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Economics for Managers Block IV MACRO ECONOMICS – II UNIT 17 Monetary Policy 1-17 UNIT 18 Inflation 18-35 UNIT 19 International Trade and Balance of Payments 36-69 UNIT 20 Economic Indicators 70-86 UNIT 21 Business Cycles 87-102 UNIT 22 Economic Growth, Development and Planning 103-121

 Ref. No. EFM SLM 102021B4 For any clarification regarding this book, the students may please write to The ICFAI Foundation for Higher Education (IFHE), Hyderabad specifying the unit and page number. While every possible care has been taken in type-setting and printing this book, The ICFAI Foundation for Higher Education (IFHE), Hyderabad welcomes suggestions from students for improvement in future editions. Our E-mail id: cwfeedback@icfaiuniversity.in Center for Distance and Online Education (CDOE) The ICFAI Foundation for Higher Education (Deemed-to-be-University Under Section 3 of UGC Act, 1956) Donthanapally, Shankarapalli Road, Hyderabad- 501203.

iii BLOCK IV: MACROECONOMICS – II The last block to the course on Economics for Managers deals with concept of monetary policy, inflation, balance of payment, economic indicators and business cycles. The block ends with a unit on growth and development. The block has six units. The first unit of this block, Monetary Policy, discusses about different aspects of monetary policy. As monetary policy affects both individual business and economy, it is important to have a clear idea about different instruments of this policy. The unit also evaluates monetary policies in the context of different type of economies. The second unit, Inflation, provides a clear idea about inflation. Inflation,

an increase in the general price level of goods and services,

is one of the major issues of macroeconomics. Therefore, the knowledge of different types of inflation and its various sources are required to understand the measures to control it. The third unit, International Trade and Balance of Payments, examines the role of international trade on an economy. The unit also discusses the concept of balance of payment (BoP), the reasons for disequilibrium in BoP and methods of correcting the disequilibrium. The fourth unit, Economic Indicators, introduces you to the features of different economic indicators. The unit also discusses about some of the important economic indicators in predicting the condition of the economy. The fifth unit, Business Cycles, focuses on different stages of business cycles. The unit also examines different theories of business cycles. The last unit, Economic Growth, Development, & Planning, deals with economic development and planning. The unit focuses on different theories of economic growth and various factors contributing to economic development. The unit ends with a discussion on economic reforms in India and India's future economic condition. The block units have been revised by the addition of new content where required, updations through exhibits and examples.

Unit 17 Monetary Policy Structure 17.1 Introduction 17.2 Objectives 17.3 Objectives

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of Monetary Policy 17.4 Instruments of Monetary Policy 17.5 Problems in Monetary Policy 17.6 Monetary Targeting 17.7 Monetary Policy in a Developing Economy 17.8 Monetary Policy in an Open Economy 17.9 Link between Monetary Policy and Fiscal Policy 17.10

Summary 17.11 Glossary 17.12 Self-Assessment Test 17.13 Suggested Reading/Reference Material 17.14 Answers to Check Your Progress Questions 17.1 Introduction The previous unit discussed about
fiscal policy and its significance. In this unit we will
discuss another macroeconomic policy- monetary policy. Monetary policy is an important aspect of overall macroeconomic policy. Monetary and credit policies affect individual businesses and the economy as a whole, as well. Monetary policy decisions have widespread implications for the economy as it affects key economic variables like price level, exchange rate, real interest rate, unemployment rate and real GDP. Because of these implications central bank actions are of keen interest to media, industry, and financial market participants etc. The basic element which is affected by monetary policy is the overall money supply.

98%	MATCHING BLOCK 2/127	W

Monetary policy can be defined as "the deliberate effort by the central bank to influence economic activity by variations in the money supply, in availability of credit or in the interest rates consistent with specific national objectives."

Monetary authorities use various techniques to achieve their economic objectives. In this unit, we will discuss the objectives of monetary policy, its problems and its role in a developing economy and in an open economy. Before studying this unit student should recall fiscal policy, its objectives and its significance in economic development (Unit 15).
Block IV: Macro Economics – II 2 17.2
Objectives By the end of this unit, students should be able to: ? Explain
the objectives of

monetary policy and its instruments ? Identify and discuss the problems related with monetary policies ? Analyze monetary policies in the context of different type of economies ? Evaluate the relation between fiscal and monetary policies 17.3 Objectives of Monetary Policy The following are the general objectives of the monetary policy. However, each country has its own national economic objectives and the central bank monetary policy objectives are always aligned to the national objectives. 17.3.1 Price stability Price fluctuations are disruptive of economic activity. High level of Inflation and deflation are hindrances to the smooth functioning of an economy. Price stability implies that avoidance of prolonged inflation and deflation. Very low level of inflation, Negative inflation rate (Deflation) and very high level of inflation are harmful to the economy. Quantitatively most of the central banks targets inflation with a band. For example RBI tries to bring inflation within the inflation rate band of 2% to 6%) Hence, it is essential to avoid large fluctuations in the overall prices as measured by the wholesale price index (WPI) and consumer price index (CPI). 17.3.2 Exchange rate stability The exchange rate can be defined as

the value of a particular country's currency in terms of another currency. Instability in the exchange rate

affects international trade and impairs the financial relations of a country, which can, in turn, lead to financial crises. Exchange rate volatility may restrict investments in those countries. Therefore, there should be a degree of stability in the country's exchange rate. 17.3.3 Full employment and maximum output The levels of employment and output in an economy are based on certain factors like technology and human resources, and are not affected by monetary policy in the long run. Full employment indicates optimum utilization of scarce resources – land, labor, capital and organization. Monetary policy can influence the levels of output and employment only in the short run. The central bank of the country has the responsibility of stabilizing the economy and taking steps through its monetary policy to smoothen sharp variations in output and employment. 17.3.4 High rate of growth The monetary policy should be conducive to economic growth. Monetary policy can contribute to the growth of an economy in two ways – one way is to balance

Unit 17: Monetary Policy 3 the aggregate monetary demand and the aggregate supply of goods and services i.e. to maintain price stability, which is conducive to economic growth. The other way is to encourage savings and investments in the economy. Central banks ensure liquidity in the economy through various monetary policy instruments. Exhibit 17.1 captures the highlights of the RBI's August 2021 bi-annual monetary policy statement released by the RBI Governor on October 8 th , 2021 Exhibit 17.1: RBI Bi-Annual Monetary Policy Statement, August 2021 The Monetary Policy Committee (MPC) met on October 8 th , 2021 to release the RBI's Bi-Annual Monetary Policy Statement for August, 2021. The highlights of this statement are: ? Policy interest rates kept unchanged in order to support the economic recovery. ? The committee decided to continue maintaining an accommodative stance to facilitate liquidity and to keep the borrowing costs lower for the state and companies to help drive investments. ? The GDP growth forecast for Financial Year 2022 is kept at 9.5% ? CPI inflation estimated to be at 5.3% ? RBI stops the buying of G-SAP (Government – Securities Acquisition Program) Bonds ? The Variable Reverse Repo auctions to be enhanced to 14 day auctions along with 28 day auctions. The auctions will be increased from Rs.4 trillion to Rs.6 trillion ? The transaction limit of IMPS (Immediate Payment Service) has been increased to Rs.5 lakh from Rs.2 lakh ? It was decided to introduce internal Ombudsman Scheme to address the issues related to NBFCs ? For the purpose of Small Finance Banks (SFBs), the LTRO (Long term Repo Operations) of Rs.10, 000 crore is extended upto December 31, 2021. Source: https://economictimes.indiatimes.com/news/newsblogs/rbi-monetary-policy- latest-news-mpc-meeting-shaktikanta-das-live-updates/liveblog/86855975.cms Activity 17.1 The Government frames monetary policies, which affect businesses and the economy. Monetary policy is used to regulate the money supply. Therefore, what are the feasible objectives of monetary policy? Answer:

Block IV: Macro Economics – II 4 17.4 Instruments of Monetary Policy Central banks has two types of monetary policy instruments- Quantitative instruments and qualitative instruments. Quantitative instruments of monetary policy are as follows. 17.4.1

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Open market operations Open market operations refer to the buying or selling of securities by the Central Bank.

The securities involved are government securities, banker's acceptances or foreign exchange. The sale of the securities by the Central Bank causes a decrease in the quantity of money and credit. The activity of buying securities from the market increases the money in circulation, which results in an increase in the cash reserves with commercial banks, and credit generation. 17.4.2 Liquidity Adjustment Facility (LAF) The LAF allows the scheduled commercial bank to avail liquidity if required against collateral for overnight basis. The commercial banks are allowed to use government securities as collateral. The LAF operates based on the repurchase agreements Under the LAF facility RBI has two instruments- Repo rate and reverse

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repo rate. Repo rate is the rate at which RBI lends money to commercial banks against collateral for short period. Reverse repo rate is the rate at which RBI takes overnight loan from commercial banks against collateral. 17.4.3 Marginal Standing Facility This is an additional window extended by RBI to provide liquidity to commercial banks. If the bank required additional money, they can get overnight loan from RBI without giving collateral by dipping into the Statutory Liquidity ratio. 17.4.4 Sterilization Sterilization can include: Sterilization of foreign exchange flows: Sterilization can be defined as a form of monetary action in which a central bank seeks to limit the effect of inflows and outflows of foreign exchange on the domestic money supply, thereby trying to ensure domestic price and exchange rate stability. Impact of foreign exchange inflows on domestic money supply: Indian exporters earn foreign exchange (Forex) and convert these currencies into Indian Rupees; the process results in an augmentation of the Forex Reserves with the Central Bank, (RBI), while the supply of money with the public increases. In addition, Foreign Institutional Investors (FIIs), who or which are private investors or investment funds like hedge funds, insurance companies, pension funds and mutual funds based in or registered in a country other than the one in which it is currently investing, bring in or take out huge sums in the shape of volatile portfolio funds, to invest in domestic share market (equity).

Unit 17: Monetary Policy 5 Foreign Direct Investments (FDIs) comprise very large inflows of capital funds but these are relatively stable in terms of tenure. In addition, Forex flows occur on account of a host other factors like foreign aid, loans etc. Similarly, Indian importers, governmental institutions and others need Forex to meet their import bills. In addition, outflows occur due to repayment of loans/foreign aid granted to a needy country by India/ repatriation of profits and capital by foreign companies and for a few other reasons. Impact on domestic money supply: As such inflows tend to be large and bunched during the upswing phase of the economy, RBI finds itself flush with Forex and has to release a matching amount of Indian currency into the market which tends to add to the inflationary pressures in an economy which is already hotting up, resulting in a potentially unsustainable upswing of investments, output, employment and prices. In addition, rising prices tend to create difficulties for exporters while imports become increasingly attractive, thereby exercising a degree of negative influence on exchange rate stability. One can easily understand that an opposite influence is exerted by the outflow of Forex from the country. In such a situation, which has been created primarily by excessive Forex inflows or outflows, the central bank has to step in to counter the effects of augmented/reduced money supply as well as ensure exchange rate stability. This is done by selling or purchasing securities and financial assets to mop up or release liquidity in the system, as the case may be. In addition, the central bank uses the sterilization process to manipulate the value of one domestic currency relative to another, and this process involves the foreign exchange market. An example of Sterilization: Sterilization requires a central bank to look beyond its borders by getting involved in foreign exchange. For example, suppose USA has a net BoP deficit and has to pay Japan 100 trillion Yen. Federal Reserve (Fed) will purchase Yen, and this purchase is made with dollars that Fed had in its reserves. This action results in there being less than yen in the overall market - it has been placed in reserves by the Fed - and there are more dollars, since the dollars that were in the Fed's reserve are now in the open market. To sterilize the effect of this transaction, the Fed can sell government bonds, which remove dollars from the open market and replace them with a government obligation (securities). 17.4.5

Bank rate policy The bank rate policy refers to

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the rate of interest at which the Central Bank rediscounts approved bills of exchange. This policy

requires market rates to change in response to the bank rate. An increase in the bank rate leads to an increase in other interest rates. Hence, borrowing becomes costlier and consequently, there is less demand for loans. A reduction in the

100%	MATCHING BLOCK 6/127	W

bank rate leads to a reduction in other interest rates

causing an increase in demand for loans. In recent times RBI is not using bank rate as a monetary policy instrument since Block IV: Macro Economics – II 6 commercial banks are no longer depending on RBI for long term funds. Commercial banks raise long term funds from various institutions like private equity funds etc. 17.4.6 Reserve requirement changes

96%	MATCHING BLOCK 8/127	W

The Central Bank can regulate money supply by changing the reserve requirements of commercial banks.

An increase in the

54%	MATCHING BLOCK 9/127	W

reserve requirements decreases the amount of demand deposits that banking system can support, thus reducing the money supply, and vice-versa. 17.4.7

Cash Reserve Ratio The average daily balance that the bank is required to maintain with RBI is called the Cash reserve ratio (CRR). This daily balance is a portion of the Net Demand and time liabilities (NDTL) of the bank. NDTL is calculated as the sum of demand and time liabilities (deposits) of the bank with public and other banks minus deposits with other bank. Deposits with other bank is considered as asset of the bank. A decrease in CRR increases the money available with commercial banks for lending and this would increase

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money supply in the economy 17.4.8 Statutory Liquidity Ratio (SLR) Statutory Liquidity ratio (SLR) is the portion of

Net Demand and Time liabilities (NDTL) that the bank is required to keep in liquid form or near liquid form. Banks are allowed to keep this portion in the form of unencumbered government securities, cash and gold. A decrease in SLR increases the money available for lending and this will increase money supply in the economy. RBI and Reserve Ratio – Recent trends in India At a time when many countries slowed down in growth while some of them showing even recessionary trends due to Euro zone crisis, central banks of various countries adopted the cheap money policy of reducing the reserve ratio and interest rates. But RBI did not follow that process until recently. One of the factors that contribute to inflation in India is raising food prices. The reasons for rise in food prices could be many like erratic monsoon, untimely rains, draught etc. The uncertainty about food prices made RBI to take cautious steps and to wait for more clarity on inflation. With the softening of the manufacturing sector and falling inflation, falling oil prices in the international market, RBI had announced repo rate cut rates during April 2015.Governor of RBI, Mr. Raghuram Rajan, observed that RBI was into concerted efforts in revamping the growth of the economy through monetary policy. After Raghuram Rajan Dr Urjit Patel become the RBI governor and during his time the government implemented the demonetization policy in 2016. Urjit Patel resigned from the post in December 2018. Mr. Shaktikanta Das took charge as the RBI governor in December 2018. Contd....

Unit 17: Monetary Policy 7 In the recent years RBI follows an expansionary monetary policy to revive the struggling economy. In March 2020 RBI reduced the CRR by 100 basis points to 3% and repo rate by 75 basis point to 4.4 to revive the economy. However, in September 2021, the CRR was kept at 4% and the repo rate at 4% and reverse repo rate at 3.35% Source: https://www.rbi.org.in/ 17.4.9 Qualitative instruments of monetary policy Selective credit controls are qualitative methods to regulate credit. The various selective credit control methods are:

Rationing of credit: This is used to prevent excessive expansion of credit.

In this method RBI limits or deny credit to certain sectors, firm or individuals based on the creditworthiness. RBI uses different methods under this. RBI may put cap on the amount of credit available to a particular sector or industry. Another method is charging high interest rate on large loans. Regulation of consumer credit: Banks are providing loans to buy electronics items like refrigerator, TV etc. If RBI feels that excessive credit is available in any of the segment, RBI can increase the down payment to discourage consumers from taking loan. Direct action: These are the steps taken against commercial banks and financial institutions, which fail to follow the credit regulations of the Central Bank. Changes in margin requirements:

Changes in margin requirements are used to curb speculative activities.

Margin is the difference between the values of collateral and the amount of loan. For example. A customer want to buy a house worth 1 crore and the bank gives a maximum of 90 lakh as loan. Here the margin is 10 lakh or 10% of the collateral. Customer has to raise this amount on its own to buy the house and a change in margin requirement always affects the ability of customer to take loan and this may affect money supply in the economy. Moral suasion: Moral suasion is adopted

100%	MATCHING BLOCK 13/127	W

to put pressure upon the lending activities of commercial banks through exhortations

i.e. by verbally asking the commercial banks to follow certain policies. Method of publicity: In this method central banks creates awareness among the public about the current economic situation of the economy and the monetary policy of the central bank. This may create public opinion and commercial banks will be compelled to transmit the monetary policy changes to the consumers. Numerical Example A

100%	MATCHING BLOCK 14/127	W

banking system has reserves of Rs 400 crore and the reserve requirement is 10%.

Now if the reserve requirement is increased to 20% then what is the amount of decrease in the banking system's capacity to support demand deposit?
Block IV: Macro Economics – II 8

59%	MATCHING BLOCK 15/127	W

Banking system has reserves of Rs 400 crore and the reserve requirement is 10%. The banking system can support demand deposit up to Rs 400 crore / 0.10 = Rs 4000 crore. The reserve requirement is increased to 20%. Now the banking system can support demand

deposit up to Rs 400 crore / 0.20 = Rs 2000 crore. The amount of decrease in the banking system's capacity to support demand deposit = Rs 4000 crore - Rs 2000 crore = Rs 2000 crore Exercises A. If the

100%	MATCHING BLOCK 16/127	W

banking system has reserves of Rs. 500 crore and the reserve requirement is 20 percent,

to what extent can the system support demand deposits? a. Rs. 5000 crore b. Rs. 2000 crore c. Rs. 10000 crore d. Rs. 2500 crore B. The

90%	MATCHING BLOCK 17/127	W

banking system has reserves of Rs 500 crore and the reserve requirement is 20 percent. If the reserve requirement is increased to 25 percent, the banking system's capacity to support demand deposits decreases by ________________. a. Rs 500 crore b. Rs 1000 crore c. Rs 250 crore d. Rs 750 crore C. The banking system has reserves of Rs 2000 crore and it can support demand deposits upto Rs 10,000 crore. What is the reserve requirement for the banking system? a. 20 % b. 40 % c. 30 % d. 15 % Check Your Progress - 1 1. Which of the following is not an instrument of monetary policy? a. Open market operations b. Bank rate policy c. Reserve requirement changes. d. Government spending Unit 17: Monetary Policy 9 2. Which of the following could be the results of the central bank selling government securities? a. It increases the quantity of money and credit b. It reduces the quantity of money and credit c. It reduces the quantity of money and increases the credit d. It increases the quantity of money and reduces the credit 3. ________

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rate is the rate of interest at which the central bank rediscounts approved bills of exchange.

a. Lending b. Debt c. Bank d. Forwarding 4. When would the commercial banks have fewer funds to provide credit to the customers? a. When the central bank decreases the reserve requirements b. When the central bank increases the reserve requirements c. When the central bank leaves the reserve requirements unchanged d. When the commercial bank increases the lending rate 17.5

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Problems in Monetary Policy 17.5.1 Lags in monetary policy There is a

gap in

97%	MATCHING BLOCK 20/127	W

time between the point at which the need for a particular monetary policy is felt and the time at which the aggregate demand

gets altered. There are two types of lags in monetary policy – an inside lag and an outside lag. The inside lag is further divided into a recognition lag and an action lag. Recognition lag refers to the time period taken to identify the requirement for alterations in monetary policy. Action lag is the

100%	MATCHING BLOCK 21/127	W

time gap between the recognition of the need, and the implementation of the policy.

The outside lag can be described as the time period taken to affect demand and supply after the execution of the policy. Due to these lags, the effectiveness of policies gets reduced. 17.5.2 Pressure of financial intermediaries Financial intermediaries like insurance companies, pension funds, cooperative banks, etc. convert idle funds into active balances as they lend against mortgages and assets, which yield higher returns. These actions increase the velocity of money and weaken the contractionary power of monetary policy. 17.5.3 Contradictions in objectives Some of the objectives of monetary policy are incompatible i.e. one objective may obstruct the achievement of the other objective. This leads to ambiguity among authorities as to which objectives are to be achieved and given greater priority.

