markets.

QUESTION NO.19 What is Adverse Selection ?

➦Adverse selection **is a situation** in which asymmetric information about quality **eliminates high-quality goods** from a market. ➦One example of adverse selection is that of **health insurance**. The people who are most likely to purchase health insurance are those who are most likely to use it, i.e. people with unhealthy life styles and those with underlying health issues. The insurance company being aware of this raises the average price of insurance cover. This prices healthy consumers out of the market as healthy people will be unwilling to pay such high premium. The result is that only high risk individuals buy insurance.This is a market failure. ➦Another example is the used car market which is popularly referred to as '**market for lemons**'. The owner of a car knows much more about its quality than anyone else. The buyer's willingness to pay for any particular car will be based

on the 'average quality' of used cars. Anyone who sells a 'lemon' (an unusually poor car) stands to gain. The market becomes flooded with lemons(poor cars). Eventually the market may offer nothing but lemons(poor cars). The good-quality cars disappear because they are kept by their owners or sold only to friends.In short **buyers expect hidden problems** in items offered for sale, leading to low prices and the best items being kept off the market.

QUESTION NO.20 What is Moral Hazard ?

➡Moral hazard is **opportunism** where an **informed person** is taking advantage of a **less-informed person** through an **unobserved action.** ➡**For example**: the **insured consumers are likely to take greater risks**, knowing that a claim will be paid for by the insurance company. The higher the costs that are covered by the insurance company, the less a person cares whether the doctor charges excessive fees or uses inefficient and costly procedures as part of his health care.This causes insurance premiums to rise for everyone, driving many potential customers out of the market. This became a big issue in India when the health insurance providers and big private hospitals came in conflict and the issue was resolved by putting in place a 'third party administration' to settle the medical claims.

CHAPTER 8 GOVERNMENT INTERVENTIONS TO CORRECT MARKET FAILURE

QUESTION NO.1 Write a Short Note On GOVERNMENT INTERVENTION TO MINIMIZE MARKET POWER ?

(i) Governments intervene by **establishing rules and regulations** [Competition (Amendment) Act, 2007]**(ii)**Policy options for limiting market power also include **price regulation** in the form of **setting maximum prices** that firms can charge.**(iii)**In some cases, the government's regulatory agency determines an acceptable price, so as to ensure a competitive or fair rate of return. This practice is called **rate-of-return regulation. (iv)**Another approach to regulation is **setting price-caps** based on the firm's variable costs, past prices, and possible inflation and productivity growth.

QUESTION NO.2 Write a short note on Government Intervention to correct Externalities ?

➡**May be classified as:(i)** Direct controls **(ii)** Market-based policies

QUESTION NO.3 Write a short note on Direct controls measures ?

(i)Direct controls prohibit specific activities for instance limiting emissions. Production, use and sale of many commodities and services are prohibited in our country. **(ii)Smoking** is completely banned in many **public places. (iii)**Stringent rules are in place in respect of **tobacco advertising**, packaging and labeling etc.**(iv)**Governments **may pass laws** to alleviate the effects of negative externalities.[Environment (Protection) Act, 1986.]**(v)**The government may, through legislation, **fix emissions standard** which is a legal limit on how much pollutant a firm can emit. **(vi)**Another method is to **charge an emissions fee** which is levied on each unit of a firm's emissions. **(vii)**Governments **may also form special bodies/ boards** [Ministry of Environment & Forest, the Pollution Control Board of India and the State Pollution Control Boards.]

QUESTION NO.4 Write a short note on Market-based policies ?

➡This is achieved by:**(i) pollution tax(ii) cap-and-trade system.**

QUESTION NO.5 What is Pollution Tax ?

➡These taxes are named **Pigouvian taxes after A.C. Pigou**.➡These taxes, by **'making the polluter pay'**, seek to internalize external costs into the price of a product or activity. ➡Tax **increases the private cost of production or consumption** as the case may be, and would **decrease the quantity demanded** and therefore the **output of the good will be reduced** which creates negative externality. ➡The **proceeds from the tax** can be specifically earmarked for projects that protect or **enhance environment.**

QUESTION NO.6 What are the problems faced in administering an efficient pollution tax ?

(i) Pollution taxes are **difficult to determine and administer** **(ii)** **involves the use of complex and costly administrative procedures** for monitoring the polluters.**(iii)** This method **does not provide any genuine solutions to the problem**.**(iv)** In the case of goods which have inelastic demand, **producers will be able to easily shift the tax burden** in the form of higher product prices. This will have an inflationary effect and may reduce consumer welfare.**(v)** Pollution taxes also have potential **negative consequences on employment and investments** because high pollution taxes in one country may encourage producers to shift their production facilities to those countries with lower taxes.

QUESTION NO.7 What is Cap-and-Trade System ?

➦These are **marketable licenses to emit limited quantities of pollutants** and can be bought and sold by polluters. ➦The **high polluters** have to buy more permits, which increases their costs, and makes them less competitive and **less profitable.** ➦The **low polluters** receive extra revenue from selling their surplus permits, which makes them more competitive and **more profitable.**

QUESTION NO.8 What is the advantages claimed for tradable permits(Cap-and-Trade System) ?

(i) The system allows **flexibility and reward efficiency.**(ii) It is **administratively cheap and simple to implement** and ensures that **pollution is minimised** in the most cost-effective way.**(iii)** It also provides **strong incentives for innovation.**(iv) **Consumers may benefit** if the extra profits made by low pollution firms are passed on to them in the form of lower prices.

QUESTION NO.9 What is main argument in opposition of tradable emission permits(Cap&Trade System) ?

(i) The **main argument** in opposition to the employment of tradable emission permits is that **they do not in reality stop firms** from polluting the environment;.**(ii)**Moreover, if firms have monopoly power could easily be compensated by **charging higher prices to consumers.**

QUESTION NO.10 What is the reasons for government provision of merit goods ?

(i)there will be welfare loss to the society due to under production and under consumption .**(ii)** **Information failure** is widely prevalent with merit goods and therefore individuals may not act in their best interest because of imperfect information. **(iii)Equity considerations** demand that merit goods such as health and education should be provided free on the basis of need rather than on the basis of individual's ability to pay.**(iv)** There is a lot of **uncertainty as to the need for merit goods** E.g. health care. Due to uncertainty about the nature and timing of healthcare required in future, individuals may be unable to plan their expenditure and save for their future medical requirements. The market is unlikely to provide the optimal quantity of health care when consumers actually need it, because they may be short of the necessary finances to pay the market price.

QUESTION NO.11 What is the Action Taken By Government in case of merit goods ?

(i) The possible government responses are **regulation, subsidies, direct government provision and a combination of government provision and market provision**. **(i)Regulation** determines how a private activity may be conducted. For example, the way in which education is to be imparted is government regulated. **(i)**Governments can **prohibit** some type of goods and activities, set standards and issue mandates making others oblige. For example, government may make it compulsory to avail insurance protection. Compulsory immunization may be insisted upon as it helps not only the individual but also the society at large. **(i)**Government could also **use legislation** to enforce the consumption of a good which generates positive externalities. E.g. use of helmets, seat belts etc. The Right of Children to Free and Compulsory Education Act, 2009 which mandates free and compulsory education for every child of the age of six to fourteen years is another example. **(i)**A **variety of regulatory mechanisms** may also be set up by government to enhance consumption of merit goods and to ensure their quality.

QUESTION NO.12 How do governments correct market failure resulting from demerit goods?

(i) At the extreme, government **may enforce complete ban** on a demerit good, e.g. Intoxicating drugs. In such cases, the possession, trading or consumption of the good **can be made illegal.(ii)** Through persuasion which is mainly intended to be achieved by **negative advertising campaigns** which emphasize the dangers associated with consumption of demerit goods.**(iii) Through legislations** that prohibit the advertising or promotion of demerit goods in whatsoever manner.**(iv) Strict regulations** of the market for the good may be put in place so as to limit access to the good, especially by vulnerable groups such as children and adolescents(a young person)

(v) Regulatory controls in the form of **spatial(space) restrictions** e.g. smoking in public places, sale of tobacco to be away from schools, and **time restrictions** under which sale at particular times during the day is banned.**(vi)**Imposing unusually high taxes on producing or purchasing the good **making them very costly and unaffordable** to many is perhaps the most commonly used method for reducing the consumption of a demerit good. For example, the GST Council has bracketed four items namely, high end cars, pan masala, aerated drinks and tobacco products into demerit goods category and therefore these would be taxed (with a cess being added on to the basic tax) at much higher rates than the top GST slab of 28 per cent.**(vii)**The government **can fix a minimum price** below which the demerit good should not be exchanged.

QUESTION NO.13 Write a short note on GOVERNMENT INTERVENTION IN THE CASE OF PUBLIC GOODS ?

➦In the case of such **pure public goods** where entry fees cannot be charged, government t**ax revenues** is the only option.➦**Excludable public goods can be provided by government and the same can be financed through entry fees.** ➦A very commonly followed method is to **grant licenses to private firms** to build a public good facility. ➦Certain goods are **produced and consumed as public goods** and services despite the fact that they can be produced or consumed as private goods. This is because, left to the markets and profit motives, **these may prove dangerous to the society.** Examples are scientific approval of drugs, production of strategic products such as atomic energy, provision of security at airports etc.

QUESTION NO.14 Write a short note on Government PRICE INTERVENTION ?

➦Price intervention generally **takes the form of price controls** which are legal restrictions on price. ➦Price controls may take the form of either a **price floor** (a minimum price buyers are required to pay) or a **price ceiling** (a maximum price sellers are allowed to charge for a good or service). ➦Fixing of minimum **wages and rent** controls are examples of such market intervention.

QUESTION NO.15 Write a short note on GOVERNMENT INTERVENTION FOR CORRECTING INFORMATION FAILURE ?

(i) Government makes it **mandatory to have accurate labeling and content disclosures** by producers. For example: SEBI requires that accurate information be provided to prospective buyers of new stocks.**(ii) Public dissemination(announcement)** of information to improve knowledge and subsidizing(promoting) initiatives in that direction.**(iii)** Regulation of advertising and setting of advertising standards to **make advertising more responsible, informative and less persuasive.**

QUESTION NO.16 Write a short note on GOVERNMENT INTERVENTION FOR EQUITABLE DISTRIBUTION ?

➦**Some common policy interventions include:**

(a)progressive income tax, **(b)**targeted budgetary allocations, **(c)**unemployment compensation,
(d)transfer payments, **(e)**subsidies, **(f)**social security schemes,
(g)job reservations, **(h)**land reforms, **(i)**gender sensitive budgeting etc.

➦Government also intervenes to **combat black economy and market distortions(disbalance)** associated with a parallel black economy.

QUESTION NO.17 When Government failure occurs ?

➦It occurs when:**(i)** intervention if ineffective cause **wastage of resources.(ii)** intervention produces **fresh and**

more serious problems.

CHAPTER 9 FISCAL POLICY

QUESTION NO. 1 What are the Objectives of Fiscal Policy ?

(i) Achievement and maintenance of **full employment,(ii)**maintenance of **price stability,(iii)**acceleration of the rate of **economic development**, and**(iv)**equitable distribution of **income and wealth(v)**eradication of **poverty (vi)**removal of **regional imbalances** in different parts of the country.

QUESTION NO. 2 What are the Instruments of Fiscal Policy ?

➡The tools of fiscal policy are **taxes, government expenditure, public debt and the government budget.**

QUESTION NO.3 Explain Government Expenditure as an Instrument of Fiscal Policy ?

➡Government expenditures include:**(i) current expenditures** to meet the day to day running of the government,**(ii) capital expenditures** which are in the form of investments made by the government in capital equipments and infrastructure, and **(iii) transfer payments** i.e. government spending which does not contribute to GDP because income is only transferred from one group of people to another without any direct contribution from the receivers.
➡**During a recession**,-Government **may increase expenditure in** public works, such as construction of roads, irrigation facilities, sanitary works, ports, electrification of new areas etc.-These expenditures **directly generate incomes**/will leads to **an increase in demand/ leads to expansion in production /strengthen the general confidence of businessman /Primary employment will induce secondary and tertiary employment**, and economy will again be **put on an expansion track.**
➡**During inflation**,-**Government expenditure is reduced;-Reduced incomes** on account of decreased public spending helps to **eliminate excess aggregate demand.**

QUESTION NO. 4 Define Taxes as an Instrument of Fiscal Policy ?

➡Tax as an instrument of fiscal policy consists of changes in rates of taxes which aimed at **encouraging or restricting private expenditures** on consumption and investment.
➡**During recession and depression,** the tax policy is framed to encourage private consumption and investment. A general **reduction in income taxes** leaves **higher disposable incomes** with people inducing **higher consumption**. Low corporate taxes **increase the prospects of profits** for business and **promote further investment**.
➡**During inflation, new taxes can be levied** and the rates of **existing taxes are raised** to **reduce disposable incomes** and to **wipe off the surplus purchasing power.** ➡However, **excessive taxation usually stop new investments** and therefore the government has to be **cautious about a policy of tax increase.**

QUESTION NO.5 Define Public Debt as an Instrument of Fiscal Policy ?

➡A rational policy of **public borrowing and debt repayment** is a potent weapon to **fight inflation and deflation.**
➡Public debt may be **internal or external**; when the government borrows from its **own people** in the country, it is called internal debt. On the other hand, when the government borrows from **outside sources,** the debt is called external debt. ➡Public debt takes two forms namely, **market loans and small savings.**➡In the case of **market loans**, long-term capital bond and government treasury are issued which are traded in debt markets. For financing capital projects, long-term capital bonds are issued and for meeting short-term government expenditure, treasury bills are issued.➡The **small savings** represent public borrowings, which are not negotiable and are not bought and sold in the market.In India, various types of schemes are introduced for mobilising small savings e.g., National Savings Certificates, National Development Certificates, etc.➡**Borrowing** from the public through the sale of bonds and securities **curtails the aggregate demand** in the economy. ➡**Repayments of debt** by governments increase the availability of money in the economy and **increase aggregate demand.**

QUESTION NO.6 Define Budget as an Instrument of Fiscal Policy ?