Block IV: Macro Economics – II 10 17.5.4 Underdeveloped nature of money and capital markets Unorganized money and capital markets restrict the monetary authorities from regulating the monetary variables. Expansion or contraction of the money supply become impossible as these markets are quite insulated from actions taken in the organized market by the monetary authorities. Thus the authorities cannot raise or lower the cost of borrowing in the unorganized private sector. Types of Monetary policies There are mainly two types of monetary policies- Expansionary monetary policy and contractionary monetary policy. Expansionary Monetary policy Expansionary monetary policy is used during a period of recession or economic slowdown. Under this policy central banks increases the money supply in the economy by reducing the reserve requirements or reducing the repo rate or margin requirements etc. This would increase availability of funds of the commercial banks and banks will reduce the interest rate on loans. Lower interest rate will encourage consumers or industrialists to take more loans and invest in the economy. More investments and consumer spending will increase aggregate demand and economic growth in the economy. Contractionary Monetary policy Contractionary monetary policy is used during a period of high inflation. Contractionary monetary policy means reduction of money supply in the economy. Here, RBI increases the reserve requirements like CRR, SLR and increases the repo rate. This would reduce the amount of fund available to commercial banks and commercial banks would increase interest rate on loans. Higher interest rate would discourage borrowers from taking loan and this would reduce investment and consumer spending in the economy. Lower consumer spending is expected to reduce the inflation in the economy. 17.6

64%	MATCHING BLOCK 22/127	W

Monetary Targeting Monetary targeting can be defined as the practice of formulating monetary policy in terms of

a

100%	MATCHING BLOCK 23/127	W

target growth of money stock. Keeping in view the need to regulate money supply in line with increases in output, a committee set up to review the working of the monetary system in India recommended that the Reserve Bank adopts a system of monetary targeting with feedback. The Reserve Bank should

determine the range within which the volume of money and credit should grow, according to

90% **MATCHING BLOCK 24/127** W

the expected rate of growth of the real sector and an acceptable order of increase in prices. The target may be modified, if the real sector

does not match the expectations. Amendments should be made in the target range as the relationship between money, output and price is valid only for a certain period of time, and in this way, the policy of monetary targeting can be used to aid the RBI in deploying its monetary policy instruments.

Unit 17: Monetary Policy 11 RBI and Monetary Policy Framework Agreement During the Budget Speech in March 2015, the Finance Minister, Mr. Arun Jaitley, came out with a proposal of Monetary Policy Framework (MPF) Agreement with the RBI. The main aims of MPFA were to (i) provide more autonomy to RBI by forming a Monetary Policy Committee (ii) to amend RBI Act by end of 2015 (iii) empower RBI to use monetary measures, chiefly the rate of repo transactions (iv) focus on price stability with an "operating target" to secure 6% inflation by 2016 and further lowering it by 2% and maintaining at 4% in the following years. The RBI is vested with several responsibilities like setting SLR, stabilize exchange rate volatility, maintain capital account controls, partnering the government for framing industrial policy for prime lending loans etc. Monetary targets can be defaulted if proper support through fiscal policy is not provided by the government. Check Your Progress - 2 5. The time lag

92% **MATCHING BLOCK 25/127** W

between recognition of the need and the implementation of the policy is known as ________.

a. Recognition lag b. Action lag c. Outside lag d. Inside lag 6. Which of the following is not true about monetary policy in the Indian context? a. The monetary policy aims at price stability and growth b. The monetary policy measures in India were never influenced by the fiscal policy c.

67% **MATCHING BLOCK 26/127** W

The monetary policy has been primarily acting through the availability of credit d. The cost of credit has been adjusted upward in the past to meet inflationary situations 17.7

Monetary Policy in a Developing Economy In India, monetary policy measures are usually taken in response to fiscal policy. The main objective of monetary policy in a developing country like India is price stability, economic growth and realistic foreign exchange rates. Some of the salient features of monetary policy in India are: ? In India, the objectives of monetary policy are attained by ensuring availability of credit, stability in the exchange rate and overall financial stability.

Block IV: Macro Economics – II 12 ?

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Direct involvement of the central monetary authority in the allocation of credit to the non-government sector has become an important element of the national economic policy. ?

Monetary policy has been used to stimulate sectoral and overall development, and to support programs aimed at social justice. ?

65% **MATCHING BLOCK 28/127** W

Containment of inflationary pressures without adversely affecting the growth potential has been one of the main objectives of monetary policy. ?

Monetary policy today is putting greater emphasis on

95% **MATCHING BLOCK 29/127** W

flexibility, promoting a competitive environment and imparting greater discipline and prudence in the operations of the financial system. 17.8 Monetary Policy in an Open Economy Central banks in open economies manage reserve flows, and monitor

exchange rates and international financial developments. Exhibit below describes the unconventional monetary policy followed by Bank of Japan. Exhibit 17.2: Monetary policy in Japan The Bank of Japan is the central bank of Japan, in which authority it decides and formulates the monetary policy of Japan. The basic objective of a monetary policy is to maintain price stability, which

100% **MATCHING BLOCK 30/127** W

is decided by the Policy Board at Monetary Policy Meetings.

Price stability has been set as the main objective as it provides the nation with the foundation for economic activity. On this basis, the Bank of Japan set a price target of 2 percent in January, 2013. Bank of Japan followed an unconventional quantitative and qualitative easing policy to achieve the target. The quantitative easing component comprised of expansion of the monetary base while the qualitative aspects dealt with asset purchases. The policy was further extended in 2014. In January 2016, the Bank of Japan decided to adopt a negative interest rate policy. The policy had a complicated three tiers with 0.1%, zero and -0.1%. The negative interest rates though benefited in the issuance of long term bonds and FPI investment by Japanese financial institutions, it resulted in squeezing the spread between the deposits and lending interest rates, contributing to a fall in the banks' profitability. In 2018, BoJ announced a series of adjustments to the monetary policy which were

71% **MATCHING BLOCK 31/127** W

referred to as "Strengthening the framework for Continuous Powerful Monetary Easing Framework". The changes included adoption of a forward guidance with regard to two policy rates –

The 10 year yield and Negative interest rate. The BoJ adopted a upper and lower range (+/- 0.2%) of the 10 year target. Sources: https://www.adb.org/sites/default/files/publication/469246/adbi-wp896.pdf
https://www.boj.or.jp/en/mopo/outline/index.htm/
Unit 17: Monetary Policy 13 17.8.1 Reserve flows International events can affect the volume of the Central Bank's reserves, and this affects the Central Bank's control over the country's money supply. One of the factors that affect central bank reserves is the level of deposits and withdrawals by foreigners into the economy.

100% **MATCHING BLOCK 32/127** W

Insulation of domestic money supply from international reserves is called sterilization.

The Central Bank can accomplish this task through open market operations that work in the opposite direction to international reserve movements. 17.8.2

64% **MATCHING BLOCK 33/127** W

The role of the exchange rate system The exchange rate system has a significant role in a country's financial system.

The value of the domestic currency in terms of various foreign currencies are the foreign exchange rates that apply to the domestic currency.

100%	MATCHING BLOCK 34/127	W	

Exchange rate systems are of two types: floating and fixed. In a floating exchange rate system, the exchange rate is determined by the market forces of supply and demand;

81%	MATCHING BLOCK 41/127	SA	179E1150-International Economics-(SLSM).doc (D165627856)

floating exchange rate system, the exchange rate is determined by the market forces of supply and

countries following this type of system can practice monetary policy (specifically inflation control) independently of other countries. A fixed exchange rate system is a system where countries set and defend certain exchange rates. Countries with fixed exchange rate systems have to peg the currency against one or more currencies. 17.8.3

62%	MATCHING BLOCK 35/127	W	

The foreign desk The Central Bank assists the national government in the international financial market by buying and selling currencies on behalf of the treasury.

The treasury operates in the foreign exchange market, and sometimes interferes with its functioning, when there are “excessive” fluctuations in the exchange rate of the currency. Therefore, we can say that the central bank bears the responsibility of taking measures to reduce the possibility of any international financial crisis for the country. 17.9 Link between Monetary Policy and Fiscal Policy Fiscal policy is a policy, which helps the government to meet its financial requirements and manage its finances for necessary government expenditures. Monetary policy

74%	MATCHING BLOCK 36/127	W	

refers to the policies pursued by the RBI to regulate the growth of money and credit in the economy. The two policies are interrelated as the fiscal policies determine the direction of monetary

policies, while monetary control is required for fiscal policy to be effective.

89%	MATCHING BLOCK 37/127	W	

A common feature in both policies is that they deal with regulatory mechanisms and

restrict inflation and recession in the economy. Activity 17.2 Monetary policy deals with the regulation of the money supply. Assume that you are the authority responsible for framing monetary policy in a country. While framing the policy, which instruments do you consider helpful in regulating credit?
Block IV: Macro Economics – II 14 Answer: Check Your Progress - 3 7. Which of the following types of exchange rate system is determined by the market forces? a. Fixed b. Floating c. Pegged d. Both a and b 8. Which of the following is the common feature among monetary policy and fiscal policy? a. Both deal with interest rates b. Both deal with tax rates c. Both deal with foreign exchange d. Both deal with the regulatory mechanisms 17.10 Summary ?

98%	MATCHING BLOCK 38/127	W

Monetary policy can be defined as "the deliberate effort by the central bank to influence economic activity by variations in the money supply, in availability of credit or in the interest rates, consistent with specific national objectives." ?

The objectives of

100%	MATCHING BLOCK 39/127	W

monetary policy are price stability, exchange stability, full employment and

high growth. ? The effectiveness of monetary policy is reduced when problems like time lags in implementation crop up, when financial intermediaries move in the opposite direction to the central bank, and when there are contradictions in policy objectives. ? Monetary targeting can be defined as the practice of formulating monetary policy in terms of a target growth of money stock. 17.11
Glossary Bank rate policy: The bank rate policy refers to
the rate of interest at which the
Central Bank rediscounts approved bills of exchange.
Exchange rate stability: Stability in the Exchange rate is the value of a particular country's currency in terms of another currency. It is one of the objectives of monetary policy.
Unit 17: Monetary Policy 15
Reserve Requirement: Reserve requirement is a percentage of deposits that banks must hold as vault cash or on deposit at a Federal Reserve Bank. WPI: WPI is an index

of the prices of products and services consumers buy. 17.12 Self-Assessment Test 1. Describe the problems of monetary policy. 2. Define and explain the term monetary targeting. 3. Explain the role of monetary policy in a developing economy and an open economy. 17.13 Suggested Reading/Reference Material 1. H.L.Ahuja. Principles of Microeconomics. 22 nd edition, S.Chand Publishing, 2019 2. Dwivedi D.N., "Microeconomic Theory and Applications", 3 rd edition, Vikas Publishing House, New Delhi, 2016 3. H.R. Appannaiah. Essentials of Managerial Economics. 3 rd edition. Himalaya Publishing House, 2021 4. D.M.Mithani. Macroeconomics. 1 st edition, Himalaya Publishing House, 2021 5. D.M.Mithani. Managerial Economics-Theory and Applications. 8 th edition. Himalaya Publishing House, 2021 6. H.L.Ahuja, "Advanced Economic Theory", revised edition, Sultan Chand Limited, New Delhi, 2017 7. Gaurav Datt & Ashwani Mahajan, "Indian Economy", 70thedition, S. Chand & Company Ltd., 2016 8. Sanjiv Verma. The Indian Economy (Economic Survey 2020-21 & Budget 2021-22). Unique Academy Publishers. 2021 9. V.K.Puri and S.K.Mishra. Indian Economy. 38 th edition. Himalaya Publishing House, 2021 Additional References: 1. RBI. Handbook of Statistics on Indian Economy. 2020 https://www.rbi.org.in/scripts/AnnualPublications.aspx?head=Handbook%2 0of%20Statistics%20on%20Indian%20Economy 2. World Bank open knowledge repository. India Development Update. 2020. https://openknowledge.worldbank.org/bitstream/handle/10986/34367/India- Development-Update.pdf?sequence=1&isAllowed=y 3. IMF Working Paper. Make in India: Which exports can drive the next wave of Growth? 2016.

Block IV: Macro Economics – II 16 17.14

Answers to Check Your Progress Questions 17.14.1 Model Answers to Check Your Progress Questions Following are the model answers to the Check Your Progress questions given in the Unit 1. (

d) Government spending The monetary policy of an economy operates through three important instruments, i.e., the regulation of money supply, control over aggregate credit and the interest rate policy. Government expenditure and revenues come under the purview of fiscal policy. 2. (b) It reduces the quantity of money and credit

89%	MATCHING BLOCK 40/127	W

When the central bank sells securities, it reduces the quantity of money and credit as well. Most people save their money in bank accounts. When the central bank sells securities, they withdraw money from their accounts to buy securities, which in turn reduce the cash reserves of banks. 3. (

c) Bank

100%	MATCHING BLOCK 42/127	W

The bank rate is the rate of interest at which the central bank rediscounts approved bills of exchange. 4. (

b) When the central bank increases the

98%	MATCHING BLOCK 43/127	W

reserve requirements The central bank stipulates the statutory limits of cash reserve requirements for commercial banks. It asks banks to maintain a minimum percentage of their deposits as reserves. The central bank can regulate money supply by simply changing the reserve requirements of commercial banks. 5. (

b) Action lag Usually central banks

100%	MATCHING BLOCK 44/127	W

take time in recognizing that there is a need to alter monetary policy. This is known as recognition lag. Similarly, there may be some time gap between the recognition of the need and the implementation of the policy. This is known as action lag.

98%	MATCHING BLOCK 45/127	W

Outside lag happens because monetary authorities can change money market conditions but there are other entities in the economy – consumers, firms, government, etc. which take some time to change their plans to cope with the changes. 6. (

b) The monetary policy measures in India were never influenced by

92%	MATCHING BLOCK 46/127	W

the fiscal policy The monetary policy measures in India have generally been in response to fiscal policy. It is particularly so when a sizable increase in RBI credit to government is a normal phenomenon.

100%	MATCHING BLOCK 47/127	W

In India, the monetary policy always aims at price stability and growth. This requires arriving at a balance between these two objectives, depending on the evolving situation but also making sure that the inflation remains within reasonable limits.

Unit 17: Monetary Policy 17 7. (b) Floating

100%	MATCHING BLOCK 48/127	W

Exchange rate systems are of two types: floating and fixed. In a floating exchange rate system, the exchange rate is determined by the market forces of supply and demand while in a fixed exchange rate system

81%	MATCHING BLOCK 53/127	SA	179E1150-International Economics-(SLSM).doc (D165627856)

floating exchange rate system, the exchange rate is determined by the market forces of supply and

the countries set and defend certain exchange rates. 8. (d) Both deal with the regulatory mechanisms Both the policies are interdependent and

100%	MATCHING BLOCK 49/127	W

a common feature in both the policies is that in general, they deal with regulatory mechanisms and with maneuvering the economy in periods of inflation and recession. 17.14.2

Model Answers to Exercises Following are the model answers to the Exercises given in the unit.
A. (d) Rs. 2500 crore If the

86%	MATCHING BLOCK 50/127	W

banking system has reserves of Rs. 500 crore and the reserve requirement is 20 percent. So, the system can support demand deposits upto the limit of 500/0.2 = Rs 2,500 crore.

B. (a) Rs 500 crore The

95%	MATCHING BLOCK 51/127	W

banking system has reserves of Rs 500 crore and the reserve requirement is 20 percent. So, the system can support demand deposits upto the limit of 500/0.2 = 2,500 crore. If the reserve requirement is increased to 25 percent, the system will support demand deposits only to the extent of 500/0.25 = 2,000 crore.

Therefore, banking system's capacity to support demand deposits, decreases by Rs 500 crore (Rs 2,500 crore – Rs 2,000 crore) C. (a) 20 % If the

58%	MATCHING BLOCK 52/127	W

banking system has reserves of Rs 2000 crore and the system can support demand deposits to an extent of Rs 10,000 crore. The reserve requirement

would be 2000 / 10,000 = 0.2 or 20%.
18 Unit 18 Inflation Structure 18.1 Introduction 18.2 Objectives 18.3

92%	MATCHING BLOCK 54/127	W

Types of Inflation 18.4 Sources of Inflation 18.5 Measuring Inflation 18.6 The Economic Impact of Inflation 18.7 Phillips Curve 18.8 Measures to Control Inflation 18.9

Summary 18.10 Glossary 18.11 Self-Assessment Test 18.12 Suggested Reading/Reference Material 18.13 Answers to Check Your Progress Questions 18.1 Introduction In the previous
block, we have discussed
the basics of macroeconomics. We also understood the concepts of consumption and investment function and fiscal and monetary policies. In this unit we will discuss about inflation.
Inflation can be defined as an increase in the amount of money relative to the amount of goods or services available, which in turn leads to an increase in the general price level of goods and services.
A rise in the cost of goods reduces the buying power of money over time i.e. inflation decreases the purchasing power of a rupee. Inflation can be measured by the Consumer Price Index and the Product Price Index. This unit will discuss the types of inflation, sources of inflation, methods to measure inflation and measures to control inflation. Before studying this unit student should recall the concept of aggregate demand and aggregate supply (Unit 13), costs of factors of production (Unit 8 and Unit 9) and fiscal policy (Unit 15) and monetary policy (Unit 16). 18.2
Objectives By the end of this unit, students should be able to: ?
Explain
various types of
inflation ? Identify different sources of inflation
Unit 18: Inflation 19 ? Describe different methods of measuring inflation ? Analyze the relationship between inflation and unemployment rate ? Determine suitable measures to control inflation 18.3 Types of Inflation In the words of

100%	MATCHING BLOCK 55/127	W

Keynes, "inflation refers to a rise in price level after full employment level has been achieved."

However, economists define inflation in terms of a continuous rise in prices. Brooman defines it as "a continuing increase in the general price level". Based on the degree of increase in price level, inflation is classified into three categories – creeping inflation,

walking or trotting, running inflation, and galloping or hyperinflation. Creeping inflation can be described as a situation where the rate of increase in the price level is small or gradual. Inflation rate of less than 3% is called creeping inflation. Creeping inflation encourages investment in the economy. When prices rise moderately and the annual inflation rate is a single digit at an intermediate range of 3-7% per annum or less, then it is termed as walking or trotting inflation. If prices increase rapidly for a longer period of time and is not properly controlled, it becomes running inflation. Running inflation leads to a fall in savings in the economy and hampers economic growth, if it is not controlled. In running inflation, the price increase is between 8-10 percent per annum. If monetary authorities lose control over running inflation, it becomes galloping inflation. Galloping inflation occurs when the inflation reaches double- or triple- digit figures. Exhibit 18.1: The Hyperinflationary Situation in Venezuela Latin American country Venezuela has been experiencing one of the worst hyperinflation situation in recent years. Inflation rate has been increasing in Venezuela since 2013-14 and it reached 10 Million percent in December 2019 after reaching the peak of 350000% in February 2019. As per IMF, the cumulative decline in the Venezuelan economy since 2013 reached 65% in 2019. Venezuela's current account deficit stands at -29.95% in 2019. According to UN almost 3 million Venezuelans left the country since 2014. They are now living in neighboring countries of Brazil, Columbia, Ecuador, Peru and Chile. Venezuela faced acute food shortage and in 2016 neighboring country Columbia opened its boarder for Venezuelan people to buy food items from its territory. The reason for the crisis was the result of oil crisis. Venezuela mostly produces oil and it imports all essential items from other countries. When the oil price crashed its oil export was badly affected and it led to depreciation of its currency against other currencies and it is unable to import food items. Sanctions imposed by USA and other countries over Venezuela worsened the situation. In 2017, USA imported 41% of the oil export from Venezuela. Contd....

Block IV: Macro Economics – II 20 IMF and World Bank have initiated several measures to bring down the inflation. Venezuelan Government also took measures such as bringing in higher valued currency notes, boosting digital payments to resolve cash crisis, increasing corporate tax rate, forced devaluation by removing five zeroes from its currency etc. In June 2021, the annual inflation stands at 2,719%, https://www.panoramas.pitt.edu/economy-and-development/maduro%E2%80%99s- new-solution-hyperinflation-venezuela Apart from the above, based on the factors causing price rise, inflation can be termed as demand-pull, cost-push, demand-shift, structural, markup, open and suppressed. Deflation and disinflation: Negative inflation rate is called deflation. During a period of deflation prices in the economy is falling and this shows signs of recession in the economy. Generally a period of recession demand for various goods and services are falling and this may lead to deflation in the economy. On the other hand disinflation means fall in inflation rate. For example during the month of December, 2019 inflation rate was 10% and it came down to 6% in February, 2020. This is called disinflation. Disinflation may be because of the ant inflationary policies of central bank and governments. Open inflation and suppressed inflation (repressed inflation): If the government or monetary authorizes are not controlling the spending of the people or the prices, that is called open inflation. When people get more income they spend that additional income for buying goods and services (without regulation of government) and this increases prices in the economy. This is called open inflation. On the other hand in suppressed or repressed inflation price controls like price floor or price ceiling is present in the market. Price controls may lead to hoarding of good by the traders. Headline inflation and core inflation: Headline inflation is the total inflation of the economy measured based on a basket of goods and services. Headline inflation is often called raw inflation and it measures the change in cost of living of people. On the other hand Core inflation is measured after excluding volatile goods like food and beverages (including vegetables) and fuels. These items will lead to unwarranted changes in headline inflation because of its volatile, nature. Volatile items are removed because prices of these items depends on factors outside the control of economic factors such as weather conditions, political factors etc. Anticipated inflation and unanticipated inflation: Anticipated inflation is as per expectation of the public. For example, public anticipates 8% inflation in the coming year and the same is actual inflation. Anticipated inflation will not make any change in relative prices as price of all items change in same rate. Unanticipated inflation is not as per the expectation of the public and this would
Unit 18: Inflation 21 create problem for the economy. For example if people expect inflation rate of 8% and the actual inflation rate 11%. Here the unexpected inflation is 3%. Threshold inflation: Threshold inflation is the acceptable level of inflation required for the economy. Chakravartty Committee defined it as "acceptable rise in prices purported to reflect changes in relative prices necessary to attract resources to growth sector". 18.4 Sources of Inflation The main causes of inflation are as follows: ? Inflation occurs when the aggregate demand for products exceeds the aggregate supply of products. Prices usually increase when aggregate demand is higher than aggregate supply. Put in other words, factors such

100% **MATCHING BLOCK 56/127** W

as increase in money supply, the government budget deficit, increase in export earnings, etc.

create new demand, and if supply does not match this increased demand, demand-pull inflation arises. In this type of inflation, the unemployment level is at a minimal level. ? Inflation may also occur due to increase in the cost of factors of production. The increase in the cost of factors of production results in a decrease in the supply of products by producers in the economy, or it makes producers push up the prices of their products to cover their higher costs of production. In cost-push inflation, the unemployment level may be high if high costs reduce production and thus, employment of factors of production including labor. Activity 18.1 In country A, inflation is hampering the growth of the economy. Therefore, the government wants to take measures to check it. However, the government authorities are unable to identify the causes of inflation. Can you suggest to the government authorities some possible causes of inflation, so that they can take prompt measures to curb it? Answer: 18.4.1 Aggregate Demand and Aggregate Supply

75%	**MATCHING BLOCK 62/127**	SA	Camilla_White_5010032___Economic_Environment_A ... (D157520007)

Aggregate demand (AD): Aggregate demand is the total demand for all goods and services

produced within an economy. It can be described as the relationship between the total quantity of output that consumers are willing and able to purchase at various price levels in a defined period of time. The aggregate demand curve slopes downward because of the real balances effect,

Block IV: Macro Economics – II 22 the foreign trade effect and the interest rate effect. Therefore the price effect, which is seen in the downward slope of the demand curve, is the combination of these three effects. Real balances effect: One of the important reasons for the downward slope of the aggregate demand curve is the increase in the value of a rupee with a fall in the prices of goods and services. When price falls, the value of money held by the individual increases, as he can now buy more goods per rupee. Therefore the quantity demanded automatically increases with a fall in price, other things being constant. The

76%	**MATCHING BLOCK 57/127**	W

real balances effect causes an inverse relationship between real output and price level.

Foreign trade effect or relative price effect: Another reason for the downward slope of the AD curve is the changes that occur in imports and exports. When consumers have a choice between domestic products and foreign products, they check the relative prices of products. If foreign products are cheaper than domestic products, they buy more of imported goods and less of domestic products, and vice versa. Therefore, when the relative price of the good rises, even if its actual price has not gone up, there is a decline in the quantity demanded of the good.

97%	**MATCHING BLOCK 58/127**	W

Interest rate effect: Changes in price level affect the demand for loans, which in turn affect interest rates.

A fall in the price level reduces the demand for loans because producers are not sure of selling at a profit when prices are falling. This leads in the next step to a drop in interest rates. Lower interest rates encourage people to borrow more and to make loan-based purchases leading to an increase in aggregate demand. Therefore, through the fall in interest rate, the price fall results in an increase in demand. Aggregate supply (AS): Aggregate supply is the total quantity of output supplied at every price level in an economy in a given time period.

The slope of the aggregate supply curve is always positively upward. The upward slope of the supply curve

or the positive relationship between price and quantity supplied can be explained in terms of the profit effect and the cost effect. Profit effect: A fall in the prices of goods and services leads to decrease in profits with costs remaining constant. This leads to a reduction in production or supply. Similarly, production increases if costs are constant, when there is a rise in price since more profits can be generated. Cost effect: Another factor that pushes production or supply up with an increase in price is cost. While costs remain constant in the short run, this is not true of the long run, when, all things being equal, costs begin to increase. At this point, to maintain a constant profit, producers have to know that they will get a higher price for their product. They

will increase the output only when the price of the output increases at as much as the cost of production is increasing.

Hence, the quantity of output supplied has a direct relationship with price, as seen in the upward sloping supply curve. Unit 18: Inflation 23 18.4.2 Demand-pull inflation When the demand for the output exceeds the supply available at the existing prices, then there will be a rise in the price of the output. This can be explained using a graph as in Figure 18.1. In the graph,

the shift in the AD curve towards right indicates an excess demand for goods and services at existing prices. The AD increases to Y 1 from Y o because of the shift in the AD o curve to AD 1 . But at the price level P o , the AS is Y o . Therefore the excess demand is Y 1 -Y o . To eliminate the excess demand, the price level increases to P 1 , where AD and AS are equal at Y 2 . Figure 18.1: Demand-Pull Inflation

AD 0 AD 1 AS P 1 P 0 Y 0 Y 2 Y 1 Price Level X O Y Source: ICFAI Research Center

97%	MATCHING BLOCK 63/127	W

The factors causing a shift in the AD can be classified into real and monetary factors. The real factors:

The real factors that could be responsible for the

93%	MATCHING BLOCK 64/127	W

rightward shift in an AD curve are – an increase in the government expenditure with no change in tax receipts, a decrease in the tax receipts with no increase in government

spending, and/or a

90%	MATCHING BLOCK 65/127	W

rightward shift in the consumption function, investment function and/or export function. The monetary factors:

100%	MATCHING BLOCK 66/127	W

A decrease in the demand for money or an increase in the supply of money causes a rightward shift in the AD curve. 18.4.3

Cost-push inflation Cost-push inflation occurs when

80%	MATCHING BLOCK 67/127	W

an increase in the cost of factors of production results in decrease in the supply. (

Refer Figure 18.2). When AS curve shifts leftward from AS o to AS 1 , the price level increases from P o to P 1 .

100%	MATCHING BLOCK 68/127	W

There are three types of cost-push inflation – wage-push inflation, profit-push inflation and supply shock inflation.

Block IV: Macro Economics – II 24 Figure 18.2: Cost-Push Inflation AS 1 AS 0 AD Price Level P 0 P 1 Y O X Q 1 Q 0 Quantity Source: ICFAI Research Center Wage-push inflation is a result of the increase in the money wages of the workers at a higher rate than the increase in the productivity. Profit-push inflation results from the increase in prices more than the increase in the cost of production. Here, the slice of profit has increased without any corresponding increase in productivity of the profit earner, while other factor costs have remained constant. Supply shock inflation occurs when there is a rise in the costs of raw materials or scarcity of it due to the natural calamities. Check Your Progress - 1 1. Which type of inflation occurs when the inflation reaches double- or triple- digit figures? a. Hyper inflation b. Creeping inflation c. Running inflation d. Galloping inflation 2. Which type of inflation induces investment in the economy? a. Creeping inflation b. Running inflation c. Galloping inflation d. Hyper inflation

Unit 18: Inflation 25 3. Which type of inflation can be described as a situation where the rate of increase in the price level is small or gradual? a. Hyper inflation b. Creeping inflation c. Running inflation d. Galloping inflation 4. In which of the following types of inflation, the price increase is between 8- 10 percent per annum. a. Mild inflation b. Creeping inflation c. Running inflation d. Galloping inflation 5. An increase in the salaries of the people is followed by a rise in the general price level. Which type of inflation takes place in this situation? a. Demand pull inflation b. Profit push inflation c. Wage push inflation d.

Supply shock inflation 6. ________ arises from an increase in the cost of raw materials or shortages that occur as a result of natural calamities.

a. Wage push Inflation b. Demand pull Inflation c. Supply shock Inflation d. Cost push Inflation 18.5 Measuring Inflation Inflation can be measured through the wholesale price index and the consumer price index. They are discussed in detail below: 18.5.1 Wholesale

Price Index (WPI) The wholesale price index measures the variations in the price levels of commodities that flow through the wholesale trade intermediaries. The

index helps policy makers in policy formulation and economic analysis.

The Office of the Economic Adviser (OEA) in the Ministry of Industry is responsible for compiling the wholesale price index.

The series covers 435 commodities in all. The weights assigned to the items included in the commodity basket of WPI series are based on their volume in wholesale transactions in the economy. The WPI is drawn up at frequent intervals, and therefore

76%	MATCHING BLOCK 72/127	W

continuous monitoring of the price level is possible. The non-commodity producing sector i.e. services and non-tradable commodities

are not covered in the WPI.
Block IV: Macro Economics – II 26 Example: Inflation in Germany Before World War I, Germany had a creeping inflation of one or two percent. The rate of inflation started increasing as the World War broke out. To prevent a run on the gold reserves of Germany, the Central Bank of Germany (Reichsbank) cancelled the redeemability of its notes. The Reichsbank provided assistance to the government to finance the war. The Reichsbank helped the government by discounting every issue of new treasury obligations. Thus, the government debts became a hurdle for the proper functioning of the Reichsbank. When the war came to an end, the amount of money in circulation had risen fourfold and prices by some 140%. Government expenditures skyrocketed and revenues were in gradual decline. To meet the growing deficits, larger quantities of money were printed, which in turn generated even larger deficits. Thus, the German monetary authorities were trapped in a vicious circle. 18.5.2

83%	MATCHING BLOCK 73/127	W

Consumer Price Index The consumer price index indicates the cost of living of a particular group in the population. CPI is measured on the basis of the changes in retail prices of selected goods and services on which a particular income group of consumers spend their money. There are several consumer price indices

and each index measures the retail prices of goods consumed by different segments as the consumption patterns of different groups vary. Each commodity is given a different weightage. The consumption basket data is collected from family budget surveys and the price data are obtained from retail outlets. Consumer Price Index (CPI) considers prices of both goods and service items. CPI does not include intermediate items and it considers only the price of final god s and services. Consumer price index actually reflects the cost of living of the people. In India government releases different types of CPI like CPI of industrial workers, rural areas etc. The Table below gives the Group wise CPI index for August, 2021 Table 18.1: The Group wise CPI index for August, 2021 Groups Rural Urban Combined Food and Beverages 161.9 167.6 164.0 Pan, tobacco and intoxicants 190.2 196.0 191.7 Clothing and footwear 166.3 156.4 162.4 Housing -- 162.4 - Fuel and Light 163.1 158.5 161.4 Miscellaneous 163.3 155.7 159.6 Overall 163.6 162.2 162.9 Note: 2012 is taken as base year; rural and combined CPI for housing was not compiled Source: http://mospi.nic.in/sites/default/files/CPI/State_wise_group_indices_Aug2021.pdf

Unit 18: Inflation 27 18.5.3 Producers' Price Index (PPI) It refers to the basket of indices that measures the average change in selling price received by domestic producers of goods and services over time. PPI measures price change from the perspective of a seller. It has a broader coverage of products and industries, and services, not covered by WPI. It provides a more comprehensive data than WPI. India is expediting the work to replace WPI with PPI from the fiscal year 2016 for capturing price movements and decide on policy measures accordingly. Countries like Japan, the UK, Germany, the US, Australia, Israel, Ireland, Canada, the Netherlands and Chile have adopted it for better policy targeting. Numerical Example The value of price index of a country in the year 20xx was 230 and in 20x1, it was 250. What is the rate of inflation in the year 20x1? Inflation is the rate of change in overall prices of the previous year. Let, Pt – 1 represents the price level of last year and Pt represents today's price level. Therefore, the inflation rate over the past year is given by (Pt – Pt-1)/Pt-1 = (250 –230)/200 = 0.10 or 10%. Exercise A. Given the following information, what is the rate of inflation in the year 20x5? Year Price Index Value 20x1 100 20x2 125 20x3 175 20x4 200 20x5 225 a. 12.5% b. 25% c. 125% d. 50% 18.6

The Economic Impact of Inflation 18.6.1

Effect of inflation on the distribution of income and wealth

The effects of inflation on various groups of society can be described as follows: Debtors and Creditors: Debtors are benefited by inflation as it causes a fall in the value of money they must repay in the future. The price level increases at a higher rate than the interest rates. Creditors, however, are at a disadvantage as they receive less than the amount in real terms. Producers: Inflation benefits producers as the rise in the price level is, in most cases, more than the rise in costs.

Block IV: Macro Economics – II 28

Investors: The effects of inflation on investors are based on two factors – the investor's investment in equity, and his investment in fixed income securities. Equity investments generally rise in value during inflation, benefiting investors because of the increase in equity prices. Investments in fixed income securities results in loss to investors in real terms as the real income from the investment falls. Labor force: If the labors are not able to anticipate inflation correctly, inflation will reduce their real wages (real purchasing power of wages). Labors signs the labor contracts with employers based on the expected inflation. Generally the wage contract include wage increases to compensate inflation. If the expected inflation is less than actual inflation, real wage of the labors will decline. 18.6.2

Effect of inflation on production Mild inflation encourages firms to invest more and increase the production capacity until full employment is reached. But if inflation increases further or reaches hyperinflation, production and employment generation are adversely affected. Hyperinflation adversely affects the level of production due to the following reasons: ? Savings come down due to the decrease in purchasing power, which finally leads to a fall in the capital investments. ? Maintaining large stocks during inflation reduces supply and results in the black marketing. ? Inflation brings a shift from the production of normal consumer goods to luxury goods. ? Effect of market efficiency When prices changes too often, prices will not reflect the actual market conditions as price will not provide signals to both consumers and producers. The invisible hand, often mentioned in economics, will not work and market mechanism will not allocate resources efficiently. ? Impact of inflation on the government Generally government is a gainer

of

inflation. Inflation redistributes income in favor of the rich and they are the ones who pay income tax to the government. However, during the period of hyperinflation government also suffers as tax payers have more motivation to delay the payment of taxes since the value of money decreases fast. This

is
will reduce the ability of the government to provide basic services to the public. ?
Shoe leather cost During the inflation people and firms tries to reduce cash holdings as the values of money depreciates. This compels them to hold cash in bank accounts and the need to withdraw money frequently to meet various needs. The cost of visiting the bank branches or ATMs is called shoe and leather cost. This is a type of opportunity cost.
Unit 18: Inflation 29 Check Your Progress - 2 7. Which of the following indexes does not represent the cost of living of a particular section of people? a. WPI b. CPI c. CPI-IW d. CP-AL 8. How does inflation act as a blessing for people who invest by taking loans? a. Reduction in value of loan repayment amount b. Increase in value of loan repayment amount c. Purchasing power increases d. Rise in interest rates 18.7 Phillips Curve The Phillips curve represents the relationship between inflation and unemployment rates and
indicates a trade-off between them. (Refer Figure 18.3). Policy makers can choose a particular combination of inflation and unemployment from the menu indicated by
the Phillips curve. Later economists found
that the Phillips curve was relevant only in the short run, and that there would be no trade-off in
the long run, when the Phillips curve is vertical. The vertical Phillips curve occurs because of the natural rate of
unemployment that prevails in the long run. Figure 18.3: Phillips Curve: A Trade-Off Unemployment ?P/P 5 3 2 6 Inflation Source: ICFAI Research Center The implication of this concept for inflation is that any increase in unemployment above the natural rate results in deflationary pressure. Conversely a drop in unemployment below the natural rate causes inflationary pressure in the economy. The
natural rate of unemployment is therefore the rate of unemployment below which the inflation rate tends to increase and above which the inflation rate tends to decrease.
The natural rate of unemployment prevails
when the actual rate of inflation is equal to the expected rate of inflation. In the long run, the Phillips curve is a vertical line positioned at the natural rate of unemployment.
Block IV: Macro Economics – II 30 The concept of Stagflation: It refers to the paradoxical combination of an economy experiencing unemployment along with a high rate of inflation. It is therefore also called inflationary recession. In U.S., it is measured in terms of ‘discomfort index’. 18.8 Measures to Control
Inflation The measures to control inflation can be classified into monetary, fiscal and other measures. Example: Measures to control inflation The Reserve Bank of India raised its key repurchase agreement rate by a quarter percentage point to 4.75 percent, to check inflation that has hovered at multiyear highs in recent months. The central bank’s policy emphasizes growth as well as price stability. The bank said it would also emphasize provision of appropriate liquidity to meet credit growth and support investment and export demand, without neglecting price stability. 18.8.1
Monetary measures Monetary policy is framed by the central bank of a country. The central bank is required to regulate the money supply in the economy in order to control the rate of inflation. Quantitative and qualitative measures are used to control the money supply. Quantitative credit control measures are
in the form of bank rate policy, open market operations and variable reserve ratio,
which influences the cost and availability of credit in an economy. The cash reserve ratio is the most significant monetary control measure and a high cash reserve ratio requirement reduces the capacity of the banks to lend. Qualitative or the

selective control measures include the regulation of consumer credit, directives, moral persuasion, publicity, etc. to control monetary expansion in the economy. 18.8.2

Fiscal measures Some of the fiscal measures to control inflation are public expenditure, taxation and public borrowing. Public expenditure: A decrease in the public expenditure by the government can control the inflation rate. The public expenditure should not be reduced in productive areas, but should be cut in the non-productive areas.

Taxation: The amount of disposable income depends on the taxation policy of the government. The imposition of direct or indirect taxes reduces the purchasing power of the people. Anti-inflationary taxation should reduce that part of the disposable income which would otherwise have been spent on consumption.

Unit 18: Inflation 31

Public borrowing: During inflationary periods, government can start special saving programs to take away the extra purchasing power which would otherwise increase pressure on demand. Similarly, government can offer bonds to public at attractive interest coupon rates.

Activity 18.2 Assume that your are a member of the finance department in the government. If inflation is hindering the development of the economy, what measures would you adopt to control the inflation? Answer: Activity 18.3 What do you understand by inflation? Do you think that fixed income earners like pensioners are the worst sufferers during inflation? Explain why or why not? Answer: 18.8.3

Other measures Price control and rationing: Price control is a situation where the government fixes an upper limit on the prices of goods and services. Rationing helps in distribution of essential goods evenly among the people. Wage policy: The government can undertake certain steps like restriction of additional benefits offered to employees, their salaries, etc. to control excess demand, which results from high disposable income.

Check Your Progress - 3 9. Which are the variables that are important in Phillip's curve? a. Inflation and money supply b. Consumption and savings c. Consumption and investment d. Inflation and unemployment

Block IV: Macro Economics – II 32 10. _______________

is the rate of unemployment below which the inflation rate tends to increase and above which the inflation rate tends to decrease.

a. Natural rate of unemployment b. Actual rate of unemployment c. Disguised unemployment d. Frictional unemployment 11. Which of the following is an anti-inflationary fiscal policy? a. Reduce taxes b. Decrease in public borrowing c. Decreasing Public expenditure d. Increasing public expenditure 18.9

Summary ? Inflation can be defined as an increase in the amount of money relative to the amount of goods or services available, which in turn leads to an increase in the general price level of goods and services. Based on the degree of the increase in price level, inflation is classified into three categories – creeping inflation, running inflation, and galloping or hyper-inflation. ?

Demand increasing factors such as increase in money supply, the government budget deficit, and increase in export earnings, etc. cause inflation and this type of inflation is termed as demand-pull inflation. Inflation also may occur due to the increase in costs of factors of production, and this type of inflation is called cost-push inflation. ?

90%	MATCHING BLOCK 75/127	SA	Camilla_White_5010032___Economic_Environment_A ... (D157520007)

Aggregate demand is the total demand for all goods and services

produced within an economy.

97%	MATCHING BLOCK 74/127	W

The aggregate demand curve slopes downward because of real balance effect, foreign trade effect and interest rate effect. Aggregate

supply is the total output supplied at every price level in an economy in a given time period. ? Inflation can be measured through wholesale price index and consumer price index.