➦Government's budget is widely used as a policy tool **to stimulate(increase) or contract (decrease) aggregate demand as required.** ➦The budget is simply a **statement of revenues** earned from taxes and other sources **and expenditures** made in a year. ➦The **net effect** of a budget on aggregate demand depends on the government's **budget balance.** ➦A government's budget can either be **balanced, surplus or deficit.**➦A **balanced budget** results when expenditures in a year equal its revenues for that year. Such a budget will have **no net effect on aggregate demand** since the leakages(outflow) from the system in the form of taxes collected are equal to the injection(inflow) in the form of expenditures made.➦A **budget surplus** that occurs when the government collects more than what it spends, though sounds like a highly attractive one, has in fact a **negative net effect on aggregate demand** since leakages(outflow) exceed injections(inflow). ➦A **budget deficit** wherein the government expenditure in a year is greater than the tax revenue it collects has a **positive net effect on aggregate demand** since total injections(inflow) exceed leakages(outflow) from the government sector.

QUESTION NO.7 What is the TYPES OF FISCAL POLICY ?

Expansionary fiscal policy:➦Expansionary fiscal policy is designed to **stimulate (increase/grow) the economy during the contractionary(declining) phase of a business cycle** ➦This is accomplished by **increasing aggregate(total) expenditures and aggregate(total) demand** through an increase in all types of **government spending and / or a decrease in taxes.**

Contractionary fiscal policy:➦Contractionary fiscal policy is basically the **opposite** of expansionary fiscal policy. ➦Contractionary fiscal policy is designed to **restrain(restrict) the levels of economic activity** of the economy during an inflationary phase ➦This is carried out by **decreasing the aggregate(total) expenditures and aggregate(total) demand** through a **decrease in all types of government spending and/ or an increase in taxes**. ➦Contractionary fiscal policy should ideally lead to a **smaller government budget deficit or a larger budget surplus.**

QUESTION NO.8 How can Contractionary fiscal policy be achieved ?

(i) Decrease in government spending (ii) Increase in personal income taxes and/or business taxes (iii)A **combination** of decrease in government spending and increase in personal income taxes and/or business taxes.

QUESTION NO. 9 Write a short note on FISCAL POLICY FOR REDUCTION IN INEQUALITIES OF INCOME AND WEALTH ?

(i) A progressive direct tax system ensures that those who have greater ability to pay contribute more towards providing the expenses of government and that the tax burden is distributed fairly among the population.**(ii) Indirect taxes** can be differential: for example, the commodities which are primarily consumed by the richer income group, such as luxuries, are taxed heavily and the commodities consumed by lower income group are taxed light.**(iii)** A **carefully planned policy of public expenditure** helps in redistributing income from the rich to the poorer sections of the society. This is done through spending programmes targeted on **welfare measures** for the disadvantaged , such as **(a) poverty alleviation(removal) programmes.(b) free or subsidized medical care,** education, housing, essential commodities etc. to improve the quality of living of poor.**(c) infrastructure provision** on a selective basis.**(d) various social security schemes** under which people are entitled to old-age pensions, unemployment relief, sickness allowance etc.**(e) subsidized production** of products of mass consumption.**(f) public production and/ or grant of subsidies** to ensure sufficient supply of essential goods, and **(g) strengthening of human capital** for enhancing employability etc.

QUESTION NO.10 Write a short note on LIMITATIONS OF FISCAL POLICY ?

(i) It gives rise to different types of lags which are :**(a) Recognition lag:(b) Decision lag: (c) Implementation lag:(d) Impact lag: (ii)** Fiscal policy changes **may at times be badly** timed **(iii)** There are **difficulties in instantaneously changing governments' spending and taxation policies.(iv)**It is practically **difficult to reduce**

government spending on various items such as defence and social security as well as on huge capital projects which are already midway.**(v)** **Public works cannot be adjusted easily** **(vi)** **Due to uncertainties, there are difficulties of forecasting**(vii) **certain fiscal measures will cause disincentives.** **(viii)** Deficit financing **increases the purchasing power of people(inflation).** **(ix)** Increase is government borrowing **creates perpetual burden on even future generations as debts have to be repaid.** **(x)** **Crowding Out.**

QUESTION NO.11 Write a short note Crowding Out ?

➡Crowding out effect is the **negative effect of fiscal policy** which may generate when money from the **private sector is 'crowded out' to the public sector.** ➡In other words, when spending by government in an economy **replaces private spending,** the later is said to be crowded out.➡For example, if government provides **free computers to students,** the demand from students for computers may not be forthcoming.**It will crowd out private players also.**➡It also **raise Interest Rate in Economy:**(a)When government increases it's spending by borrowing from the **loanable funds** from market, the demand for loans increases and this pushes the interest rates up.**(b)**Similarly, when government increases the budget deficit by **selling bonds** or treasury bills, the amount of money with the private sector decreases and consequently interest rates will be pushed up. ➡**Private investments** are sensitive to interest rates and therefore some private investment spending **is discouraged.**➡Fiscal policy **becomes ineffective as the decline in private spending partially or completely offset** the expansion in demand resulting from an increase in government expenditure.

QUESTION NO. 12 What are the Automatic Stabilizers (Non Discretionary Fiscal Policy) VS Discretionary Fiscal Policy ?

➡**Automatic Stabilizers** are 'built-in' fiscal mechanisms that **operate automatically to reduce the expansions and contractions** of the business cycle.

➡**Discretionary fiscal policy** for stabilization refers to **deliberate policy actions on the part of government** to change the levels of expenditure,taxes, national output, employment and prices,spending,borrowing.

QUESTION NO.13 Write a short note 'pump priming' &'compensatory spending'?

➡**Pump priming** assumes that when **private spending becomes deficient**, certain volumes of public spending will help to revive the economy.

➡**Compensatory spending** is said to be resorted to when the government spending is carried out with the obvious **intention to compensate for the deficiency in private investment.**

CHAPTER 10 CONCEPT OF MONEY DEMAND

QUESTION NO.1 What is the FUNCTIONS OF MONEY ?

(i)Money is a convenient medium of exchange(ii)Money is explicitly defined as unit of value **(iii)** **Money serves as a unit or standard of deferred payment** **(iv)Money is a store of value**

QUESTION NO.2 What are some general characteristics that money should possess ?

(1) generally **acceptable.(2)** durable or **long-lasting.(3)** effortlessly **recognizable.(4)** difficult to **counterfeit** i.e. not easily reproducible by people.**(5)** relatively **scarce,** but has elasticity of supply***(6)** portable or **easily transported** **(7)** possessing **uniformity**; and**(8)** **divisible** into smaller parts in usable quantities or fractions without losing value.

QUESTION NO.3 What are some of the important variables on which demand for money depends on? or How much money people would like to hold in liquid form depends on many factors.What are they?

(1)Income:Direct Relation **(2)General level of prices(Inflation)**:Direct Relation**(3)Rate of interest**:Indirect Relation **(4)Real GDP**:Direct Relation**(5)Degree of financial innovation**:Direct Relation

QUESTION NO.4 Write a short note on Classical Approach: The Quantity Theory of Money (QTM) ?