The measures to control inflation can be classified into monetary, fiscal and other measures. 18.10

Glossary Cost-push inflation: Inflation originating on the supply side of markets from a sharp increase in costs. Also called supply-shock inflation. Demand-pull inflation: Price inflation caused by an excess demand for goods in general, caused, for example, by a major increase in aggregate demand. Equity: May be used in either of two unrelated senses. In the context of income distribution theory, refers to an objective, goal or principle implying "fairness". In a financial context may refer to a share or portion of ownership.

Unit 18: Inflation 33 Government debt: The total of government obligations in the form of bonds and shorter-term borrowings. Natural rate of unemployment: The rate of unemployment that would exist when the economy is operating at full capacity. 18.11 Self-Assessment Test 1. Describe demand-pull inflation and cost-push inflation. 2. What are the tools that measure the inflation rate? 3. What is the impact of inflation on the economy? 4. Explain the Phillips curve. 18.12 Suggested Reading/Reference Material 1. H.L.Ahuja. Principles of Microeconomics. 22 nd edition, S.Chand Publishing, 2019 2. Dwivedi D.N., “Microeconomic Theory and Applications”, 3 rd edition, Vikas Publishing House, New Delhi, 2016 3. H.R. Appannaiah. Essentials of Managerial Economics. 3 rd edition. Himalaya Publishing House, 2021 4. D.M.Mithani. Macroeconomics. 1 st edition, Himalaya Publishing House, 2021 6. D.M.Mithani. Managerial Economics-Theory and Applications. 8 th edition. Himalaya Publishing House, 2021 7. H.L.Ahuja, “Advanced Economic Theory”, revised edition, Sultan Chand Limited, New Delhi, 2017 8. Gaurav Datt & Ashwani Mahajan, “Indian Economy”, 70thedition, S. Chand & Company Ltd., 2016 9. Sanjiv Verma. The Indian Economy (Economic Survey 2020-21 & Budget 2021-22). Unique Academy Publishers. 2021 10. V.K.Puri and S.K.Mishra. Indian Economy. 38 th edition. Himalaya Publishing House, 2021 Additional References: 1. RBI. Handbook of Statistics on Indian Economy. 2020 https://www.rbi.org.in/scripts/AnnualPublications.aspx?head=Handbook%2 0of%20Statistics%20on%20Indian%20Economy 2. World Bank open knowledge repository. India Development Update. 2020. https://openknowledge.worldbank.org/bitstream/handle/10986/34367/India- Development-Update.pdf? sequence=1&isAllowed=y 3. IMF Working Paper. Make in India: Which exports can drive the next wave of Growth? 2016.
Block IV: Macro Economics – II 34 18.13

Answers to Check Your Progress Questions 18.13.1 Model Answers to Check Your Progress Questions Following are the model answers to the Check Your Progress questions given in the Unit 1. (

d) Galloping inflation If monetary authorities lose control over running inflation, it becomes galloping inflation. Galloping inflation occurs when the inflation reaches double- or triple-digit figures. 2. (a) Creeping inflation When the rate of inflation is small and gradual, it is known as creeping inflation. This results in small increases in prices, giving rise to investments in the economy. 3. (b) Creeping inflation Mild or creeping inflation can be described as a situation where the rate of increase in the price level is small or gradual. 4. (c) Running inflation In running inflation, the price increase is between 8-10 percent per annum. 5. (c) Wage push inflation With the increase in salaries/wages, the cost per unit of output increases. This increase in the cost of production forces producers to increase the price of the product so that their profit margin does not get affected. Thus, there is a general rise in the price level in the economy. 6. (c) Supply shock inflation Inflation that is a result of the price rise brought about by any natural calamity is known as supply shock inflation. A natural calamity like drought or flood, results in shortages of goods, giving rise to inflation. 7. (a) WPI The wholesale price index (WPI) indicates the price movement with the wholesale intermediaries whereas all other indexes are directly associated with consumers and reflect the cost of living for consumers. 8. (a) Reduction in value of loan repayment amount When prices are increasing, the real value of money comes down. The amount of goods and services that a person can buy with Rs 100 today will come down after some time when the economy is facing inflation. During inflation, when a person repays his loan, there is a reduction in the real value of the money as the purchasing power of money is comparatively low during the inflation period. In other words, the real purchasing power of money reduces.

Unit 18: Inflation 35 9. (d) Inflation

and unemployment Though the original Phillips curve identified the relationship between the change in wage rates and unemployment rates,

the modified Phillips curve indicates the relationship between inflation and the unemployment rate. According to A. W. Phillips, an inverse relationship exists between unemployment and the changes in money wages. He said that wages rise when unemployment is low and vice versa. 10. (a) Natural rate of unemployment To understand how the Phillips curve is vertical, the concept of natural rate of unemployment was developed. This says that at the natural rate of unemployment, inflation can either

accelerate or decelerate. This is the unemployment rate that exists when the actual rate of inflation is equal to the expected rate of inflation. 11. (

c) Decreasing

public expenditure A decrease in the public expenditure by the government can control the inflation rate. 18.13.2

Model Answers to Exercises Following are the model answers to the Exercises given in the unit.

A. (a) 12.5% Inflation is the rate of change in overall prices of the previous year. If Pt – 1 represents the price level of last year and Pt represents today's price level, then the inflation rate over the past year is given by (Pt – Pt-1)/Pt-1 = (225 – 200)/200 = 0.125 or 12.5%.

Unit 19 International Trade and Balance of Payments Structure 19.1 Introduction 19.2 Objectives 19.3

Basis of International Trade 19.4 Barriers to International Trade 19.5 Trends in International Trade 19.6 World Trade Organisation 19.7 Balance of Payment and its Components 19.8 Causes and Types of Disequilibrium in BoP 19.9 Methods of Correcting Disequilibrium 19.10

Exchange Rate
Policy 19.11 India's Balance of Payment and Trade Policy 19.12 Foreign Exchange Reserves 19.13
Summary 19.14 Glossary 19.15 Self-Assessment Test 19.16 Suggested Readings/Reference Material 19.17 Answers to Check
Your Progress Questions 19.1 Introduction The previous unit
was about inflation, its types, causes and the measures to control the inflation. This unit will discuss about an entirely different and new concept - international trade.
International trade is one of the determinants of the financial and economic status of a country. Through international trade, a country can export surplus goods to countries that lack these products and import goods that it lacks from some other country, which has surplus of it. This results in economic development of both the countries involved in the trade.
There are two schools of thought on international trade. One school
of thought is in favor of free trade, while the other advocates protectionism. Proponents of protectionism are of the view that the domestic country should develop its own industries independently, without being subjected to foreign competition. The advocates of free trade propose that international trade offers more opportunities for a country for rapid economic growth. Many governments impose certain restrictions on free international trade by levying import tariffs and setting up non tariff barriers to regulate trade with other countries.
Unit 19: International Trade and Balance of Payments 37
In this unit, we will discuss the basis of international trade, the significance of international trade and the various barriers to international trade. 19.2
Objectives By the end of this unit, students should be able to: ?
Explain
various theories of international trade ? Discuss various barriers to trade ? Define the concept of balance of payments and its components ? Describe the causes and types of disequilibrium in balance of payments ? Analyze methods of correcting disequilibrium ? Evaluate different exchange rate policies 19.3

Basis of International Trade Theorists have developed different theories of international trade. During 16th and 17th centuries, Mercantilism supported the idea of boosting exports and reducing imports for the best interest of a country. The idea laid emphasis on maintaining a trade surplus, i.e. to export more than import and this boosted intervention of the government to achieve a surplus in the trade balance. It witnessed trade as a zero-sum game (one in which a gain by one country results in a loss by another). Mercantilism is not economically valid for its problematic approaches, still, today many political views aim at boosting exports and limiting imports by seeking only selective liberalization of trade. Adam Smith, in 1776, promoted the idea of unrestricted free trade. He disagreed with the mercantilist notion that supported assume trade is a zero-sum game. Smith argued that every country differs in their ability to produce goods and a country has an advantage in the production of a product when it is more efficient than any other country in producing it. In the 19th century, David Ricardo built on Smith ideas, and in the 20th century, Eli Heckscher and Bertil Ohlin refined Ricardo's work. 19.3.1 Theory of absolute advantage Adam Smith proposed the Theory of absolute advantage in 1776. According to this theory, a country could experience absolute advantage when it produces a product more economically than other countries. The theory proposes that a country, which enjoys an absolute advantage in the production of certain goods, should export its surplus of those goods and import those goods, which are needed by the country. It results in specialization and increased productivity. However, this theory has certain drawbacks. The theory has many assumptions e.g. that transportation costs that are incurred in moving a good to another country are insignificant, and that exchange rates are stable due to similar levels of inflation across countries, and these assumptions may not always be valid.
Block IV: Macro Economics – II 38 19.3.2
Theory of comparative advantage

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David Ricardo, an English economist developed the theory of comparative advantage. Ricardo opines that

countries, which are involved in international trade, can improve their national welfare through this trade,
provided each has comparative advantage in the production of one good over the other
country. Put in other words, this conveys that two countries would still be benefited by engaging in international trade though one country has absolute advantage in

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the production of all products. The theory advocates that a country should be involved in the production of those goods in which it has comparative advantage.

The theory supports the view that a country will be better off by producing the goods in which it has lower relative labor costs or higher relative labor productivity.
For instance, if country A produces cotton and wheat both at a cheaper cost than country B, it may still be beneficial for country A to engage in international trade with country B. This can be understood better with the help of Table 19.1. If

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country A incurs 10 man hours to produce 1 ton of cotton and 15 man hours to produce 1 ton of wheat, and country B incurs 20 man hours to produce 1 ton of cotton and 16 man hours to produce 1 ton of

wheat, then country A should produce only cotton and exchange them for 1 ton of wheat and country B should produce only wheat and exchange them for 1 ton of cotton. By doing so, country A can obtain 1 ton of wheat at the cost of 10 man hours instead of 15 man hours that is required to produce 1 ton of wheat.

Table 19.1: Labor Costs Per Ton (in hours) Country Cotton Wheat A 10 15 B 20 16

According to the economic law of comparative advantage, every country benefits when specialization takes place and they engage in international trade. However, this theory has its own share of limitations. Comparative advantage dismisses non-bilateral economies. This means the varied characteristics of economies may not be able to follow Ricardo's Neo classical theory. One advantage inflationary pressures can be mitigated by this method of trade. 19.3.3 Haberler's Opportunity Cost theory Gottfried Haberler formulated the theory on international trade by reinterpreting the doctrine of comparative costs in opportunity costs terms. His paper on opportunity cost was published in the year 1929.

According to this theory, the cost of the commodity is the amount of second commodity that must be given up to release enough resources to produce just one unit of the first commodity.

Thus, a nation with a lower opportunity cost in the production of a commodity has a comparative advantage in that commodity. If one nation has a lower opportunity cost on product X and another on product Y, then, as per this theory, exchange or trade can take place.

Unit 19: International Trade and Balance of Payments 39 19.3.4

Heckscher-Ohlin Theory (Factor Endowment theory) Eli Heckscher and Bertil Ohlin in the 1920's developed the Heckscher-Ohlin theory in the 1920's. It is based on certain assumptions such as: ?

No obstructions to trade ? Both commodity and factor markets are perfectly competitive ?

Constant returns to scale exists ? Countries involved in trade possess

the same technology and operate at the same level of efficiency ? The two factors i.e. labor and capital are immobile in inter country transfer but mobile in inter sector transfer The theory states that there are two types of products – labor intensive and capital intensive. A country which possesses abundant labor resources produces labor intensive goods, whereas the country rich in capital resources produces capital intensive goods. When these two countries engage in trade with each other, they are mutually benefited. Limitations: The assumption that factors of production are fixed is not true as they can be developed through innovation in the long run. A labor rich country may find it economical to import labor intensive goods rather than producing them locally when minimum wage laws are imposed that influences the labor cost. Highly unlikely in practice – countries fix minimum wage laws taking account of factor availability and producers' preferences, apart from minimum needs of wage earners. Minimum wage is never so high in a labor-abundant country as to reduce employment of labor. 19.3.5 Imitation – Gap Theory Posner developed the imitation-gap theory. This theory considers the possibility of trade between two countries having the same factor endowments and consumer tastes. It states that innovation and inventions in existing products give rise to trade between the countries. The degree of trade between the countries is based on the difference between the demand lag and the imitation lag. Demand lag is the difference between the time when a new or modified product is introduced in one country and the time when consumers in the other country start demanding it. Imitation lag is the difference between the time when a product is launched in one country and the time when producers in the other country start producing it. Trade does not take place when the imitation lag is shorter than the demand lag. But generally, the demand lag is shorter than the imitation lag. There may be a fall in exports of the country which produced the new product as trade slows down at the end of the imitation lag. However, another innovation or launch of a new product can avoid fall in exports.

Block IV: Macro Economics – II 40 19.3.6

International product life cycle theory Raymond Vernon has proposed the international product life cycle theory, which relates the different stages of the life cycle of a product to trade between countries. The theory takes into account two factors – technological innovation and market structure. The theory is based on two principles. They are: ? Technological innovations lead to new product development. ? Trade patterns are affected by the market structure and the product life cycle stage of the traded product. In the early stages of the product life cycle, the country which has started the innovation would manufacture and export the new product. In the second stage, other developed countries, which possess abundant resources catch up with the production of the new product

and thus offer a cost advantage. In the final stage, less developed countries

start producing the product and the country from which the innovation originated, becomes the importer. The product life cycle theory provides a perfect description of what has happened for high technology products developed in the US in the 1960s and 1970s, however, in today's world, this theory is less valid when the increasing globalization and integration of the world economy is taken into consideration. These days, several new products are initially familiarized in Japan or Europe, or are introduced simultaneously in countries like Japan, U.S., and Europe. Sometimes, products are circulated to various locations that are considered most favorable for the products. Check Your Progress - 1 1. Which

theory proposes that a country could be better off by producing the product in which it has relatively lower

labor cost and relatively higher labor productivity? a. Absolute advantage theory b. Relative advantage theory c. Comparative advantage theory d. Imitation theory 2. Which of the following theories give more importance to technological innovation and market structure? a. Imitation Gap theory b. Comparative advantage theory c. Absolute advantage theory d. International Product Life Cycle theory

Unit 19: International Trade and Balance of Payments 41 3. Which theory propagates that the improvement in technology is a continuous process and the resulting inventions and innovations in existing products give rise to trade between two countries? a. Absolute advantage theory b. Comparative advantage theory c. Heckscher-Ohlin theory d. Imitation gap theory 4. Which theory explores
the possibility of two nations operating at the same level of efficiency, benefiting by trading with each other?
a. Absolute advantage theory b. Comparative advantage theory c. Heckscher-Ohlin theory d. Imitation Gap Theory 19.4 Barriers to International Trade Governments impose barriers to regulate international trade and protect domestic firms from foreign competition. These barriers take two forms – tariffs and non-tariff barriers. 19.4.1 Tariffs Tariffs depend upon the relationship of the country with its trading partner. Tariffs are of three types –
ad valorem duties, specific duties and compound duties. Ad valorem
duty is a percentage of the value of the product collected as tax. A specific duty is a fixed amount of money
per unit of good traded irrespective of the value of the individual unit.
Compound duties are the combination of both specific and ad valorem duties. A revenue tariff is imposed on imports of goods, which are not produced by domestic producers. A prohibitive tariff is a very high tariff imposed to stop all imports of the good. 19.4.2 Non-tariff barriers Non-tariff barriers are rules, laws or regulations which restrict imports. Some of the common types of non-tariff barriers are: Quotas: Quotas are restrictions imposed on the quantity of goods imported or exported. The main purpose of import quotas is to protect the domestic companies from foreign competition. The objective of export quotas is to protect the economy from excessive exports of specified goods. Embargoes are quotas that completely eliminate trade in certain products.
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Subsidies: Domestic players get support from the government through subsidies to make their products globally competitive. By providing a subsidy to domestic players, the government at a later point enjoys increased foreign exchange and tax revenues. Licensing: Here, importers and exporters cannot import or export certain goods unless they obtain licenses from the authorities concerned. Complying with the WTO requirements, India has recently moved close to 1000 items from the category requiring license to the Open General Licenses (OGL) list. Administered protection: Administered protection includes government regulatory actions in terms of health and product standards, and customs procedures. Health and safety standards: As international organizations take an active role in international trade, they are setting certain standards for trade. The goods which fail to meet the standards would be rejected. An emerging overview about the types of products that are to be traded and the countries involved in trade has been developed by the patterns of international trade. The variations in the trade patterns and the reasons behind the changes provide understanding about the upheavals in the economic environment and trade policies of nations. Factors in macroeconomics affect the international flow of goods and services in the trading countries and the overall world economic environment. Hence, past international trade patterns reveal crucial information about macro-economic environment and its fluctuations. Activity 19.1 Due to worldwide liberalization policies, domestic companies are facing stiff challenge from foreign companies. In such a scenario, Country A partially liberalized its economy and wanted to allow foreign competition in the automobile sector. However, the domestic players in the country were not prepared for it. Therefore, they took this issue to the finance minister and convinced him of the need to protect the sector from foreign competition for some more time by raising certain barriers. What are the various barriers that country A can erect to protect the domestic firms from foreign competition assuming that Country A has no prior barriers to international trade?

Answer:

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Check Your Progress - 2 5. What type of quota does a country impose to reduce the exports of a particular product? a. Embargoes b. Export quota c. Import quota d. Customs duty 6. ___________ includes government regulatory actions in the nature of health and product standards and customs procedures. a. Imposing tariffs b. Administered Protection c. Subsidies d. Licensing 7. How can a government restrict the volume of imports into a country? a. Tariffs b. Quotas c. Subsidies d. Regulations in trade policies 8. What are provided to domestic producers to make their products globally competitive? a. Export Quotas b. Import Quotas c. Subsidies d. Licensing 19.5 Trends in International Trade Countries across the world have realized the importance of international trade and are taking steps to remove

trade barriers.

The General Agreement on Tariff and Trade (GATT) was initiated in 1947

by industrialized countries to remove trade barriers,

and later it was transformed into WTO. World Trade Organization and other regional associations were established to remove trade barriers. Some countries have also entered into bilateral and multilateral agreements (trade blocs) to eliminate tariff and non-tariff barriers to ensure free flow of goods, services and investments.

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Example: China's Entry into the WTO In the last two decades, China has experienced rapid growth in foreign trade and investment. China's entry into the WTO further strengthened this growth and the country is fast transforming itself into a market-based economy. In fact, China is one of the world's leading exporters, and also the biggest single destination for foreign investment among developing countries. China is lifting its trade barriers. Other members of the WTO are trying to get a share of sectors, which were previously restricted in China. China has also reduced tariffs on a range of goods entering the country, from agricultural products to engineering goods. 19.5.1 Closed economy A closed economy is a country which has minimal interaction with other countries of the world i.e., imports, exports, and foreign capital flows are at a minimum. 19.5.2 Open economy An open economy is an economy which interacts with other nations to exchange goods, services, and investments. The main reasons why economies open up for international trade are: ? Unequal distribution of natural resources- The availability of natural resources differs from country to country. ? Technology requirements- The level of technological development varies between countries. ? Cost advantages- The cost of production of various products differs based upon the local conditions in different countries. 19.5.3 Economic Integration Economic integration helps strengthen trade between open economies. This helps in the economic development of these countries. Regional Trade Agreements (RTAs) between countries play an important role in economic integration. The significant developments in the nature of RTAs are given here. ? Many countries have realized that the flow of goods, services, investments, and ideas between countries is facilitated not just by the removal of tariffs and quotas, but by a wide range of policy measures. ? The trend is moving away from 'closed regionalism' toward a more open association that promotes international trade. ? Another development is that in recent times developed and developing economies are coming together in RTAs to facilitate growth across the developed-developing divide.

Proponents of RTAs argue that RTAs facilitate progress toward free trade worldwide by giving domestic industries in member countries of RTAs some time to adjust to competitive pressures. 19.5.4 Forms of Economic Integration Based on the level and nature of integration, RTAs can be classified into four categories. They are: free trade area, customs union, common market, and economic union. Free trade area: Trade barriers do not exist between the member countries in a free trade area. However, each of the member country determines trade policies that are to be followed with non-member countries.

Customs union: There are no internal trade barriers among the member nations in the

customs union. Apart from eliminating internal barriers to trade among them, the member countries establish certain common external barriers. Common market: In a common market, member countries not only allow free flow of goods, but also allow factors of production like labor and capital to move between member countries. Economic union: The member countries of economic union operate under well- coordinated fiscal and monetary policies. A completely evolved economic union involves the creation of a central bank, common currency, common economic objectives among member countries, etc. European Union (EU) is the association that comes closest to the requirements of an economic union. 19.5.5 Examples of trade blocs North American Free Trade Area (NAFTA): NAFTA was formed in 1993, when Mexico joined the free trade agreement along with USA and Canada. The objective of NAFTA is to eliminate barriers in order to ensure free flow of goods, services and investment among the three nations. Example: NAFTA The North American Free Trade Agreement (NAFTA) came into force on January 01, 1994 to promote trade between Mexico, US and Canada. The formation of NAFTA led to the lifting of trade barriers between USA, Canada and Mexico. Many US companies made long-term investments in Mexican factories and businesses. As trade barriers between the countries were lifted, Mexican exports increased.

Association of South East Asian Nations (ASEAN): ASEAN was formed in 1967
through the Bangkok declaration signed by Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand, Myanmar and Vietnam. It aims at creating free trade area among member nations. Southern Cone Common Market (MERCOSUR): MERCOSUR was formed
in 1991 by Argentina, Brazil, Paraguay and Uruguay to set a common market for goods, services, capital and labor.
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The European Union (EU): European Economic Community was established in March 1957 after the signing of the Treaty of Rome. Over a period of time, more nations joined the trade bloc. At present, the membership stands at 15 and the group is known as the European Union. The group initially operated as a customs union, but it was later transformed into a common market. The trade bloc is slowly progressing towards becoming an economic union with establishment of common Central Bank and the common currency 'euro'. This development has further enhanced the growth of international trade. South Asian Free Trade Area (SAFTA): SAFTA was formed in 1985 with the association of India, Pakistan, Bangladesh, Nepal, Bhutan, Maldives and Sri Lanka. The main objectives of SAFTA are to prompt economic growth and development in South Asia and to strengthen cooperation among member countries at international forums. 19.6 World Trade Organisation World Trade Organization (WTO) is relatively a new institution formed in the year 1995, by replacing the earlier body called GATT (General Agreement on Tariff and Trade), which was established in 1947. Replacing GATT with WTO was an attempt to create more straight forward negotiations for global free trade. It deals with the rules of trade between nations. The WTO provides a forum for negotiating agreements aimed at reducing obstacles to international trade and ensuring a level playing field for all. WTO aims at opening of national markets to international trade, with adequate flexibilities, and contributes to sustainable development, raise economic welfare, reduce poverty, and foster peace and stability in the world. WTO also makes sure that, such market opening will be accompanied by sound domestic and international policies. They contribute to economic growth and development according to each member country's needs and aspirations. WTO is situated in Geneva, Switzerland. As of June 26, 2014, WTO has 160 countries as its members, of which 117 are developing countries or separate customs territories. It is headed by Director General. The WTO is a 'member- driven', and decisions are taken by the common consensus of the member countries. The apex institutional body is called Ministerial Conference which usually meets once in every two years. Between ministerial conferences, General Council body meets and conducts the organization's business. 19.6.1 Functions of WTO ? Administering WTO trade agreements made by member countries ? Facilitating trade negotiations ? Handling trade disputes arising between countries ? Monitoring national trade policies of member countries ? Providing technical assistance and training to developing nations and ? Cooperation with other international organisations
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Agenda topics in the WTO ministerial conferences' include (i) Goods such as agriculture negotiations, anti-dumping rules, subsidies etc., (ii) Services (iii) Intellectual property (iv) Dispute settlement (v) Doha development agenda (vi) Building trade capacity (vii) trade monitoring and other related topics. WTO agreements are negotiated and signed by the majority of the member countries and these documents provide the legal ground rules for international commerce. These are essentially contract agreed and signed by the member governments to keep their trade policies within agreed limits. The objective of these agreements is to see that they help producers of goods and services, exporters and importers conduct their businesses smoothly. Main advantage of WTO common consensus system is decisions made are more acceptable to all members. Though WTO is criticized by many saying that it is dominated by developed nations like USA and EU, and despite this difficulty it has reached some remarkable agreements. 19.6.2 Ministerial Conferences' held since WTO's inception First Ministerial Conference: Singapore, 9-13 December 1996 The first inaugural conference meeting was held in Singapore in 1996, the objective was to ? Review the ongoing negotiations ? Examine the developments in trade ? Assess the commitments under the WTO agreements and decisions Second Ministerial Conference: Geneva 18-20 May 1998 The second ministerial conference was held in Geneva, when the fiftieth anniversary of its establishment was being commemorated, the success of GATT was acknowledged in terms of its contribution to world's economic growth, employment and stability by promoting the liberalization and expansion of trade. Third Ministerial Conference: Seattle, November 30-December 3, 1999 The third ministerial conference was held in Seattle, USA. Many issues especially, relating to developing countries were discussed, the topics included were: ? Allowing developing countries more flexibility in applying food, animal and plant health and safety (SPS) measures to their products ? Greater market access to developed nations in exporting agricultural commodities, and ? Issues related to textiles and clothing The negotiations were marred by poor organization and controversial management of large street protests. The representatives of developing countries became uncooperative on being excluded from the talks.
The United States and

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the European Union attempted to finalize the deal on agriculture and the negotiations collapsed. Fourth Ministerial Conference: Doha, 9-13 November 2001 The fourth ministerial conference was held in Doha. The issues which could not get common consensus were brought for the discussions in Doha round. In the conference, trade ministers agreed to create a new round of multilateral trade negotiations. They passed two declarations. They were: ? Doha Development Round, which was meant for on-going negotiations in agriculture and services and ?
Agreement on Trade-Related aspects of Intellectual Property Rights (TRIPS)

A series of meetings between ministers failed to break the deadlock and it was expected that all members would reach consensus on how to complete the remaining agreements. However, the meeting got stuck because of the discord created by agricultural issues. Fifth Ministerial Conference: Cancun, 10-14 September 2003 The fifth ministerial meeting was held in Cancun, Mexico, the objective was: ? To set a direction among nations to come to agreements and negotiations on agriculture and non-agriculture market access, special treatment for developing nations The agreement had set a date to come to terms, Cancun conference ended up failing in their mission and could not come to any firm decisions to solve the problems. Sixth Ministerial Conference: Hong Kong, 13-18 December 2005 The sixth ministerial meeting was held in Hong Kong. In this meeting some important decisions were taken under common consensus. ? Countries agreed to phase out their agricultural export subsidies by the end of 2013 ? Terminating any cotton export subsidies by the end of 2006 ? Further concessions to developing countries included an agreement on to introduce duty free and tariff free access for goods from least developed nations. Seventh and the Eighth Ministerial Conferences: Geneva, 30 November-2 December 2009 The seventh and the eighth ministerial conferences were held in Geneva. The seventh ministerial conference had given importance to transparency and open discussion rather than small group processes and informal negotiating processes. The general theme for the discussion was on Multilateral Trading System and the current global economic environment. In the eighth ministerial conference

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membership agreements were made on inclusion of Russia, Samoa, and Montenegro. The consent of Russia`s membership was seen as an important development. Ninth Ministerial Conference: Bali, 3-6 December 2013 The ninth ministerial conference was held in Bali, Indonesia. The majority of the WTO members agreed to the Bali Package which aims to ease trade barriers to international trade. This was a significant meeting where majority of the countries agreed to lower the trade barriers; this was in fact a part of Doha Development Round in 2001. Tenth Ministerial Conference The General Council of WTO, on 10 December 2014, agreed that the 10th Ministerial Conference be held in Nairobi, Kenya from 15 to 18 December 2015. The completion of Afghanistan and Liberia's accession to the WTO was on the agenda. It concluded in the adoption of the Nairobi Package, a series of six Ministerial Decisions on agriculture, cotton and issues related to least- developed countries (LDCs). Eleventh Ministerial Conference Eleventh Ministerial Conference was held in Buenos Aires, Argentina, from 11 to 13 December 2017. The Conference ended with a number of ministerial decisions, including on fisheries subsidies and e-commerce duties, and a commitment to continue negotiations in all areas. Twelfth Ministerial Conference The next twelfth ministerial conference is scheduled for June 8-11, 2020 in Nur- Sultan, Kazakhstan which was signed on October 30, 2019. Due to the Pandemic, the conference was delayed and re-scheduled from November 30 th to December 3 rd , 2021 in Geneva, Switzerland. Check Your Progress - 3 9. In which of the following types of trading blocs are external barriers present for non-member countries and internal barriers absent for member countries? a. Free Trade Area b. Customs Union c. Common Market d. Economic Union 10. What is the advantage of a free trade area? a. No barriers to trade for member countries b. Common currency for member countries

Block IV: Macro Economics – II 50 c. Common political and foreign policy d. Common external trade policy 11. In a _________, each of the member country determines trade policies that are to be followed with non-member countries. a. European union b. Customs union c. Free trade area d. Common market 19.7 Balance of Payment and its Components

The sixth edition of the Balance of Payments and International Investment Position Manual (BPM6) of the International Monetary Fund (IMF) defines the Balance of Payments (BoP) as a statistical statement that summarizes economic transactions between residents and non-residents during a specific time period. It records all international transactions comprising both visible (merchandise) and invisible (services and remittances) goods, similar to that of double-entry system of accounting. The BoP, thus, includes all transactions showing: (a) Transactions in goods, services and income between an economy and the rest of the world, (b) Changes of ownership and other changes in that economy's monetary gold, special drawing rights (SDRs), and financial claims on and liabilities to the rest of the world, and (c) Unrequited transfers. These transactions are categorised into (i) the "current account" including "goods and services", the "primary income" and the "secondary income", (ii) the "capital account" and (iii) the "financial account". (i) Current account: This is an important segment of BoP. It covers all transactions (other than financial items) that are involved in satisfying the economic needs of a nation directly. In other words, it covers all transactions that involve economic values. This account is distinguished as: ? Goods and services account (or trade account): Involves the flow of goods (merchandise) and invisibles (services) between the residents and non-resident entities. The invisibles are further classified into: (a) Services - travel, transportation, insurance, Government Not Included Elsewhere (GNIE) and miscellaneous (such as communication, construction, financial, software, news agency, royalties, management and business services etc.).

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b) Income (investment income & compensation of employees) - Investment income covers receipts and payments of income associated, respectively, with residents' holdings of external financial assets and with residents' liabilities to non-residents. Investment income consists of direct investment income, portfolio investment income, and other investment income. (c) Current Transfers (grants, gifts, remittances, etc.) which do not have any quid pro quo. ? Primary income account: It reflects the amount payable and receivable in return for providing temporary use of labour, financial resources, or non-produced non-financial assets (natural resources). ? Secondary income account: Also known as unilateral transfers, it shows the redistribution of income between the residents and non-residents. Here, resources for current purposes are provided without an economic value being exchanged in return (transfers). Thus, the current account is much broader than just the merchandise trade. The net effect of all transactions under this account is termed as 'current account balance'. In short, it provides the inflows and outflows of foreign resources from exports and imports respectively and is an indicator of the savings-investment gap in the economy. In India, current account deficit is the most worrying factor, mostly caused by trade deficit, partly offset by net exports of services and net receipts from transfers. For instance, in fiscal year Q2 2018-19, India's CAD at US$ 35.1 billion surged to a four year high of 2.7% of GDP. As per the 5th edition of the revised Balance of Payments Manual given by the International Monetary Fund, the former capital account has been redesigned as capital account and financial account. (ii) Capital account: It comprises- ? Credit and debit transactions under non-produced non-financial assets; and ? Capital transfers between the residents and non-resident entities. In short, it captures the net acquisition of non-produced non-financial assets and other capital receipts. Land sold to embassies, transfers that are capital in nature, acquisitions, sale of leases and licenses fall under this category. (iii) Financial account: It records changes involving net acquisitions and disposals of financial assets and liabilities between the nation and the rest of the world. The financial account of BOP has 4 main components. This classification is done based on the type of investments. They are: ? Direct investments ? Portfolio investments

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Other investments ? Reserve Assets (external assets that are readily available to and controlled by monetary authorities for direct financing of payments imbalances, for indirectly regulating the magnitude of such imbalances through intervention in exchange markets to affect the currency exchange rate, and/or for other purposes). A deficit in the current account is financed generally with a corresponding surplus in the capital and financial accounts of the BoP. There can be a surplus or deficit in any of the above accounts that could cause an imbalance in the BoP. In India, in 2017-18, as per the provisional estimates, the current account deficit was USD 49 billion, capital account deficit was USD 29 million while financial account recorded a surplus of USD 48 billion. Apparently, the country faced unfavorable BoP. In the 4 th Quarter of 2020-21, India's current account deficit was USD 8.1 Billion, which represented 1.0% of country's GDP. The deficit was primarily due to a higher trade deficit and lower net invisible receipts. Net Errors and Omissions: In principle, though a BoP account is balanced, imbalances are bound to occur on account of imperfect compilation, different data sources and procedures. This imbalance is called as 'net errors and omissions'. In other words, it shows the difference between total receipts and payments.
Table below shows the major items

57%	MATCHING BLOCK 79/127	SA	Aparna Rane_MMS_2020-22.pdf (D111583178)

of India's Balance of Payments for January to March 2021 Table 19.2: Major items of India's Balance of Payments

for January to March 2021 (USD Billion) Items of BoP

100%	MATCHING BLOCK 81/127	SA	Aparna Rane_MMS_2020-22.pdf (D111583178)

Credit Debit Net A. Current Account 173.4 181.5 -8.1 1. Goods 91.3 133.0 -41.7 Of which: POL 8.0 28.7 -20.7 2. Services 56.0 32.5 23.5 3. Primary Income 5.2 13.9 -8.7 4. Secondary Income 20.9 2.1 18.9 B. Capital Account and Financial Account 162.7 153.8 8.8 Of which: Change in Reserves (Increase (-)/Decrease (+)) 0.0 3.4 -3.4 C. Errors & Omissions (-) (A+B) 0.7 -0.7

Source:

100%	MATCHING BLOCK 80/127	W	

https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=51820

Unit 19: International

61%	MATCHING BLOCK 82/127	SA	Unit 14- Balance of Payment.docx (D103423476)

Trade and Balance of Payments 53 19.7.1 Distinction between Balance of Trade (BoT) and Balance of Payments (BoP) Both are related terms but with different meanings.

78%	MATCHING BLOCK 83/127	SA	Unit 14- Balance of Payment.docx (D103423476)

Balance of trade refers to the difference in value of exports and imports of

goods and services between countries. If, at any point of time,

60%	MATCHING BLOCK 84/127	SA	Unit 14- Balance of Payment.docx (D103423476)

value of exports exceeds value of imports, a country is said to experience export surplus or a favourable balance of trade. If the value of imports exceeds exports, then the country experiences an adverse or deficit balance of trade.

If exports equal imports, which are highly unlikely in open economies, it can be stated that balance of trade is said to be balanced. Trade transactions are part of current account transactions in BOP statement. The BoP is a statistical statement that comprises transactions of an economy between residents and non-residents (of the economy) during a period. It consists of the goods and services account, the primary income account, the secondary income account, the capital account, and the financial account. The different accounts within the BoP are distinguished according to the nature of the economic values provided and received, under the double-entry system of accounting in the BoP. The current account includes flows of goods, services, primary income, and secondary income between residents and non-residents and thus constitutes an important segment of BoP. The capital account comprises credit and debit transactions under non-produced non-financial assets and capital transfers between residents and non-residents. The financial account reflects net acquisition and disposal of financial assets and liabilities during a period. 19.8

Causes and Types of

Disequilibrium in BoP Disequilibrium in BoP may not always refer to a situation in which a country's credit is not equal to the debit. Even when the credit is equal to the debit in an accounting sense, there may be disequilibrium in the economy. The BoP can be denoted as: B = C – D Where, B denotes the BoP, C is Credit and D is Debit. When B is zero, the BoP is in equilibrium. A country's BoP is favorable when B is positive when the total receipts exceed the total payment. A country's BoP is unfavorable when the total debit exceeds the total credit. Disequilibrium in BoP can occur due to surplus or deficit in the BoP.

Following are the main reasons of producing a

disequilibrium in the balance of payments of a country: Cyclical Fluctuations

Business or cyclical fluctuations induced by the operations of the trade cycle, their phases and amplitudes differ in different countries, which generally produce cyclical disequilibrium in a country's BoP. For example, if there occurs a Business Recession in foreign countries it may easily cause a fall in the

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exports and exchange earnings of the country concerned resulting in disequilibrium in the BOP. Rapid Economic Development Rapid economic development causes

the resulting income and price effects adversely affect the balance of payments position of a developing country. In these countries, the marginal inclination to import is high
with an increase in income. People's demand for imported articles as well as domestic goods will be
in
rise, and hence less may be spared for export. Unfavorable Balance of Trade Huge investment and development programs in the developing economies, with import exceeding exports,
are the root causes of the disequilibrium in the BOP of these countries. There is an increasing propensity to import for these countries for want of capital for Rapid industrialization, whereas exports may not be boosted up to that extent.
Inadequate Promotion of Exports With a wide growth in the domestic production of foodstuff, raw material, substitute goods, etc. in the advanced countries, there is a decrease in their need to import from the agrarian underdeveloped countries. The considerably changed demand for export results in structural disequilibrium in these underdeveloped countries. Similarly, with the tendency of poor nations for self- reliance and their strategies of curtailing their imports
also have made the advanced nations also suffer in their exports. Terms of
Trade Since the

100%	MATCHING BLOCK 85/127	SA	TYBCom Sem VI Business Economics Paper VI (Eng ... (D163511825)

intensity of reciprocal demand for products of different countries differs,

in

90%	MATCHING BLOCK 86/127	SA	TYBCom Sem VI Business Economics Paper VI (Eng ... (D163511825)

terms of trade of a country may set differently with different nations. Under multi-trade transactions which may lead to disequilibrium in

away.
Burden of Payment of Foreign Debt One important
reason for a surplus or deficit in Balance of payments may
arise out of international borrowing and investment. A country may tend to have an adverse balance when it borrows heavily from another country, while the lending country will tend to have favorable balance and a deficit balance
when the loan is Rapid. Capital Movements The capital movements can also cause disequilibrium in the balance of payments of a country. A massive inflow of foreign capital into a country is followed by an unfavorable Balance of payments. A large outflow of capital, on the other hand, is accompanied by the favorable Balance of payments. Inflationary Spiral at Home An inflationary rise in prices within the country may also produce disequilibrium in the Balance of payments. The prices of export items may go
Unit 19: International Trade and Balance of Payments 55

up, causing a decline in the volume of exports from the country concerned. The inflationary spiral within the country may also result in an increase in the volume of imports. Natural Factor Natural calamities, such as flood, lack of rain, have adverse effect on the agricultural and industrial production in the country and may easily cause disequilibrium in the Balance of payments. In such situation, the imports may go up while export may face a decline and result in a discrepancy in the country's
Balance of payments. Demonstration Effect Demonstration effect is another most important factor causing the deficit in the Balance of payments of the country, especially of an underdeveloped nation. When people of the underdeveloped Nations come into effect with the people of advanced countries due to economic and other social and political relations there will desire to have western-style goods and patterns
of consumption. So that their propensity to import rises whereas their export quantum may remain the same or may even decline with the increase in income thus causing an adverse
BoP for the country. High Population Growth A huge population and its high rate of
growth in poor countries also have adversely affected their BOP
position. It is easy to see that an increase in population increases the need for these countries for imports and decrease the capacity to export.
Political Factors The political factors may also produce serious disequilibrium in the country's BoP. For example – The existence of political instability may result in disrupting the productive apparatus within the country, causing a decline in exports and an increase in imports. Likewise, the payments of war reparations or indemnities may also cause serious disequilibrium in the country's BoP. The imposition of heavy war reparations on Germany after the first world war produced a serious disequilibrium in its away. Miscellaneous Factors Unfavorable exchange rates, increasing internal prices, increasing defense expenditure specialization, Higher cost of democracy, etc. The changes in the tastes, habits, fashions of the people. The discovery of the new substitute for exports, the development of alternative sources of supply, etc., may also produce disequilibrium in the country's Balance of payments. Thus, at present, we find
the most of the development
of developing country nations have an adverse Balance of payments, whereas rich Nations have a favorable balance of payments.
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Disequilibrium in BoP can be of three types. They are: 19.8.1 Cyclical disequilibrium
Cyclical fluctuations caused by the changes in the
trade cycle, stabilization policies in various countries, and varying income and price elasticities of exports and imports in various countries
are few of the factors that lead to cyclical disequilibrium in BoP. 19.8.2 Secular disequilibrium Secular disequilibrium occurs due to the long-term dynamic changes in a country. The disequilibrium occurred when the domestic investments are higher than domestic savings and imports are more than exports. There is lack of funds to finance the import surplus and this leads to disequilibrium. In the next stage, domestic savings are more than domestic investments and exports are more than imports. Surplus savings are more than investment opportunities abroad and there is disequilibrium. Later when domestic savings is equal to domestic investment, long-term capital movements balance to become zero. 19.8.3 Structural disequilibrium Structural disequilibrium occurs due to the structural changes in some sectors of the economy that affects the demand and supply forces, which in turn leads to change in import and export patterns in the country.