➡QTM demonstrate that there is **strong relationship between money and price level .**➡Fisher's version, also termed as 'equation of exchange' or 'transaction approach' is formally stated as follows:**MV = PT** Where, M= the total amount of money in circulation (on an average) in an economy ;V = transactions velocity of circulation i.e. the average number of times across all transactions a unit of money(say Rupee) is spent in purchasing goods and services ; P = average price level (P= MV/T) ;T = the total number of transactions.

➡Later, Fisher extended the equation of exchange to include demand (bank) deposits (M') and their velocity (V') in the total supply of money. Thus, the expanded form of the equation of exchange becomes:**MV + M'V' = PT** Where M' = the total quantity of credit money ; V' = velocity of circulation of credit money.➡**Assumption**:Velocity of money in circulation (V) and the velocity of credit money (V') remain constant. The volume of transactions T is fixed in the short run. The theory assumes an economy in equilibrium and at full employment.➡As per this theory the **demand for money (PT) will be equal to the supply of money (MV + M'V').**

QUESTION NO.5 Write a short note on The Neo classical Approach: The Cambridge approach ?

➡The Cambridge version holds that **money increases utility** in the following **two ways:1. Possibility of split-up of sale and purchase** to two different points of time rather than being simultaneous ,and **2**. Being a **hedge against uncertainty.**➡As per this theory, **higher the income, the greater the quantity of purchases and as a consequence greater will be the need for money** .➡**The Cambridge equation** is stated as:**Md = k PY**

Where, Md = is the demand for money ; Y = real national income ;P = average price level of currently produced goods and services ;PY = nominal income ;k = proportion of nominal income (PY) that people want to hold as cash balances

QUESTION NO.6 Write a short note on The Keynesian Theory of Demand for Money?

➡According to Keynes, people hold money (M) in cash for **three motives:**

(a) The Transactions Motive:➡The transactions motive for holding cash relates to **"the need for cash for current transactions for personal and business exchange"**➡Keynes **did not** consider the transaction balances as being **affected by interest rates.** ➡The **transaction demand for money is directly related to the level of income** i.e the amount of money demanded for this purpose increases as income increases.➡It is **stated as** follows:**Lr = kY** Where Lr, is the transactions demand for money ; k is the ratio of earnings which is kept for transactions purposes ;Y is the earnings.

(b) The Precautionary Motive:➡Many **unforeseen and unpredictable contingencies** involving money payments occur in our day to day life. ➡The amount of money demanded under the precautionary motive depends on the **size of income,prevailing economic as well as political conditions and personal characteristics of the individual such as optimism/ pessimism, farsightedness etc.** ➡Keynes regarded the precautionary balances as **income elastic** and by itself **not very sensitive to rate of interest.**

(c) The Speculative Demand for Money:➡The speculative motive reflects people's desire to hold cash in order **to exploit any attractive investment opportunity.**➡According to Keynes, people demand to hold money balances to take advantage of the **future changes in the rate of interest or future changes in bond prices.** ➡Keynes assumed that that the **expected return on money is zero, while the expected returns on bonds are of two types**, namely: **(i)** the interest payment**(ii)** the expected rate of capital gain.➡We can say that the speculative **demand for money and interest are inversely related.**

QUESTION NO.7 Write a short note on Inventory Approach* to Transaction Balance ?

➡Inventory models assume that there are two media for storing value: **money and an interest-bearing alternative financial asset.** ➡Baumol used business **inventory approach*** to find an **optimum combination of bonds and cash balance.**➡The **higher the income**, the **higher is the average level or inventory** of money holdings.

➡The more the **number of times the bond transaction is made, the lesser will be the average transaction balance** holdings.➡The level of inventory holding **also depends also upon the carrying cost**. The increase in the brokerage

fee raises the transactions demand for money and lowers the average bond holding over the period. ➦An individual combines his asset portfolio of cash and bond in such proportions that his **cost is minimized.**

QUESTION NO.8 Write a short note on Friedman's Restatement of the Quantity Theory ?

➦Milton Friedman (1956) stated that **demand for money is affected by:1.Permanent income.2.Relative(excess) returns on assets**, (which incorporate risk)➦Friedman maintains that it is ***permanent income* - and not *current income*** that determines the demand for money. ➦Friedman identifies the following **four determinants(factors) of the demand for money. (i)**The nominal demand for money is a function of total wealth, which is represented by **permanent income [Income divided by the discount rate]**.Discount Rate is defined as the average return on the five asset classes ,namely **money, bonds, equity, physical capital and human capital*.(ii)**The nominal demand for money is **positively related to the price level(P).(iii)**The nominal demand for money **rises if the opportunity costs of money holdings** (i.e. returns on bonds and stock) **decline and vice versa**.
(iv) The nominal demand for money is **influenced by inflation**.

QUESTION NO.9 Write a short note on THE DEMAND FOR MONEY AS BEHAVIOR TOWARD RISK ?

➦Tobin established that demand for money is **based on the principles of portfolio management.**➦According to Tobin, the **optimal portfolio structure is determined by (i)** the **risk/reward characteristics** of different assets.**(ii)**the **taste of the individual** in maximizing his utility consistent with the existing opportunities.
➦**Points In Favour Of Holding Money**:Tobin stated that an individual would hold a portion of his **wealth in the form of money in the portfolio because (a)**the rate of return on **holding money was more certain** than the rate of return on holding interest earning assets and **(b)**It entails **no capital losses**.**(c)** It is riskier to hold alternative assets like in bonds because **government bonds and equities are subject to market price volatility**, while money is not. ➦**Points In Favour Of Investment In Alternative Financial Assets(Bonds):**Despite this, the individual will be willing to face this risk because the **expected rate of return from the alternative financial assets exceeds that of money.** ➦**Optimum Portfolio**:According to Tobin, rational investor will hold an optimally structured wealth **portfolio which is comprised of both bonds and money.** ➦**Role Of Interest Rate**:**Demand for money is negatively related to interest rate.**

CHAPTER 11 CONCEPT OF MONEY SUPPLY

QUESTION NO. 1 It is important to note two things about any measure of money supply.What are they?

(i) The **supply of money is a stock variable (i)**The stock of money always refers to the **stock of money available to the 'public'**

QUESTION NO. 2 What is Rationale of Measuring Money Supply ?

(i) It facilitates analysis of monetary developments in order to **provide a deeper understanding of the causes of money growth.(ii)** It is **essential from a monetary policy perspective to stabilise price level and GDP growth by directly controlling the supply of money.**

QUESTION NO.3 What are the Sources of Money Supply ?

(a)Central bank(b)Commercial Bank

QUESTION NO.4 Define M1, M2, M3 and M4 Measurement of Money Supply ?

M1= Currency notes and coins with the people + demand deposits of banks (Current and Saving deposit accounts) + other deposits with the RBI.
M2 = M1 + savings deposits with post office savings banks.
M3 = M1 + net time deposits with the banking system
M4= M3 + total deposits with the Post Office Savings Organization (excluding National Savings Certificates)

QUESTION NO.5 Define four new monetary aggregates on the basis of the balance sheet of the banking sector in conformity with the norms of progressive liquidity ?

(i) Reserve Money = Currency in circulation + Bankers' deposits with the RBI + Other deposits with the RBI = Net RBI credit to the Government + RBI credit to the Commercial sector + RBI's Claims on banks + RBI's net Foreign assets + Government's Currency liabilities to the public - RBI's net non-monetary Liabilities

(ii)NM1 = Currency with the public + Demand deposits with the banking system + 'Other' deposits with the RBI.

(iii)NM2 = NM1 + Short-term time deposits of residents (including and up to contractual maturity of one year).

(iv)NM3 = NM2 + Long-term time deposits of residents + Call/Term funding from financial institutions.

QUESTION NO.6 What are close substitutes of money issued by the non-banking financial institutions which are included in liquidity aggregates ?

L1= NM3 + All deposits with the post office savings banks (excluding National Savings Certificates).

L2 = L1 +Term deposits with term lending institutions and refinancing Financial institutions (FIs) + Term borrowing by FIs + Certificates of deposit issued by FIs.

L3 = L2+ Public deposits of non-banking financial companies

QUESTION NO.7 What are the Concept of Money Multiplier ?

$$\text{Money Multiplier (m)} = \frac{\text{Money Suppy}}{\text{Monetary Base}}$$

QUESTION NO.8 What is THE MONEY MULTIPLIER APPROACH TO SUPPLY OF MONEY ?

➡The money multiplier approach to money supply propounded by **Milton Friedman and Anna Schwartz,** (1963)

➡It considers three factors as immediate determinants(factors) of money supply, namely:**(a)** the stock of high-powered money (H)**(b)** the ratio of reserves to deposites, **e = {ER/D}(c)** the ratio of currency to depoists, c **={C/D}**

a) The Behaviour of Central Banks:➡If the behaviour of the public and the commercial banks remains unchanged over time, **the total supply of nominal money in the economy will vary directly with the supply of the nominal high-powered money issued by the central bank.**

b) The Behaviour of Commercial Banks:➡The behaviour of the commercial banks in the economy is reflected in the ratio of their cash reserves to deposits known as the **'reserve ratio'.**➡**If the required reserve ratio on demand deposits increases** : money supply will decrease.➡**If the required reserve ratio on demand deposits falls,** : **the money supply will increase**.

c)The Behaviour of the Public:➡This behaviour of the public is designated as the **'currency ratio'.**➡**An increase in 'currency ratio'** leads to a decrease in money multiplier and hence **decreases the supply of money.**

QUESTION NO.9 What is the meaning of Ways and Means Advances (WMA)/overdraft (OD) facility ?

➡Whenever the central and the state governments **cash balances fall short of the minimum requirement**, they are eligible to avail of a facility called **Ways and Means Advances (WMA)/overdraft (OD) facility.** ➡When the Reserve Bank of India lends to the governments under WMA /OD, **it results in the generation of excess reserve**

➡This happens because when government incurs expenditure, it involves **debiting** the government balances with the Reserve Bank and **crediting** the receiver (for e.g., salary account of government employee) account with the commercial bank.➡The excess reserve thus created can potentially lead to an **increase in money supply through the money multiplier process.**

QUESTION NO.10 What is The Credit Multiplier (Deposit Multiplier) ?

$$➡\text{Credit Multiplier} = \frac{1}{\text{Required Reserve Ratio}}$$

QUESTION NO.11 Difference between deposit multiplier and the money multiplier?

➡The deposit multiplier and the money multiplier though closely related are not identical because :
(a) generally **banks do not lend out all of their available money** but instead maintain reserves at a level above the minimum required reserve.**(b)** all **borrowers do not spend every Rupee they have borrowed**. They are likely to convert some portion of it to cash.

CHAPTER 12 MONETARY POLICY

QUESTION NO.1 Define Monetary Policy ?

➡Monetary policy refers to the use of **monetary policy instruments by the central bank**

QUESTION NO.2 Define Monetary Policy Framework Components ?

➡The three basic components of Monetary Policy are **(i)** the **Objectives** of monetary policy,**(ii)** the **Analytics(Analysis)of monetary policy** which focus on the transmission mechanisms, and **(iii)** the **Operating Procedure** which focuses on the operating targets and instruments.

QUESTION NO.3 What are the Objectives of Monetary Policy ?

➡**Objectives of Monetary Policy:(a)price stability** (or controlling inflation) and **(b)**achievement of high level of **economy's growth** and **(c)**maintenance of **full employment.(d)debt management, (e)moderate long-term interest rates, (f)exchange rate stability** and **(g)external balance of payments equilibrium**

QUESTION NO.4 What are the Objectives of Monetary Policy of developing countries ?

(i) maintenance of the **economic growth,(ii)** ensuring an **adequate flow of credit** to the productive sectors, **(iii)** sustaining - a **moderate structure of interest rates** to encourage investments, and **(iv) creation of an efficient market for government securities.(v)Financial and exchange rate stability**

QUESTION NO.5 What are four different mechanisms through which monetary policy influences the price level and the national income?

➡There are mainly **four different mechanisms:(a)** the interest rate channel,**(b)** the exchange rate channel,**(c)** the quantum channel (e.g., relating to money supply and credit), and **(d)** the asset price channel i.e. via equity and real estate prices.

QUESTION NO.6 What are the Operating Procedures ?

➡The **day-to-day implementation of monetary policy** by central banks through various instruments is referred to as 'operating procedures'. ➡It **involves three major aspects**, namely,**(i)** choosing the **operating target**,(for e.g. inflation) **(ii)** choosing the **intermediate target**, and (for e.g.economic stability) **(iii)** choosing the **policy instruments** (for e.g.CRR;SLR)

QUESTION NO.7 Write a short note on policy instruments?

➡It consists of **Direct Instruments & Indirect instruments.**

➡**Direct instruments consist of:**

(a) the required **cash reserve ratios and liquidity reserve ratios** prescribed from time to time.**(b)** directed **credit to preferred sectors** (for e.g. Credit to priority sectors like agriculture), and **(c) administered interest rates** wherein the deposit and lending rates are prescribed by the central bank.

➡**The indirect instruments mainly consist of: (a) Repos (b) Open market operations(c)Standing facilities, and (d)Market-based discount window.**

QUESTION NO.8 What are the instruments of monetary policy ?

1. Cash Reserve Ratio (CRR) :➡Cash Reserve Ratio (CRR) refers to the **fraction of the total net demand and time liabilities** (NDTL) of a scheduled commercial bank in India which it should maintain as cash deposit with the Reserve Bank. **Impact of changes in Cash Reserve Ratio (CRR):**➡**Higher the CRR** with the central bank, **lower will be the liquidity** in the system and vice versa. ➡**During inflation**, **the central bank increases the CRR**. With higher CRR, banks have to keep more reserves and the banks' lendable resources get depleted leading to decrease in the volume of bank lending and contraction in credit and money supply in the economy.
➡**During deflation**, **the central bank reduces the CRR** in order to enable the banks to expand credit and increase the supply of money available in the economy. With more credit available in the market, economic activities get accelerated(increased) bringing the economy back to stability and economic growth.