Check Your Progress - 4 12. The balance of payment account consists of _________ a. Both current account and capital account b. Only current account c. Only capital account d. Transaction in bank accounts 13. __________records the transactions for assets. a. Balance of payment b. Capital account c. Current account d. Foreign direct investment 14. _______ contains details of all international transactions for goods and services. a. Capital account b. Current account c. Balance of payments d. Balance of trade

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Balance of Payments 57 15. Which of the following types of disequilibrium's takes place in the BoP when there is a change in the trade cycle, stabilization policies, varying income and price elasticities of

various countries? a. Cyclical disequilibrium b. Frictional disequilibrium c. Secular disequilibrium d. Structural disequilibrium 19.9

Methods of Correcting Disequilibrium Disequilibrium in BoP can be adjusted by monetary and non-monetary measures. 19.9.1 Monetary measures Some of the monetary measures that are used to correct the disequilibrium are described below: Deflation: Deflation is an economic condition that is represented by the decline in the general price levels, which is caused by a reduction in the supply of money. Government reduces the prices of goods and services through deflation. Currency deflation results when there is a fall in the income of the people, which in turn leads to decrease in the domestic consumption. This finally leads to increase in exports, thus resulting in more foreign exchange for the domestic country. Exchange rate depreciation: Disequilibrium in BoP can be corrected by reducing the value of domestic currency. Exchange rate depreciation devalues the domestic currency relative to foreign currency. This results in imports becoming costlier and exports becoming cheaper. Through increase in exports by exchange rate depreciation, the positive elasticity of demand corrects the disequilibrium in BoP.

Devaluation: Devaluation can be defined as lowering the exchange value of the official currency.

Devaluation of domestic currency leads to decrease in the BoP deficit. However, certain conditions should prevail for successful devaluation such as elasticity of demand for the country's exports and imports should be greater than unity, and increasing demand for goods exported in international markets.

Exchange control: Exchange control is one way to correct disequilibrium in the BoP.

Under exchange control, all exporters of the country are supposed

70%	MATCHING BLOCK 87/127	SA	Term paper.docx (D61628708)

to surrender their foreign exchange earnings and it is rationed among importers. The license-holder

is free to import any good but in a fixed quantity. 19.9.2 Non-monetary measures Some of the non-monetary measures that are used to correct disequilibrium are import duties and quotas. Import duties are imposed on some of the imported

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items to avoid the influence of the price variations on the BoP. Import duties are imposed so as to make the import dearer with an overall aim of checking imports. Imports get reduced and Balance of payments becomes favorable. Quota system is a situation where the government determines a fixed amount or quantity of goods to be imported in a specific period of time. Under this mechanism, the government fixes a

100%	MATCHING BLOCK 88/127	SA	Term paper.docx (D61628708)

maximum quantity or value of a commodity to be imported.

This in turn reduces and the deficit is reduced and thereby the Balance of payments, the position is improved. This measure has the immediate effect of checking imports as the marginal propensity to import becomes zero once the quota limit is reached.
Check Your Progress - 5 16. How can a country rectify disequilibrium in the balance of payment? a. Through the exchange rate movement b. By controlling the capital markets c. By raising interest rates d. By controlling inflation rates 17. ____________is the reduction in the external value of the currency as a result of market forces. a. Exchange control b. Devaluation c. Exchange rate depreciation d. Deflation 18. ____________
can be defined as lowering the exchange value of the official currency
a.
Depreciation b. Deflation c. Devaluation d. Exchange rate depreciation 19.10 Exchange Rate Policy
When countries of the world trade with each other, the transactions are made through foreign exchange. In a foreign exchange market, individuals, banks, and other institutions trade in currencies. This is done mainly through commercial banks which act as clearing houses by buying and selling foreign currencies. 19.10.1 Foreign Exchange Rate System
The foreign exchange rate is the price of one nation's currency in terms of
the currency of another nation. Exchange rates are either fixed by governments or determined by market forces. Prior to World War II, most of the currencies of the world were convertible to gold. Later, the Bretton Woods system came into existence wherein countries of the world pegged their foreign exchange rate to
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the U.S. dollar. After 1973, the floating exchange rate system came into existence under which the foreign exchange rate was influenced by the market demand and supply factors. The two prominent exchange rate systems are the fixed exchange rate system and the floating exchange rate system. 19.10.2

58%	MATCHING BLOCK 89/127	SA	179E1150-International Economics-(SLSM).doc (D165627856)

Determination of Exchange Rate The exchange rate is determined by the market forces in the foreign exchange market. The equilibrium exchange rate is determined differently in the gold standard and the paper currency systems. 19.10.3 Gold standard system If the value of the currencies of countries is determined considering the gold content of the currencies it is referred to as mint par exchange. The actual exchange rate is equal to the mint par of exchange and addition/subtraction of the bank commission, which includes charges for transportation and the charges of insurance for shipping the gold from one country to another. 19.10.4 Paper currency system Under the paper currency system, the exchange rate is determined based upon the purchasing power of a national currency. The purchasing power of currency fluctuates with the change in price level in the country. Check Your Progress - 6 19.

In the _______, currencies of different countries are traded and the foreign exchange rate is determined. a. Foreign exchange market b. Foreign trade c. Stock market d. None of the above 19.11

India's Balance of Payment and Trade Policy There were major changes in

India's BoP position due to the crisis in the 1990s. The Indian government introduced certain reforms to overcome this crisis. 19.11.1 The crisis of the early 1990's There are several reasons for the occurrence of the crisis in India in the 1990s. They include: ? Decline of foreign exchange reserves. ? Increase in short-term borrowings in preceding years has resulted in increase in interest on the borrowings. ? The Gulf War of 1990, which led to increase in the prices of crude oil and petroleum products.

The Government introduced some reforms to overcome the crisis. They were: ? Half a percent point of cash margins were imposed on imports other than capital goods imports. ? Foreign institutional investments in stocks were permitted and Indian companies were allowed to raise resources from international capital markets through Global Depository Receipts (GDRs). ? Foreign direct investments were liberalized and multinational companies were free to invest their resources in infrastructure. 19.11.2 Trade policy Post-independence, the Government of India gave importance to self- sufficiency rather than relying on foreign trade. In 1960s and 70s, there was a sharp fall in the country's exports and increase in imports. Rise in oil prices during the period further deepened the balance of payment difficulties. The economy was slowly liberalized in late 1980s and early 1990s. It was at this time the focus of the Indian Government with respect to trade policy of the country shifted to export promotion measures, policies and procedures. EXIM Policy: The foreign trade policy (FTP), which is also known as the Export-Import (EXIM) Policy, is a set of policy guidelines of export and import transactions that will be provided by the Government of India through the Directorate General of Foreign Trade (DGFT. In 1962, the Government of India had set up an EXIM Policy Committee to review the previous export and import policies undertaken by the country. The Committee obtained its approval on April 12, 1985 for a period of three years. The Government used to notify the Import and Export Policy every year. This Policy book was known as the 'Red Book'. The Import Policies contained an Open General License (OGL). Under OGL, on meeting certain requirements, specific importers could import specific type of goods only. The main focus and objective however was to review and develop India's export potential, improve export performance, encourage foreign trade, particularly boost exports and create a favorable balance of payments position. However, during the late 1980's and early 1990's, to overcome the mounting foreign debt crisis, the economy was slowly liberalized through the New Economic Policy (NEP), 1991, which was deemed to be in force from June 1992. The three-year policy of 1985 that was reviewed every year eventually gave way to 5-year policy, starting 1992-97 that proceeded with 1997-2002 and 2002-2007 periods. The 5-year tenure was to minimize uncertainties for exporters and importers and to provide stability to the policies announced. Accordingly, major reforms in many sectors were also initiated that included the trade sector as well (called the Trade Sector Reforms under the New NEP, 1991). The Government framed certain policies towards the development of nascent high-tech industry. Further, the government reduced import tariffs, reduction of subsidies, etc. to meet WTO commitments. Indian companies were free to operate their business in collaboration with other companies. Import duties were reduced and investment opportunities for the
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private sector were widened. This foreign trade policy reviewed India's trade sector status every year in the month of February and made announcements accordingly. The New Foreign Trade Policy: 2015-2020: On April 1, 2015, the Government of India, Ministry of Commerce and Industry announced the New Foreign Trade Policy (FTP) 2015-2020, the following are some of the key highlights or aims of the new FTP: ? To increase the exports of goods and services and thereby (i) generate employment opportunities and (ii) increase value addition in the country through the 'Make in India' initiative. ? To align with India's trading policy with the international trading architecture so as to meet the challenges posed by the external sector. ? Introduced two new schemes: ? Merchandise Exports from India Scheme (MEIS): This was to export specified goods to specified markets. This included e-commerce exports (books/periodicals, leather footwear, handloom textiles and customized fashion garments) sent through courier or foreign post office 1 that could avail the benefit through MEIS up to ` 25000. ? Services Exports from India Scheme (SEIS): This was to increase the export of notified services in notified market. ? Duty Credit Scrips are export promotion incentives – they are tax incentives given to exporters. These scrips issued under MEIS and SEIS and the goods imported under these scrips were made transferable. ? Reduced specific export obligation to 75% of normal export obligation – a measures to nudge procurement of capital goods from indigenous manufacturers under Export Promotion Capital Goods (EPCG). ? Introduced the 'Approved Exporter System' for status-holders [exporters holding import-export code (IEC) depending on their level of export performance] wherein the exporters could 'self-certify' their manufactured goods in phases to qualify for preferential treatment under regional and/or bilateral trade agreements. ? Measures undertaken to increase the exports of hi-tech and defense items. ? Created a fast-track export clearance facility for manufacturers falling under the following schemes: Export Oriented Units (EOUs); Electronic Hardware Technology Park (EHTP); Software Technology Park (STP); and Bio-Technology Park (BTP). ? Galvanised the Niryat Bandhu Scheme – a scheme to identify new and potential exporters, counsel and mentor them through orientation 1

The Central Board of Excise and Customs (CBEC) sets up foreign sub post-offices to handle parcel and other postal material coming from abroad and shipped out of the country.

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programmes, individual facilitations etc. This was to achieve the goals of 'Skill India' scheme initiated by the Government of India. ? 108 clusters of Micro, Small and Medium Enterprises (MSMEs) identified to boost exports. ? To create 24x7, paperless working environment for traders. In short, enhance the ease of doing business and improve exports by 2020 and make India a major export contributor in world trade. The FTP 2015-20 was to end and a new FTP 2021-26 was to be implemented from 2021. However, the pandemic impacted the beginning of this FTP. In this scenario, exhibit below captures

that

expectations of the trading community towards the new FTP. Exhibit 19.1: Expectations from the Proposed New Trade Policy 2021 – 26 The Foreign Trade Policy 2015-20 was to be replaced by the new foreign trade policy 2021-26. The big question therefore is whether the new policy will continue with or discontinue the schemes implemented under FTP 2015- 20. While some schemes such as the MEIS scheme may face discontinuation; the fate of the other schemes hang in balance. MEIS may be replaced with the much anticipated RoDTEP scheme (Remissions of Duties and Taxes on Exported Products). The RoDTEP is compatible with the requirements of WTO's Subsidies and Countervailing Measures (SCM) which prohibits a governments, especially those from a certain level of government, from providing financial services to exporters in the form of incentives. There is considerable expectation that the new policy may provide boost to export of R&D services. Another area of speculation is the EOU scheme. This scheme was also not found to be compliant with the WTO mandate. Amidst these expectations and speculations, the advent of new foreign trade policy was deferred with a government notification extending the current FTP 2015- 20 till September 20, 2021.

Source: https://www.businesstoday.in/latest/economy-politics/story/govt-extends-current-foreign- trade-policy-till-sept-30-292244-2021-03-31

Activity 19.2 Assume that there is disequilibrium in BoP in our country. If you were given the job of correcting the disequilibrium, what are the possible measures you can adopt to reduce the disequilibrium in BoP? Answer:

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Foreign Exchange Reserves Foreign exchange reserves commonly known as FOREX reserves is holding the currencies of other countries as assets. FOREX reserves in India are held and managed by Reserve Bank of India (RBI) in terms of currency assets, gold and Special Drawing Rights (SDRs) allocated to it by the International Monetary Fund (IMF) in addition to the reserves it has with the IMF. Foreign exchange reserve management largely depends on various factors, such as the type of the exchange rate regime followed by the country, the extent of openness of the economy, the size of the external sector to the total GDP of the country, the nature of markets operating in the country. The two important objectives of foreign exchange management in India are (i) liquidity and (ii) Safety with optimization of returns The Reserve Bank of India Act, 1934 provides the legal framework for maintaining reserves in different foreign currency assets (FCA) and gold within the broad parameters of currencies, various instruments, issuers and counterparties. The US dollar and Euro are considered as intervention currencies. FCAs are maintained as a multi-currency portfolio comprising major currencies, such as, US dollar, Euro, Pound sterling, Japanese yen, etc. and are valued in terms of US dollars. The movements in the FCA occur mainly on account of purchases and sales of foreign exchange by RBI in the foreign exchange market, external aid receipts of the Central Government and the effects of revaluation of the assets, income arising out of the deployment of the foreign exchange reserves. The broad strategy of reserve management is decided in consultation with The Government of India. RBI maintains foreign currency assets, invested in multi-currency, multi-asset portfolios as per the existing norms, which are similar to the best international practices followed internally across the globe. The Reserve Bank has been making available in the public domain data relating to foreign exchange reserves. The Reserve Bank is among the 71 central banks across the globe which has adopted the Special Data Dissemination Standards (SDDS) template of the IMF for publication of the detailed data on foreign exchange reserves. 19.12.1 Forex Reserves and India Movement of Reserves 2 As of the week ended on June 30, 2021, foreign exchange reserves in India increased to reach US$ 620.576 billion. During the half-year ended March 31, 2021 reserves increased from USD 544.69 billion at the end of September, 2020 to USD 576.98 Billion at the end of March 2021. The table below gives the movement from September, 2020 to March 2021. 2

Half Yearly Report on Management of Foreign Exchange Reserves, October, 2013 – March, 2014, RBI
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Table 19.3: The Movement from September, 2020 to March 2021 Month End Forex Reserves (USD Million) September-20 544687 October-20 560191 November-20 574821 December-20 585771 January-21 590321 February-21 584554 March-21 576984 https://rbi.org.in/Scripts/PublicationsView.aspx?id=20359#I2
Management of Gold Reserves 3 At end-March, 2014, the Reserve Bank held 557.75 tonnes of gold, of which 265.49 tonnes are held overseas in safe custody abroad, which formed about 6.9 per cent of the total foreign exchange reserves in value terms (USD). By the end of September 2019, 618.17 tonnes of gold was held by the Reserve Bank of which 325.87 tonnes of gold being held overseas with the Bank of England and the Bank for International Settlements and the remaining is held domestically. In value terms (USD), the share of gold in the total foreign exchange reserves increased marginally from about 5.59 per cent as at end- March 2019 to about 6.14 per cent as at end-September 2019. As at end-March 2021, the Reserve Bank held 695.31 metric tonnes of gold. While 403.01 metric tonnes of gold is held overseas in safe custody with the Bank of England and the Bank of International Settlements (BIS), 292.30 tonnes of gold is held domestically. In value terms (USD), the share of gold in the total foreign exchange reserves decreased from about 6.69 per cent as at end- September 2020 to about 5.87 per cent as at end-March 2021. Investment Pattern and Earnings of the Foreign Currency Assets 4 As per the existing norms, the foreign currency assets comprise multi-currency assets that are held in multi-asset portfolios and conform to the best international practices. At end-September 2019, the total foreign currency assets was USD 402.03 billion, out of which USD 256.17 billion was invested in securities, USD 115.89 billion was deposited with other central banks, the Bank for International Settlements (BIS), and the balance USD 29.96 billion comprised deposits with overseas branches of commercial banks 3
Half Yearly Report on Management of Foreign Exchange Reserves, October, 2013 – March, 2014, RBI 4
Half Yearly Report on Management of Foreign Exchange Reserves, October, 2013 – March, 2014, RBI
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As at end-March 2021, out of the total FCA of USD 536.69 billion, USD 359.88 billion was invested in securities, USD 153.39 billion was deposited with other central banks and the BIS and the balance USD 23.43 billion comprised deposits with commercial banks overseas (Table 19.4).
Table 19.4: Deployment Pattern of Foreign Currency Assets (USD Million) As at September end 2020 As at March end 2021 Foreign Currency Assets (FCA) * 5,02,162 5,36,693 (a) Securities 3,70,568 (73.79) 3,59,878 (67.05) (b) Deposits with other central banks & BIS 1,24,159 (24.72) 1,53,389 (28.58) (c) Deposits with commercial banks overseas 7,435 (1.48) 23,426 (4.36)
Source: https://rbi.org.in/Scripts/PublicationsView.aspx?id=20359#I2 19.13
Summary ? International trade is an important determinant of the financial and economic status of a country. ? Theorists have developed different
theories of international trade. They include: Theory of Absolute Advantage, Theory of Comparative Advantage,
Heckscher-Ohlin Theory, Imitation – Gap Theory and International Product Life Cycle Theory. ?
Governments impose barriers to regulate international trade and protect domestic firms from foreign competition. These barriers take two forms – tariffs and non tariff barriers. ? Economic integration helps strengthen trade between open economies. Regional Trade Agreements (RTAs) between countries play an important role in economic integration. ?
Balance of Payment (BoP)

can be defined
as

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a systematic record of all economic transactions between the residents of the reporting country and the residents of the rest of the world over a specified period of time. ?