2. Statutory Liquidity Ratio (SLR):➡As per the Banking Regulations Act 1949, all scheduled commercial banks in India **are required to maintain a stipulated percentage** of their total Demand and Time Liabilities (DTL) / Net DTL (NDTL) in one of the following forms:**(i) Cash (ii) Gold,** or **(iii)** Investments in **un-encumbered Instruments** that include:**(a) Treasury-bills** of the Government of India.**(b) Dated securities** including those issued by the Government of India from time to time under the market borrowings programme and the Market Stabilization Scheme (MSS).**(c) State Development Loans (SDLs)** issued by State Governments under their market borrowings programme.**(d)Other instruments as notified by the RBI.** These include mainly the securities issued by PSEs[public sector enterprise].➡A **rise in the SLR** which is resorted to during **periods of high liquidity**, tends to lock up a rising fraction of a bank's assets in the form of eligible instruments, and this reduces the credit creation capacity of banks. ➡A **reduction in the SLR** during periods of **economic downturn** has the opposite effect.

3. Liquidity Adjustment Facility(LAF):
➡***A central bank is a 'bankers' bank.***ÌThe Liquidity Adjustment Facility(LAF) is a facility extended by the Reserve Bank of India to the scheduled commercial banks (excluding RRBs) and primary dealers **to avail of liquidity in case of requirement (or park excess funds with the RBI in case of excess liquidity)** on an overnight basis against the collateral of government securities including state government securities.ÌIts objective is to assist banks to adjust their **day to day mismatches in liquidity.** ➡Currently, the RBI provides financial assistance through **repos/reverse repos** under the Liquidity Adjustment Facility (LAF).
3A.Repurchase Options:➡**Repurchase Options** or in short 'Repo', is defined as **'an instrument for borrowing funds** by selling securities with an agreement to repurchase the securities on a mutually agreed future date at an agreed price which includes interest for the funds borrowed'.➡The Repo transaction in India has **two elements:**
• **In the first,** the **seller sells securities and receives cash** while the purchaser buys securities and gives cash. • **In the second,** the **securities are repurchased** by the original holder. The user pays to the counter party the amount originally received, plus the return(interest) on the money for the number of days for which the money was used, which is mutually agreed. ➡Repo operation injects **liquidity in the system.**
➡**Repo Rate As The Policy Rate:**In India, the **repo rate is considered as the policy rate.**➡If the RBI wants to make it more **expensive for banks** to borrow money, **it increases the repo rate.** ➡If it wants to make it **cheaper for banks** to borrow money, **it reduces the repo rate**.
3B.The 'Reverse Repo':➡**Reverse Repo** is defined as an instrument for **lending funds** by purchasing securities with an agreement to resell the securities on a mutually agreed future date at an agreed price which includes interest for the funds lent.➡Reverse repo operation takes place when **RBI borrows money** from banks by giving them securities. ➡Reverse repo operation in effect **absorbs the liquidity in the system.**

4.Marginal Standing Facility (MSF):➡The Reserve Bank of India, being a bankers' bank, **acts as a lender of last resort.** ➡The Marginal Standing Facility (MSF) announced by the Reserve Bank of India (RBI) in its Monetary Policy, 2011-12 refers to the facility under which **scheduled commercial banks can borrow additional amount** of overnight money from the central bank **over and above** what is available to them **through the LAF** window by dipping into their Statutory Liquidity Ratio (SLR) portfolio **up to a limit at a penal rate of interest.** ➡This provides

a **safety valve against unexpected liquidity shocks** to the banking system. ➡The MSF would be the **last resort for banks** once they exhaust all borrowing options including the liquidity adjustment facility(LAF) on which the rates are lower compared to the MSF. ➡The MSF rate being a **penal rate** automatically gets adjusted to a fixed per cent above the repo rate. ➡Practically, **MSF represents the upper band** of the interest corridor with repo rate at the middle and reverse repo at the lower band.

5. Market Stabilisation Scheme (MSS): ➡This instrument was introduced in 2004 following a **MOU(memorandum of understanding) between the Reserve Bank of India (RBI) and the Government of India (GoI)** with the primary aim of assisting the sterilization operations of the RBI. ➡Sterilization is the process by which the **monetary authority sterilizes the effects of significant foreign capital inflows** on domestic liquidity by selling government securities in the economy. ➡Under this scheme, the **Government of India borrows from the RBI** (such borrowing being additional to its normal borrowing requirements) and issues treasury-bills/dated securities **for absorbing excess liquidity** from the market arising from large capital inflows. ➡**When MSS is to be used?** MSS is used when there is high liquidity in the system.

7.Open Market Operations: ➡Open Market Operations (OMO) is a general term used for market operations conducted by the Reserve Bank of India by way of **sale/ purchase of Government securities to/ from the market** with an objective to adjust the rupee liquidity conditions in the market on a durable basis. ➡When the RBI feels there is **excess liquidity in the market,** it resorts to **sale of securities** thereby **sucking out the rupee liquidity.** ➡Similarly, when the **liquidity conditions are tight, the RBI will buy securities from the market,** thereby **releasing liquidity into the market.**

QUESTION NO.9 What are three types of repo markets operating in India ?

(i) Repo on sovereign securities **(ii)** Repo on corporate debt securities ,and**(iii)** Other Repos

QUESTION NO.10 What is Monetary Policy Framework Agreement ?

➡The Monetary Policy Framework Agreement is an agreement **reached between the Government of India and the Reserve Bank of India (RBI)** on the **maximum tolerable inflation rate** that the RBI should target to achieve price stability. ➡Announcement of an official target range for inflation is known as **inflation targeting.** ➡The **inflation target** is to be set by the Government of India, in consultation with the Reserve Bank, **once in every five years**. Accordingly,**(i)** The Central Government has **notified 4 percent** Consumer Price Index (CPI) inflation as the target for the period from August 5, 2016 to March 31, 2021 with the upper tolerance limit of **6 per cent** and the lower tolerance limit of **2 per cent.(ii)** The RBI is mandated to **publish a Monetary Policy Report every six months**, explaining the sources of inflation and the **forecasts of inflation for the coming period of six to eighteen months.(iii)** The following factors are notified by the central government as **constituting a failure** to achieve the inflation target:**(a)**the average inflation is **more than the upper tolerance level** of the inflation target for any **three consecutive quarters;** or **(b)**the average inflation is **less than the lower tolerance level** for any **three consecutive quarters.**

QUESTION NO.11 What are The Monetary Policy Committee (MPC) ?

➡An **important landmark in India's monetary history** is the constitution of an empowered six-member Monetary Policy Committee (MPC) in September, 2016 ➡**It consists of** the **RBI Governor (Chairperson), the RBI Deputy Governor, one official nominated by the RBI Board and the remaining three central government nominees representing the Government of India.** ➡They are persons of **ability, integrity and standing, having knowledge and experience** in the field of Economics or banking or finance or monetary policy. ➡The MPC **shall determine the policy rate (repo rate)** required to achieve the inflation target **through debate and majority vote** by this panel of experts. ➡With the introduction of the Monetary Policy Committee,RBI now follows a system which is **more consultative and participative** similar to the one followed by many of the central banks in the world.

➡The **new system is intended to incorporate:(i) diversity(variety) of views,(ii) specialized experience,(iii) independence of opinion ,(iv) representativeness, and (v) accountability.**The Reserve Bank's **Monetary Policy Department (MPD)** assists the MPC in formulating the monetary policy.

CHAPTER 13 THE KEYNESIAN THEORY OF DETERMINATION OF NATIONAL INCOME

QUESTION NO.1 What are three models of The Keynesian theory of income determination ?

(i) The **two-sector model** consisting of the household and the business sectors,**(ii)**The **three-sector model** consisting of household, business and government sectors, **(iii)**The **four-sector model** consisting of household, business, government and foreign sectors.

QUESTION NO.2 What is circular flow in a simple two sector model ?

➡The **two-sector model** consisting of the household and the business sectors.➡In equilibrium, we have : **National Income (Y) = Consumption(C)+Investment (I)**

QUESTION NO.3 What are the assumptions of simple two sector model ?

(i)only two sectors in the economy viz., households and firms,**(ii)**The **business firms are assumed to hire factors of production from the households**; **(iii)**There are **no corporations, corporate savings or retained earnings. (iv)**The total income produced, *Y*,accrues to the households and equals their disposable personal income Yd i.e.**Y = Y d.(v)**All **prices** (including factor prices), **supply of capital and technology remain constant.(vi)**The **government sector does not exist** and therefore, there are **no taxes, government expenditure or transfer payments. (vii)**The economy is a closed economy,i.e., **foreign trade does not exist**; **(viii)national income equals the net national product.(ix)**There are **no injections into or leakages from the system.**

QUESTION NO.4 What are the Determination of Equilibrium Income : THREE SECTOR MODEL ?

➡Three sector model consists of three components namely, **household ;business sector;and the government sector**➡In equilibrium, we have : **Y = C+I+G**

QUESTION NO.5 What are the key flows which Government sector adds in Income Determination Three Sector Model ?

(i) Taxes on households and business sector to fund government purchases.**(ii) Transfer payments** to household sector and **subsidy payments** to the business sector.**(iii) Government purchases** goods and services from business sector and factors of production from household sector, and**(iv) Government borrowing** in financial markets to finance the deficits occurring when taxes fall short of government purchases.

QUESTION NO.6 What are the Determination of Equilibrium Income in a four Sector Model ?

➡The four sector model includes the **household sector, the business sector, the government sector, and the foreign sector.** ➡In equilibrium, we have **Y = C + I + G + (X-M)...**Where **X =** Export **and M =** Import

QUESTION NO.7 Explain the leakages and injections in the circular flow of Income.

➡**In the two-sector model** with households and firms, **saving** is the only leakage and **investment** is the only injection.

➡**In the three-sector model** which includes the government, **saving and taxes** are the two leakages and **investment and government purchases** are the two injections.

➡**In the four-sector model** which includes foreign sector also, **saving, taxes, and imports** are the three leakages; **investment, government purchases, and exports** are the three injections.

➡The **state of equilibrium** occurs when the total leakages are equal to the total injections.

Savings + Taxes + Imports = Investment + Government Spending + Exports

QUESTION NO.8 What is the aggregate demand(or aggregate expenditure) function in two sector model ?

➦In a simple two-sector economy **aggregate demand (AD) consists of only two components:(i)** Aggregate demand for **consumer goods (C)**, and **(ii)** Aggregate demand for **investment goods (I)** ➦**AD = C + I**

➦In a simple economy, the **variable I** is assumed to be **constant in the short run**. ➦Therefore, the short-run aggregate demand function can be written as: $Y = C + \bar{I}$ Where $\bar{I}$ = constant investment

QUESTION NO.9 What is the supply function ?

➦By definition, **National Income Y = C + S** which shows that disposable income is, by definition, consumption plus saving. ➦**Also, S = Y - C**

QUESTION NO.10 What are the two Sector Model of National Income Determination ?

➦According to Keynesian theory of income determination, the equilibrium level of national income is a situation in which aggregate demand (C+ I) is equal to aggregate supply (C + S) i.e. **C + I = C + S or I = S**

➦The national income equilibrium can also be written as **Y = C + I or Y = C + S**

QUESTION NO.11 What is the consumption function ?

➦The Consumption function, proposed by Keynes is as follows: **C = a + bY** Where, **C** = aggregate consumption expenditure;**Y** = total disposable income; **a** = a constant term which denotes the value of consumption at zero level of disposable income i.e autonomous consumption;**b**= the slope of the function or (△C / △Y) *which is* the marginal propensity to consume (MPC) i.e the increase in consumption per unit increase in disposable income.

QUESTION NO.12 What is the Marginal Propensity to Consume (MPC) ? ➦ $MPS = \frac{\Delta C}{\Delta Y} = b$

QUESTION NO.13 What is Average Propensity to Consume (APC) ? ➦ $APC = \frac{\text{Total consumption}}{\text{Total Income}} = \frac{C}{Y}$

QUESTION NO.14 What is the saving (supply) function ?

➦**S = -a + (1-b)Y,** ➦Where **-a refers to autonomous savings** which means negative level of saving at zero level of disposable income.At this point consumption will be equal to 'a'.➦Where**(1-b) refers to marginal propensity to save**

QUESTION NO.15 What is The Marginal propensity to save(MPS) ?➦ $MPS = \frac{\Delta S}{\Delta Y} = 1 - b$ ➦ Also,**MPC+MPS = 1**

QUESTION NO.16 What is The Average propensity to save ? ➦ $APS = \frac{\text{Total Saving}}{\text{Total Income}} = \frac{S}{Y}$

QUESTION NO. 17 Define Investment Multiplier(expenditure multiplier)? ➦ $k = \frac{\Delta Y}{\Delta I}$

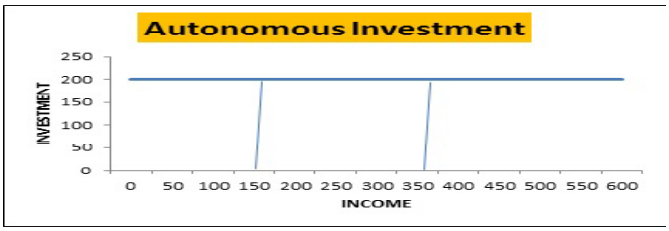
➦**Multiplier Relation With MPC & MPS** : $\frac{\Delta Y}{\Delta I} = \frac{1}{1 - MPS} = \frac{1}{MPS}$

➦There exists a **direct relationship between MPC and the value of multiplier**. Higher the MPC, more will be the value of the multiplier, and vice-versa. ➦There exists a **inverse relationship between MPS and the value of multiplier**.Higher the MPS, lower will be the value of multiplier and vice-versa.

QUESTION NO.18 What is Multiplier Relation With Leakages ? OR Increase in income due to increase in initial investment, does not go on endlessly. State the reason.

➦The leakages are caused due to:**(i) Progressive rates of taxation** which result in no appreciable increase in consumption despite increase in income.**(ii) High liquidity preference** and **idle saving** or **holding of cash balances** and **an equivalent fall in marginal propensity to consume.(iii)** Increased demand for consumer goods being met out of the **existing stocks or through imports (iv)** Additional income spent on purchasing **existing wealth** or purchase of **government securities and shares from shareholders or bond holders(v) Undistributed profits** of corporations**(vi)** Part of increment in income used for **payment of debts.(vii)** In case of full employment, additional investment will only lead to **inflation**, and **(viii) Scarcity of goods and services** despite having high MPC.

QUESTION NO.19 What is an 'Autonomous Investment' ?