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record of all economic transactions between the residents of the reporting country and the residents of the rest of the world over a specified period of time. ? When

countries trade with each other, the transactions are carried out through foreign exchange. The two main exchange rate systems are the fixed exchange rate system and the floating exchange rate system. 19.14 Glossary
Absolute advantage: (international trade). The ability of Country A to produce a commodity more efficiently (i.e. with greater output per unit of input) than Country B.
Capital account: That part of the balance of payments accounts which records a country's lending and borrowing transactions.
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Common market: A common market is a regional grouping of countries that levies common external duties on imports from nonmember countries, but which eliminates tariffs, quotas, and other miscellaneous government restrictions on trade among member countries. A common market is also referred to as a tariff union. Customs union: A customs union is formed when two or more countries agree to remove all barriers to free trade with each other, while establishing a common external tariff against other nations. Devaluation: A decrease in the official price of a nation's currency, as expressed in the currencies of other nations or in terms of gold. Economic integration: Economic integration is integrating the economic activities of the countries, which is in general, between countries of the same region to reduce trade barriers. Economic union: In an economic union, members move beyond the common market to unify their fiscal and monetary policies. Free trade: A policy where by the government does not intervene in trading between nations by tariffs, quotas, or other means. Free trade area: A free trade area is a cooperative arrangement among two or more nations, pursuant to the General Agreement on Tariffs and Trade, whereby trade barriers are removed among the members. NAFTA: The North American Free Trade Agreement (NAFTA) was signed by United States, Canada, and Mexico in September, 1993. 19.15 Self-Assessment Test 1. Give an account of various theories of international trade. 2. List out the different types of disequilibrium in BoP. 3. Explain the significance of the exchange rate policy in international trade. 19.16

Suggested Readings/Reference Material 1. H.L.Ahuja. Principles of Microeconomics. 22 nd edition, S.Chand Publishing, 2019 2. Dwivedi D.N., "Microeconomic Theory and Applications", 3 rd edition, Vikas Publishing House, New Delhi, 2016 3. H.R. Appannaiah. Essentials of Managerial Economics. 3 rd edition. Himalaya Publishing House, 2021 4. D.M.Mithani. Macroeconomics. 1 st edition, Himalaya Publishing House, 2021 5. D.M.Mithani. Managerial Economics-Theory and Applications. 8 th edition. Himalaya Publishing House, 2021 6. H.L.Ahuja, "Advanced Economic Theory", revised edition, Sultan Chand Limited, New Delhi, 2017
Unit 19: International Trade and Balance of Payments 67 7. Gaurav Datt & Ashwani Mahajan, "Indian Economy", 70thedition, S. Chand & Company Ltd., 2016 8. Sanjiv Verma. The Indian Economy (Economic Survey 2020-21 & Budget 2021-22). Unique Academy Publishers. 2021 9. V.K.Puri and S.K.Mishra. Indian Economy. 38 th edition. Himalaya Publishing House, 2021 Additional References: 1. RBI. Handbook of Statistics on Indian Economy. 2020 https://www.rbi.org.in/scripts/AnnualPublications.aspx?head=Handbook%2 0of%20Statistics%20on%20Indian%20Economy 2. World Bank open knowledge repository. India Development Update. 2020. https://openknowledge.worldbank.org/bitstream/handle/10986/34367/India- Development-Update.pdf?sequence=1&isAllowed=y 3. IMF Working Paper. Make in India: Which exports can drive the next wave of Growth? 2016. 19.17 Answers to Check Your Progress Questions 19.17.1 Model Answers to Check Your Progress Questions Following are the model answers to the Check Your Progress questions given in the Unit 1. (
c) Comparative advantage theory There are various theories that explain how a country can be better off through international trade. According to the comparative advantage theory, two countries would trade with each other even when

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one country has absolute advantage in all products and the other country does not have absolute advantage in any product. According to

this theory, each
country will be better off by concentrating on the production of goods in which it has the relatively lower labor cost or relatively higher labor productivity. 2. (
d)
International Product Life Cycle theory The International Product Life Cycle theory
states that the product life cycle begins with innovation and takes place in the rich developed countries. In the second stage of the product life cycle, the production is shifted to the developed countries to gain competitive advantage. When the product reaches maturity stage and when production is standardized, less skilled labor is required and the production of that particular product is shifted to less developed countries. 3. (d) Imitation Gap Theory According to the Imitation Gap Theory, two countries with the same factor endowments and consumer preferences can trade with each other. The theory says that improvement in technology is a continuous process, and this may give rise to trade between these countries.
Block IV: Macro Economics – II 68 4. (
c) Hecksher-Ohlin theory According to the Heckscher – Ohlin theory,
there are two type of products - labor intensive and capital intensive.

It says that two countries operating at the same level of efficiency can, and do, benefit from trade due to the differences in their factor endowments. 5. (b) Export quota Export quotas are meant to protect the economy from the excessive exports of specified goods. 6. (b) Administered Protection Administered protection is one of the non-tariff barriers imposed by a government to reduce /delay imports. 7. (b) Quotas Quotas are a form of import protectionism, that limits the total quantity of imports of a commodity for a given time period. Import quotas are aimed at reducing the quantity of imports in order to protect the interests of domestic producers or to conserve foreign exchange. 8. (c) Subsidies In order to help the local industry compete at global level, governments provide certain resources at a cheaper rate. This enables the firms to cover their costs quickly. Such help is known as subsidies.

Increased foreign exchange earnings and the subsequent tax revenues are favorable for the government. But subsidies are given out of taxes on individuals. So the subsequent increased revenue for the government has to be utilized for the development of the economy as a whole. 9. (

b) Customs union In customs union there are no internal barriers

for member countries. In this type of trading bloc, external barriers are present for non-member countries. 10. (a) No barriers to trade for member countries In a free trade area, there is no trade barrier between member countries. The member countries are free to make their own trade policy with non-member countries. 11. (c) Free Trade Area In a free trade area, each of the member country determines trade policies that are to be followed with non-member countries. 12. (a) Both the current account and capital account Balance of payments is a set of accounts that measures all the economic transactions between a nation and the rest of the world. It takes into account, exports and imports of goods, services, and financial capital.

Unit 19: International Trade and Balance of Payments 69 13. (

b) Capital account Balance of Payments has two main components i.e. current account and capital account. Current account comprises the payments made for various services. Capital account is a record of all international transactions for assets which include bonds, treasury bills, bank deposits, stocks, currency, real estate, etc. 14. (b) Current account Balance of Payments has two main components -

current account and capital account. Current account comprises the payments made for various services like travel, insurance and transfer payments. 15. (

a) Cyclical disequilibrium This type of disequilibrium causes a variation in the BoP only for a short period. When the economy is going through a period of expansion, exports will be greater than imports and there will be a trade surplus. When the economy is going through a depression, exports will be less than imports, leading to a trade deficit in the BoP. 16. (a) Through the exchange rate movement Equilibrium in balance of payment can be achieved through a movement in the exchange rate where the capital and current account balance i.e. capital and current account is equal to zero. 17. (c) Exchange rate Depreciation The decline in the currency value as a result of the various market forces like demand for the commodities the country exports, etc., is known as depreciation of the currency. Devaluation involves the role of government with regard to the decline of the currency value. 18. (c) Devaluation In order to correct the disequilibrium in the balance of payments, governments sometimes reduce the value of their currency. This makes imports costlier and exports cheaper. This exercise is known as devaluation. Depreciation, on the other hand, is the reduction of the currency value as a result of market forces. 19. (a) Foreign exchange market The value of currencies of different countries varies depending on the exchange value of their currencies. In the foreign exchange market, the currencies of different countries are traded and the foreign exchange rate is determined.

Unit 20 Economic Indicators Structure 20.1 Introduction 20.2 Objectives 20.3 The Concept of Economic Indicators 20.4 Features of Economic Indicators 20.5 Classification of Economic Indicators 20.6
Summary 20.7 Glossary 20.8 Self-Assessment Test 20.9 Suggested Reading/Reference Material 20.10 Answers to Check Your Progress Questions 20.1 Introduction In the previous unit
we discussed about international trade and balance of payments. This unit will illustrate the features of different economic indicators. Some economies are healthy and productive whereas others are weak and inefficient. Depending on their economic conditions, countries are referred to as 'developed' or 'developing'. Economists use economic indicators to study the economic conditions prevailing in an economy. In addition, economic indicators are also useful in predicting the future economic growth and state of the economy. To put it simply, economic indicators are useful in understanding the economic growth of nations. In this unit, we will discuss about economic indicators and their features. Later in the unit, some of the important economic indicators that are useful in predicting the present and future state of the economy are explained. 20.2 Objectives By the end of this unit, students should be able to: ?
Identify the features of
different economic indicators ? Classify different economic indicators ? Analyze economic condition of a country depending on economic indicators of that country 20.3 The Concept of Economic Indicators Economic indicators indicate the present and future state of the economy of a country. An economic indicator is a statistic about an economic activity. Economic indicators allow analysis of economic performance and predictions of
Unit 20: Economic Indicators 71 future performance. Any economic statistic that indicates the current level of economic growth and forecasts the future growth rate is called an economic indicator. The list of economic indicators is in fact very large because any economic statistic that indicates the rate of growth of economy is called an economic indicator. Some of the important economic indicators are gross domestic product (GDP), inflation rate, unemployment rate, interest rate, and foreign exchange reserves.
The study of business cycles is one application of economic indicators.

Economic indicators include economic summaries, various indices, and earnings reports such as the unemployment rate, interest rate, consumer price index (a measure for inflation), consumer leverage ratio, housing starts, gross domestic product, industrial production, bankruptcies, broadband internet penetration, retail sales, stock market prices, foreign exchange reserves, and money supply changes. 20.4 Features of Economic Indicators Economic indicators have three major features and they are related to: ? The business cycle/economy ? Frequency of the data ? Timing 20.4.1 Related to Business Cycle/Economy Depending upon their relation to an economy's business cycle, economic indicators may be classified into: ? Procyclic: Economic indicators that move in the same direction as the business cycle or economy are known as procyclic indicators. Generally, procyclic indicators increase during boom periods and decrease during recessionary periods. Example: The gross domestic product of an economy is a prominent economic indicator that measures the economic activity in a nation. It has generally been observed that the GDP figures increase during boom periods and decrease during recessions. Thus, the GDP is a procyclical economic indicator. ? Countercyclic: Economic indicators that move in an opposite direction to the business cycle are known as Countercyclic indicators. Countercyclic indicators show a decrease during boom periods and increase during recessionary periods. Example: The unemployment rate in an economy increases during recessionary periods and decreases during boom periods. Therefore, it is a countercyclical indicator of economic activity. ? Acyclic: Economic indicators that are not linked in any way to the changes in business cycle or the health of the economy are known as acyclic indicators. For example, the distribution of income among the individuals in an economy does not bear any relationship to the changes in the economy. Thus, it is an acyclic economic indicator.

Block IV: Macro Economics – II 72 20.4.2

Frequency of the Data Depending on the frequency with which data is released, economic indicators are classified into monthly indicators, quarterly indicators, weekly indicators, etc. For example, in certain countries the GDP is a quarterly economic indicator as it is released every three months. 20.4.3 Timing ? Economic indicators can be classified into leading, lagging, and coincident indicators based on the timing of their changes in relation to how an economy as a whole changes. ? Leading indicators: These economic indicators change even before changes occur in the economy or business cycle. Example: The changes in stock prices in an economy occur prior to the changes in the business cycles. Thus, stock prices are leading indicators of economic activity. ? Lagging indicators: Economic indicators that show changes after the changes in the business cycle are known as lagging indicators. Example: The unemployment rate changes after the changes in the economy. Therefore, it is a lagging economic indicator. ? Coincident indicators: When the changes in the economic indicators occur along with the changes in the business cycle, the indicators are known as coincident indicators. Example: The personal incomes of individuals change along with the changes in the economy. Therefore, personal income is regarded as a coincident indicator of economic activity. Activity 20.1 Observe the characteristics exhibited by the following economic indicators and classify them. Provide justification for your answer. Industrial production: Industrial production as an economic indicator measures the total output produced in an economy during a specified period. Industrial production tends to increase during boom periods and decrease during recessionary periods. Answer: Personal saving rate: The personal saving rate refers to that portion of the personal income of individuals which has not been consumed. People's savings tend to go up when the economy is doing well and to fall when the economy declines.

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Answer: Construction spending report: The construction spending report measures the total amount spent on both residential and non-residential construction activity in the economy. There is generally an increase in the amount spent on construction when the economy is flourishing. Also, people tend to spend less on construction during a depression period. Answer: Car sales: In the US, figures relating to the total sales of cars are released prior to the release of any economic data. The car sales figures are released every month. It is observed that the sales of cars go down before the economy goes through a recession phase and they shoot up just before the economy recovers. Answer: Check Your Progress - 1 1. Economic indicators that do not have any relation to the changes in the business cycle are called as _________. a Countercyclic indicators b Acyclic indicators c Procyclic indictors d Lagging indicators 2. Which of the following indicators change before the occurrence of changes in the economy? a Lagging indicators b Leading indicators c Coincident indicators d Countercyclic indicators

Block IV: Macro Economics – II 74 3. The gross domestic product of a country is a ______________. a Procyclic indicator b Acyclic indicator c Countercyclic indicator d Lagging indictor 20.5 Classification of Economic Indicators As explained earlier, any economic statistic that helps evaluate the present state of the economy and estimate future economic growth is an economic indicator. In this unit, we shall discuss some of the important economic indicators that are useful in forecasting the economic growth of nations. To facilitate the understanding of these concepts, economic indicators are classified into: ? General indicators ? Business indicators ? Consumption indicators 20.5.1 General Indicators The various economic indicators discussed under this heading are: ? GDP ? Inflation ? Interest rate ? Unemployment rate ? Foreign exchange reserves ? International trade

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GDP Gross domestic product (GDP) is the value of the total final output of all the goods and services produced within

an economy in a single year. Generally, GDP data is published every three months. GDP is one of the prominent measures of economic activity because it gives the monetary value of all the goods and services produced in an economy during a specified period, thus giving an indication about the health of the economy. GDP moves in the same direction as the changes in the business cycle. Hence, it is a procyclical economic indicator. Also, the changes in GDP occur along with the changes in the business cycle. Therefore, it is a coincident economic indicator. The National Statistical Office (NSO) has estimated India's GDP to have grown at 4.8 per cent in the first half (April-September) of 2019-20, lower than 6.2 per cent recorded in the second half (October-March) of 2018-19. According to Economic Survey 2020-21, India's real GDP to record an 11.0% growth in FY2021-22 and nominal GDP to grow by 15.4%.

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According RBI 's monetary policy announced in October 2021, Professional forecasters survey sees real GDP growth moving from 20.1 per cent in Q1 of 2021- 22 to 5.9 per cent in Q4. It could be 13.1 per cent in Q1 of 2022-23 due to a high base effect, and 6.1 per cent in Q2. The Reserve Bank of India's biannual monetary policy report announced on 8 th October 2021 has projected 7.8 per cent growth for the Indian economy in FY23, provided the monsoon next year is normal, supply chains are restored, Changes in GDP may have the following impact on the economy: ? A decrease in GDP growth rate of a country indicates that its economy is moving at a slow pace. ? An unexpectedly high growth in GDP indicates a potential increase in the economy's inflation. ? An unexpectedly high growth in GDP might lead to the expectation that there will be an increase in interest rates, which, in turn, causes the exchange rate to appreciate. Inflation Inflation is a general rise in the prices of goods and services in the economy. It occurs only when there is an increase in the prices of most items in the market. An increase in the prices of some items does not lead to an inflationary situation. However,

a continuous increase in the price levels of an economy over a period

of time

is inflation, and it leads to a decline in the purchasing power of the nation's currency.

Generally, inflation is measured as a percentage increase in the consumer price index 5 . In India, the changes in inflation rate are released on a weekly basis. As of May 2019, inflation rate in India was 5.5% as per the Indian Ministry of Statistics and Programme Implementation. CPI numbers are typically measured monthly, making them unsuitable for policy use with a significant lag. While announcing the review of the monetary policy on 8 th October 2021, the RBI's six-member monetary policy committee retained the growth forecast for FY22 at 9.5%, and lowered its projection for retail inflation projection from 5.7% to 5.3%. Interest rates An interest rate is the rate charged or paid for the use of money, normally expressed as a percentage. Interest rates play a major role in influencing the economic behavior of the people of a nation. An increase in interest rates implies that there will be an increase in the cost of capital (or the cost of borrowing capital/money). Higher interest rates tend to moderate economic growth.

Higher interest rates limit

the growth in consumer spending as they 5 The consumer price index measures the prices of goods and services purchased by

consumers in the economy. The prices

of all the goods and services produced in an economy

are pooled together to form an overall price index.

Block IV: Macro Economics – II 76 increase the cost of borrowing, and reduce disposable income. Higher interest rates also cause an appreciation in the exchange rate and tend to reduce inflationary pressures. Thus, people will lower their capital requirements when the interest rates increase. This leads to a slowdown in economic activity. Thus, interest rates influence economic growth of nations. Unemployment rate

The unemployment rate refers to the number of unemployed people in the economy as a percentage of the total workforce in the economy. The total labor force includes the total number of people employed as well as those who are looking out for jobs. Changes in business cycles have an impact on the unemployment rate. In recessionary periods, employees lose their jobs because companies try to maintain their profit levels by reducing costs (including employee costs). Similarly, during boom periods, there will be an increase in demand for employees as companies focus on improving their profits by increasing productivity. Thus,

the unemployment rate increases during recessionary periods and decreases during boom periods.

We can, therefore, conclude that it is a countercyclic indicator of economic activity. It has generally been observed that the changes in unemployment rate occur after the changes in the business cycle, indicating that it is a lagging economic indicator. Statistics of unemployment in India has traditionally been collected, compiled and disseminated once in every five years by the Ministry of Labour and Employment (MLE), which is done primarily from sample studies conducted by the National Sample Survey Office. In 2016, Centre for Monitoring Indian Economy started sampling and publishing monthly unemployment in India statistics. In February 2020, it was found that the unemployment rate in India rose to 7.8. Exhibit 20.1 Summarizes the Unemployment Rate in India in 2020-21 The unemployment rate in India in the first quarter of 2020-21 jumped to 20.9%, due to the nationwide lockdown that was in vogue during this quarter. By the end of quarter 2 in September 2020, the unemployment rate came down to 13.2%. It further reduced to 10.3% by the third quarter of 2020-21. However, when compared with the third quarter of 2019-20, this rate is higher, as it was 7.8% in Q3, 2019-20. The labour force participation rate is another indicator of unemployment. Labour force here refers to the number of persons either employed or unemployed or unemployed on an average in a week preceding the date of survey. The labour force participation rate measures the percentage of population in labour force at a given point of time. This percentage was marginally higher in the third quarter of 2020-21 at 47.3% when compared to third quarter of 2019-20 which was 47.2%.

Source: https://economictimes.indiatimes.com/news/economy/indicators/unemployment -rate-in-urban-india-dropped-to-10-3-in-third-quarter-of-2020-21- nso/articleshow/86070295.cms

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Foreign exchange reserves Foreign exchange reserves refer to the amount of foreign currency held as a reserve base or financial backup, by a country's banking system, for its international transactions and payments. As on October 29, 2005, India's foreign exchange reserves amounted to US$ 143 billion. The adequacy of a country's foreign exchange reserves should be determined on the basis of two major factors. They are: ? Demand for the country's own currency ? People's perception of a currency: Generally people buy a currency if they think it is going to do well in the future. The general perception among people is that the US economy is fundamentally strong and that the dollar will continue to do well against the Euro or the yen. International trade The international trade data report published by the government of a country shows that country's exports and imports during a specific period. When a country's exports are more than its imports, the difference between the two is called net exports. Net imports occur when the imports of a nation are greater than its exports. This signifies a trade deficit in the nation. Also, during a boom period, a country's trade balance shows more imports and fewer exports. Therefore, the trade balance is a countercyclical indicator of economic activity. International trade data is also a coincident indicator of the economy as the changes in international trade occur along with the changes in the business cycle of an economy. Table below shows the exports and imports data for 2019 Table 20.1: The

Exports and Imports Data for 2019 Particulars 2017 2018 2019 Total exports (in US $ million) 294,364 322,292 323251 Total imports (in US $ million) 444,052 617,946 478,884 Source:
https://wits.worldbank.org/CountryProfile/en/Country/IND/Year/2018/SummaryBusiness Indicators
The various economic indicators discussed under this heading are: ? Industrial production ? Capacity utilization ? Wholesale prices index/producer price index ? Consumer price index ? Retail sales ? Construction spending Industrial production This is the total output produced by industries in an economy during a particular period. As an economic indicator, industrial production measures the rate of
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change of output in an economy. The measurement is done by comparing the industrial output of the previous year with the industrial output of the present period. The Index of Industrial Production (IIP) is an index for India which details out the growth of various sectors in an economy such as mineral mining, electricity and manufacturing. The IIP index is computed and published by the Central Statistical Organisation (CSO) on a monthly basis. The all India IIP is a composite indicator that measures the short-term changes in the volume of production of a basket of industrial products during a given period with respect to
that in a chosen base period. The Eight Core Industries comprise nearly 40.27% of the weight of items included in the IIP. These are Electricity, steel, refinery products, crude oil, coal, cement, natural gas and fertilizers. Industrial production in India was 2% in January
of 2020.
Exhibit below shows the Industrial Production in India in 2021 Exhibit 20.2: The Industrial Production in India in 2021 In July, 2021
the Index of Industrial Production stood at 131.4. The IIP during the April-July period of 2021 rose 34.1 percent compared to a negative growth of 29.3
percent during the previous year 2020-21. The indices for manufacturing, mining and electricity were at 130.9, 104.6, and 184.7, respectively in July, 2021. Manufacturing which forms a major 77.63% of the IIP grew 10.5% in July 2021, compared to a negative growth of 11.4% in the previous year 2020-21. There has been improvements in mining too which grew 19.5% while power generation increased by 11.1 percent. The output from India's eight core sectors which is called the Infrastructure output rose 9.4 percent. These eight core sectors account for 40.27% of the weight of the items included in IIP. Among the eight sectors, coal, cement and natural gas had highest growth. Inspite of these growth indications, the IIP still lies 0.3 percent below the pre- pandemic levels in July, 2019.
Source: https://www.ndtv.com/business/

industrial-production-iip-data-news- government-releases-factory-output-data-for-july-2021-iip-at-11-5-2536633

Capacity utilization Capacity utilization is an economic statistic that measures the utilization level in relation to the total capacity of industries. It is measured as a ratio of actual and potential output of industries in a country. Thus, capacity utilization can be effectively used to measure the degree to which a nation's capital is being used for production of goods. Capacity utilization increases during boom periods and decreases during recessionary periods. Thus, it is a procyclic indicator of economic activity.