➦**In above example** autonomous investment is Rs.200 crore.

QUESTION NO.20 What is Autonomous consumption ?

- C = 40 + .80 (DI)

Autonomous Consumption

Disposable Income	Consumption [C]	Savings [S]
0	40	-40
100	120	-20
200	200	0
300	280	20
400	360	40

QUESTION NO.21 What is INDUCED CONSUMPTION ?

➦**Induced Consumption = Amount Of Consumption- Autonomous consumption**

QUESTION NO.22 What is Foreign Trade Multiplier or autonomous expenditure multiplier ?

➦The autonomous expenditure multiplier = $\frac{1}{1-b+v}$

Where b marginal propensity to consume, and v is marginal propensity to import which is greater than zero.

CHAPTER 14 NATIONAL INCOME ACCOUNTING

QUESTION NO.1 What are the usefullness and significance of national income estimates ?

(i) evaluating the **short-run performance of an economy. (ii) enables businesses to forecast** the future demand for their products.**(iii)Helps In Economic Welfare: (iv)show income in terms of different sectors of the economy**. **(v)**provide a quantitative basis for **evaluation of governments economic policies. (vi)** National income estimates **throw light on income distribution (vii) assist in determining eligibility for loans.(viii) guide to make policies for growth and inflation.(ix)make projections about the future development** trends of the economy.

QUESTION NO.2 What are the Limitations and challenges of National Income Computation ? or What are Points Which Are Ignored in National Income Computation ?

(a) Income distributions and GDP per capita is completely **inadequate measure of welfare. (b) Quality improvements is ignored.(c) Productions hidden is not accounted.(d) Non-market production** and **Non-economic contributors** to well-being **is ignored**.**(e)** The **dis-utility of loss of leisure time** . **(f) Economic 'bads'(g)** The **volunteer work and services rendered without remuneration (h) leisure time, fairness, gender equality, security of community feeling etc.,(i)** The distinction between **production that makes us better off and production that only prevents us from becoming worse off is ignored.**

QUESTION NO.3 What are the Conceptual Difficulties in determination of National Income Computation ?

(a) Lack of an agreed definition of national income,**(b)** Accurate **distinction between final goods and intermediate goods,(c)** Issue of **transfer payments.(d)** Services of **durable goods.(e)** Difficulty of incorporating **distribution of income.(f) Valuation of a new good** at constant prices, and**(g)** Valuation of **government services.**

➡**Other challenges relate to:(a) Inadequacy of data** and lack of reliability of available data,**(b)** Presence of **non-monetised sector,(c)** Production for **self-consumption,(d) Absence of recording** of incomes due to illiteracy and ignorance,**(e)** Lack of **proper occupational classification**, and**(f)** Accurate **estimation of consumption(depreciation) of fixed capital**

QUESTION NO.4 What is the meaning of CIRCULAR FLOW OF INCOME ?

➡Circular flow of income refers to the **continuous circulation of production, income generation and expenditure** involving different sectors of the economy. ➡Corresponding to the three phases, there are three methods of measuring national income. They are: **Value Added Method (alternatively known as Product Method); Income Method; and Expenditure Method.**

QUESTION NO.5 What is the DIFFERENT CONCEPTS OF NATIONAL INCOME ?

➡National income accounts have three sides: **a product side, an expenditure side and an income side.**

QUESTION NO.6 What is VALUE ADDED METHOD OR PRODUCT METHOD ?

➡GDP mp = Value of output - Intermediate consumption = (Sales + change in stock) -Intermediate consumption ➡NDP mp = GDP mp - Depreciation ➡NDP fc=Net Domestic Product (NDP mp) - Net Indirect taxes ➡NNP fc= Net Domestic Product (NDP fc) + NFIA

QUESTION NO.7 What is INCOME METHOD ?

➡NDP fc or **National Income =** Sum of factor incomes paid out by all production units within the domestic territory of a country **= Compensation of employees + Operating Surplus (rent + interest+ profit) + Mixed Income of Self- employed + Net Factor Income from Abroad** ➡NNP fc= Net Domestic Product (NDP fc) + NFIA

QUESTION NO.8 What is EXPENDITURE METHOD ?

➡**Calculation of GDP mp :**Final consumption expenditure + gross domestic capital formation + net exports.
➡**Calculation of GNP mp :**Gross National Product at Market Price (GNPmp)-Net Factor Income From Abroad
➡**Calculation of GNP fc :**GNP Mp-Net Indirect Taxes
➡**Calculation of NNP fc :**Gross national product at factor cost (GNP Fc)- Depreciation

QUESTION NO.9 What is NNPfc/GDP mp/NDP mp/GDPfc/NNP mp/GNPmp ?

Remember this format and frame the equation accordingly.Final conclusion should be National Income in defining all above measures.

GDPmp	xxx
(-)Depreciation	xxx

NDPmp	xxx
(-)Net Indirect Tax	xxx
NDP fc	xxx
(+)NFIA	xxx
NNPfc (National Income)	xxx

QUESTION NO.10 What is PER CAPITA INCOME ?

➦It is obtained by **dividing the country's gross domestic product, adjusted by inflation, by the total population.**

QUESTION NO.11 What is PERSONAL INCOME(PI) ?

PI = NI + income received but not earned - income earned but not received.

QUESTION NO.12 What is DISPOSABLE PERSONAL INCOME (DI) ?

➦**Personal disposable Income=Personal Income-Direct tax paid by households– Miscellaneous receipts of Government administrative undertakings in the form of fees,fines etc**

QUESTION NO.13 What is GROSS NATIONAL DISPOSABLE INCOME?

➦**Gross National Disposable Income (GNDI) = GNPmp + Net current transfer received from rest of the world.**

QUESTION NO.14 What is NOMINAL GDP VS REAL GDP: GDP AT CURRENT AND CONSTANT PRICES ?

➦**For example**, the GDP of 2015-16 may be expressed either at prices of that year or at prices that prevailed in 2011-12. In the former case, it is Nominal GDP but in the latter case it is Real GDP.

The Institute of Chartered Accountants of India

Examination Results, Nov 2017

Logo

Final Examination - Merit List, Nov 2017

(Top candidates upto 50 Ranks securing minimum of 55 percent and above marks)

Roll Number	426168
Name	ADITYA MITTAL
Reg No	NRO0329834
Total marks	565
Rank No	3

The Institute of Chartered Accountants of India
Examination Results, Nov 2017

THANKS TO AADITYA JAIN SIR .I SCORED 100 OUT OF 100 MARKS IN SFM WITH ALL INDIA RANK 3 YOU ARE NO.1 SFM FACULTY OF INDIA.PLZ CHECK MY RESULT AT NRO-0329834;ROLL NO.-426168;ITS A TRIBUTE TO YOUR TEACHING

Roll Number	**426168**
Name	**ADITYA MITTAL**
Group I	
Financial Reporting	062
Strategic Financial Management	100
Advanced Auditing and Professional Ethics	059
Corporate and Allied Laws	057
Total	**278**
Result	**PASS**
Group II	
Advanced Management Accounting	083
Information Systems Control and Audit	059
Direct Tax Laws	073
Indirect Tax Laws	072
Total	**287**
Result	**PASS**
Grand Total	**565**