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Capacity Utilization in India averaged 74.79 percent from 2008 until 2019, reaching an all-time high of 83.20 percent in the first quarter of 2011 and a record low of 69.10 percent in the third quarter of 2019.

Unit 20: Economic Indicators 79 Figure below shows the capacity utilization from Jan, 2018 –March, 2021. Figure 20.1: The Capacity Utilization
from Jan, 2018 –March, 2021 Source: https://tradingeconomics.com/india/
capacity-utilization According to above data, the capacity utilization improved to 66.6 in Jan 2021 from a low of 47.3. This low capacity utilization was result of covid 19 pandemic in 2020. Wholesale Prices Index/Producer Price Index The Wholesale Prices Index (WPI) is an index of the prices of goods and services bought by consumers. It is an important measure of inflation in the economy. The WPI covers a range of goods and services from bread to PCs. In the US, the producer price index (PPI) is used to measure inflation in the economy. The PPI is an index that measures the changes in the prices of goods meant for sale in the economy. PPI is also an important statistic that can be used to measure inflation in an economy. A major difference between WPI and PPI is that WPI takes into consideration the prices of both goods and services, while PPI is concerned only about the prices of goods and does not consider the change in the price level of services. PPI shows an increase during a boom period and a decrease during recessionary periods. Thus, it is a procyclic indicator of economic activity. In India, Office of Economic Advisor (OEA), Department of Industrial Policy and Promotion, Ministry of Commerce and Industry calculates the WPI. The Indian WPI was first published in 1902, and was used by policy makers until it was replaced by the PPI in 1978. Consumer Price Index (CPI) The consumer price index (CPI) measures the average changes in the prices of goods and services consumed by the population of a country. It therefore serves as a statistic to measure inflation in the economy. Hence, a huge increase in CPI is not desirable as it indicates an inflationary situation in the country. The CPI increases during boom periods and decreases during recessions. Thus, it is a procyclic indicator of economic activity.
Jan 2018 Jul 2018 Jan 2019 Jul 2019 Jan 2020 Jul 2021 Jan 2021
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Changes in the CPI may have the following implications for the economy: ? A high increase in CPI indicates an inflationary situation. This induces the central bank to increase interest rates so as to curb inflation in the economy. Retail sales Retail sales are an important economic indicator because consumer spending drives much of our economy. Think of all of the people and companies involved in producing, distributing, and selling the goods you use on a daily basis like food, clothes, fuel, and so on. The most common examples of retailing include giants such as Best Buy and
Wal-Mart.

But retailing includes even the smallest kiosks at local mall. Examples of online retailers are Amazon, eBay, and Netflix. Observing the retail sales made in an economy during a particular period helps economists to understand the spending patterns of consumers in the economy. The retail sales data includes the merchandise sold by retailers (either for cash or for credit) in the economy during a specified period. Retail sales data is a good measure of inflation in the economy. Retailing has a tremendous impact on the economy. Consumers benefit from retailing is that, retailers perform marketing functions that makes it possible for customers to have access to a broad variety of products and services. Retailing also helps to create place, time and possession utilities. Construction spending Construction spending measures the total amount spent on construction (both residential and non-residential) by the private and the public sector during a particular period. A building is regarded as a non-residential building when the minor part of the building (i.e. less than half of its gross floor area) is used for dwelling purposes. Non-residential buildings comprise; industrial buildings, commercial buildings, other buildings. Construction spending, as the name suggests, measures the total amount spent on construction (both residential and non-residential) by the private and the public sector during a particular period. The construction spending report shows an increasing trend during boom periods and a decreasing trend during recessionary periods. Thus, it is a procyclic indicator of economic activity. Construction is an important sector that contributes greatly in the economic growth of a nation. The Construction Industry is an investment-led sector where government shows high interest. Government contracts with Construction Industry to develop infrastructure related to health, transport as well as education sector. 20.5.2 Consumption Indicators The various consumption indicators discussed under this heading are: ? Consumer confidence index ? Employee cost index ? Building permits ? Personal income ? Income distribution ? Fixed investment
Unit 20: Economic Indicators 81

Consumer Confidence Index (CCI) The consumer confidence index (CCI) is an economic statistic that tries to capture the sentiments of consumers regarding the present and future economic state of the nation. The consumer confidence indicator provides an indication of future developments of households' consumption and saving, based upon answers regarding their expected financial situation, their sentiment about the general economic situation, unemployment and capability of savings. CCI measures how confident consumers are about the overall state of the economy. It also measures how confident people feel about their income's stability. As a result, consumer confidence is a key indicator for the overall shape of the economy. Consumer confidence usually increases when the economy expands. CCI is generally based on a survey that interviews a representative sample of households in an economy. A positive CCI indicates that the consumers have a positive perception of the economic state of the country. In other words, a positive CCI implies that the consumer perceives the economy to be growing. When consumers have a positive perception of the economy, they tend to spend more. This in turn contributes to the growth of the economy. The economic factors that most affect the demand for consumer goods are employment, wages, prices/inflation, interest rates, and consumer confidence. Employee Cost Index (ECI) The changes in the costs of employees at all levels in companies are measured by the employee cost index (ECI). The term costs of employees include salaries, wages, bonuses, and fringe benefits. An increase in ECI is an indication of inflation in the economy. This is based on the notion that workers demand for an increase in wages following a rise in consumer prices. Thus, it is believed that an increase in ECI indicates an increase in inflation in the economy. Building permits A building permit is an official approval issued by the local government agency that allows you and contractor to proceed with a construction or remodeling project on your property. It is intended to ensure that the project plans to comply with local standards for land use, zoning, and construction. A building permit report consists of the number of building permits issued by the government during a particular period. This report reflects the demand for housing in an economy. Generally, the demand for housing is high in a growing economy when compared to a slow-growth economy. Thus, an increase in the number of building permits is a positive sign of economic growth. Personal Income The term "personal income" is sometimes used to refer to the total compensation received by an individual, but this is more aptly referred to as "individual income." In most jurisdictions personal income, also called "gross income," is subject to taxation above a certain base amount. Personal income
Block IV: Macro Economics – II 82

refers to the income earned by all the individuals in an economy. It includes salaries and wages, dividends, interests, earnings of proprietors, compensation of workers, transfer payments, pension and retirement benefits, etc. Personal income has a large effect on consumer consumption. As consumer spending drives much of the economy, national statistical organizations, economists, and analysts track personal income on a quarterly or annual basis. Personal disposable income is the post-tax income available with individuals for their personal consumption. This income is a good indicator of economic activity and standard of living of the people. Disposable income is also a good indicator of the future consumer demand in the economy. Income distribution Income distribution is the smoothness or equality with which income is dealt out among members of a society. Income distribution is perfectly equal when everyone earns exactly the same amount of money. Distribution theory is the systematic attempt to account for the sharing of the national income among the owners of the factors of production i.e. land, labour, and capital. Economists have traditionally researched on the costs of these factors and the size of their return. Income distribution plays a key role in revealing the percentage of individuals at various wage levels. The number of poor people in a country and the average quality of life depend on how well the income is distributed in the country. The information regarding the percentage of individuals at various wage levels can be used to find out the overall wage patterns in an economy. The five income sources are; labour, unemployment benefits, profits, interest and rent. Different group receives different types of income in different proportions. There are two widely used measures of inequality to capture the personal income distribution i.e. the Gini coefficient and the squared coefficient of variation. As the income distribution influences the cohesion of society, determines the extent of poverty for any given average per capita income and the poverty-reducing effects of growth, and even affects people's health, it is extremely crucial for development Fixed investment Fixed investment is the purchasing of newly produced fixed capital and is measured as a flow variable. Therefore, fixed investment is the accumulation of physical assets such as machinery, buildings, land, vehicles, installations, or technology. The amount spent by individuals on capital goods with a view to increasing production capacity, etc. is known as fixed investment. The extent of fixed investment made in an economy in a particular year is an indicator of change in the supply of installed capital in the economy. The amount of fixed investment increases during boom periods and decreases during recessionary periods. Thus, it is a procyclical indicator of economic activity.

Unit 20:

Economic Indicators 83 Activity 20.2 Utopia is a small island. Given below are some economic statistics of Utopia. Based on the given data, forecast the economic conditions of the island. Justify your answer. Particulars 2000 2010 2020 (E) GDP (in $ million) 1258 1439 1534 PPI 391 421 676 CPI 441 524 774 Exports (in $ million) 34,902 50,986 80,987 Imports (in $ million) 57,890 80,891 1,90,987 Unemployment rate 6.7 5.6 4.9 Answer: Check Your Progress - 2 4. Which among the following is not a business indicator? a. Foreign Exchange Reserves b. Capacity Utilization c. Wholesale Price Index d. Consumer Price Index 5. The consumer confidence index is an economic statistic that ________. a. Indicates the general rise in prices of consumer durable goods b. Indicates the changes in tastes and preferences of consumers c. Indicates the sentiments and the general expectations of the consumers regarding the present and future economic state of the nation d. Indicates the increase in individual prices of consumer goods 6. The number of building permits issued is an economic statistic that indicates ___. a. The amount spent on all types of new construction in an economy b. Demand for new housing in the economy c. Demand for construction of factories in the economy d. Growth of real estate the economy

Block IV: Macro Economics – II 84 20.6 Summary ? Economic statistics that indicate the present and future state of the economy are known as economic indicators. ? Economic indicators may be classified on the basis of three main features. They are: relation to business cycle economy, frequency of the data and timing. ? There are numerous economic indicators that help to predict the economic growth of nations. In this unit, we discussed some of the important economic indicators. For our convenience, we have classified them into general indicators, business indicators, and consumption indicators. 20.7 Glossary Acyclic indicator: Economic indicators that do not have any relation to the changes in business cycle are known as acyclic economic indicators. Consumer confidence index: It is an economic statistic that indicates the sentiments and general expectations of the consumers in an economy. Countercyclic indicator: The economic indicators that move in the opposite direction to the business cycle or economy are known as Countercyclic economic indicators. Employee cost index: It measures the changes in the costs of labor (include salaries, wages, bonuses and fringe benefits) for employees at all levels in companies. Economic indicators: Economic indicators are 'economic statistics' that indicate the current level of economic growth and also the stability of the economy. Producer price index: It measures the price levels of all goods for sale in the primary market place. Procyclic indicator: An economic indicator which moves in the same direction as that of the business cycle or the economy is known as procyclic indicator. 20.8 Self-Assessment Test 1. What are economic indicators? Discuss the importance of general and business indicators. 20.9

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Answers to Check Your Progress Questions 20.10.1 Model Answers to Check Your Progress Questions Following are the model answers to the Check Your Progress questions given in the Unit. 1. (

b) Acyclic indicators Acyclic economic indicators cannot establish a relationship between the changes in the economic indicators and the changes in the business cycles of an economy. For instance, the income distribution among people does not have any relationship with the health of the economy. 2. (b) Leading indicators Economic indicators that change before the occurrence of changes in the economy are known as leading economic indicators. These indicators indicate

Block IV: Macro Economics – II 86

an increase or decrease in the economy at future date by showing a decrease or increase in the numbers. 3. (a) Procyclic indicator Gross domestic product (GDP) moves in the same direction as that of the economy. Thus, it is a procyclic indicator. 4. (a)Foreign exchange reserves Foreign exchange reserves refer to the amount of foreign currency held by a nation's banking system as a reserve base, or financial backup, for its international transactions and payments. The foreign exchange reserves are indicators of the health of an economy as a whole. Thus, foreign exchange reserves are not just indicators of business environment in an economy. 5. (c) Indicates the sentiments and the general expectations of the consumers regarding the present and future economic state of the nation Consumer confidence index (CCI) is the economic statistic that indicates the sentiments and general expectations of the consumers in an economy. 6. (b) Demand for new housing in the economy A building permit report reflects the number of building permits issued in the country thus establishing the demand for new housing.

Unit 21 Business Cycles Structure 21.1 Introduction 21.2 Objectives 21.3 Characteristics of Business Cycles 21.4 Theories of Business Cycles 21.5 Causes of Business Cycle 21.6 Business Cycle in the Indian Economy 21.7 Economic Stability 21.8 Impact of Business Cycle on Economy 21.9 Forecasting Business Cycles 21.10 Employment Fluctuations 21.11

Summary 21.12 Glossary 21.13 Self-Assessment Test 21.14 Suggested Reading/Reference Material 21.15 Answers to Check Your Progress Questions 21.1 Introduction The previous unit

discussed

economic indicators. In this unit we will discuss business cycles. The growth of economies is rarely steady over a long period - growth is usually followed by recession, and sometimes even depression. Economic recession is characterized by a fall in national output, decline in

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profits and real incomes, and high unemployment. When the economy recovers from recession, and the recovery is very strong, there may

be a boom period, when there is high demand, plenty of employment opportunities and the standard of living of people rise.

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In this unit, we will explain the various phases of the business cycle

in an economy. 21.2

Objectives By the end of this unit, students should be able to: ?

Identify
different stages in business cycles ? Discuss the theories of business cycles ? Analyze the employment situation of a country 21.3 Characteristics of Business Cycles A business cycle is the characteristic up-down-up fluctuation in economic activity as aggregate measures like total national output, income and employment, in an economy. The length of a business cycle (the period from
Block IV: Macro Economics – II 88 one peak to the next) can range from two years to ten years. It consists of two major phases – recession and expansion. (Refer Figure 21.1). The exact duration of each phase of the business cycles is hard to predict. The characteristics of the recession period are as follows: ? There is a fall in consumer spending, which leads to accumulation of inventories. Accumulation of inventories discourages producers from producing more, leading to a fall in the production of goods, and investment in plant and machinery. This results in a fall in the real GDP. ? Reduction in production results in a decline in the demand for labor, which in turn leads to layoffs and high unemployment. ? The decline in the demand for raw materials due to the decrease in output causes a fall in the price, which is followed by overall deflation (fall in the general price level). ? There is a decline in profits during the recessionary period. Stock prices fall. Due to

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fall in demand for credit, interest rates also fall. According to Joseph Schumpeter, there exist four stages in

the business cycle – prosperity, recession, depression and recovery. Prosperity is the stage when there is an increase in production in all the sectors of the economy. The increase in production enhances employment opportunities, and leads to a rise in consumer spending. During a recession, there is a general

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fall in prices, decline in the demand for capital goods and cancellation of new projects

and a fall in the stock prices.

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Initially, the demand for consumer goods remains the same, but slowly it

diminishes. The performance of various stocks in the stock market is one of the indicators, which reflects the pulse of the industrial and financial segments of the economy. Figure 21.1: The Business Cycle Boom Contraction or depression Expansion or recovery Recessionary through Trend line Business Peak Recession Time period Real GDP Source; ICFAI Research Center Unit 21: Business Cycles 89 Depression is the result of a prolonged recession. During a

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depression, there is a fall in the production of goods and services,

which leads to widespread unemployment both of capital equipment and labor. The decline in income levels leads to a further drop in consumption, feeding back into lower production because of lack of demand. Example: The Great Depression After the Great Depression in the 1930's, economists decided to study business cycles systematically. The Great Depression, which was a huge economic bust in US that lasted for over a decade, caused widespread unemployment. During the Great Depression in the 1930s, the unemployment rate reached 25 percent, and never fell below 10 percent during the entire decade. Unemployment was not the only indication - total production too declined by about 40 percent over the decade. The expenditure incurred in all the four sectors (household, business, government, and foreign trade) also decreased. Specifically, investment expenditures on capital goods by the business sector went down by as much as 90 percent. The decline in government expenditure was around 15 percent during the period. There was a decline of 60 percent in net exports by the foreign sector. In fact, the economic scenario during the Great Depression was a complete contrast to the economic scenario in the 1920s, when the economy was up and on a roll with low unemployment, high aggregate production and huge investment expenditure on capital goods. Recovery is a period when there are increasing employment opportunities, and a consequent rise in income levels and increase in the demand for goods and services. Check Your Progress - 1 1. In an economy variation in economic activity lasting for two to ten years, with expansion and contraction in the total national output, income and employment is called __________. a. Boom and depression b. Business cycle c. Peak and trough d. Boom and recovery 2. ____________

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is characterized by a fall in production, increased unemployment and a fall in the general price level.

a. Boom b. Depression c. Recovery d. Expansion
Block IV: Macro Economics – II 90 3. ________analysis

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helps to understand the relationship between real GDP, unemployment, and inflation.

a. Gross Domestic productivity b. Business cycle c. Gross national income d. Opportunity cost 4. ________

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in the economy will lead to fall in prices, decline in the demand for capital goods and cancellation of new projects.

a. Recession b. Inflation c. Expansion d. Boom 21.4 Theories of Business Cycles 21.4.1 Multiplier-Accelerator theory There are many theories which attempt to explain the cyclical behavior of the macroeconomic activity. One of them is the multiplier-accelerator theory. According to this theory, income is determined by investment (income increases by a multiple of the initial investment), while investment is, in turn, determined by the amount of income generated over the previous period (by a factor which is known as the accelerator).

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Thus, for a constant volume of investment to be maintained, output must grow at a certain rate. To generate cycles, two more ingredients are necessary. There must be

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a 'ceiling' beyond which real output cannot grow. This is provided by full employment of the labor force. There must also be a 'floor' that is provided by the fact that gross investment cannot be negative. A disturbance such as an accidental increase in investment will cause a cumulative upward movement of output. This continues till output hits the full employment ceiling, beyond which it cannot grow. Since output stops growing, it is not necessary to add to capital stock. Thus, net investment falls. But this leads to a decrease in output. This continues till gross investment falls to zero, below which it cannot go. Income then stops falling. Once excess capacity has been reduced, there is no need for further negative net investment i.e., reduction of capital stock. Net investment rises from the negative level, pulls up income and starts the economic upturn again. 21.4.2 Demand induced cycles Business cycles can

also be looked at from the perspective of aggregate demand and aggregate supply. We can use a diagram to help our understanding. (Refer Figure 21.2). Assume that at point B, the economy is in short-term equilibrium. If there is tight money supply and less spending by the government, the aggregate demand curve AD shifts leftwards to form new aggregate demand Unit 21: Business Cycles 91 curve AD1. If there is no change in aggregate supply, the new equilibrium point will be C. At the new equilibrium point, the aggregate price level falls from P to P1 and output declines from Q to Q1. The rate of inflation also falls. During a boom period, the

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AD curve shifts towards right and output reaches the potential GDP or may even be higher.

During this stage, prices rise.

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Figure 21.2: A Decline in Aggregate Demand Leads to an Economic Downturn ? ?

P Q 1 Q C B AD AD 1 AD 1 AD Potential output Q P AS Real Output Price Level P 1 Source; ICFAI Research Center From this, it is quite clear that variations in aggregate demand can cause business cycle fluctuations in output, employment and prices. 21.4.3 Other theories There are many other theories which have attempted to explain business cycles by looking specifically at the behavior of investors, changes in public expenditure, money supply, and other variables. But they all have their limitations in predicting the downturns and upturns in business cycles in reality. 21.5 Causes of Business Cycle The business or trade cycle relates to the volatility of economic growth, and the different periods the economy goes through (e.g. boom and bust). There are many different factors that cause the economic cycle – such as interest rates, confidence, the credit cycle and the multiplier effect. Some economists also point to supply side explanations, such as technological shocks. 21.5.1 Interest rates Changes in the interest rate affect consumer spending and economic growth. For example, if interest rates are cut, this reduces borrowing costs and therefore increases disposable income for consumers; this leads to higher spending and Block IV: Macro Economics – II 92 economic growth. However, if the Central Bank increase interest rates to reduce inflation, this will tend to reduce consumer spending and investment, leading to an economic downturn and recession. 21.5.2 Changes in house prices A rise in house prices creates a positive wealth effect and leads to higher consumer spending. A fall in house prices causes lower consumer spending 21.5.3 Consumer and business confidence If there is a succession of bad economic news, this tends to discourage people from spending and investing, making a small downturn into a bigger recession. But, when the economy recovers this can cause a positive bandwagon effect. Economic growth encourages consumers to borrow and banks to lend. This causes higher economic growth. Confidence is an important factor in causing the business cycle. 21.5.4 Lending/finance cycle A boom in credit and lending is a factor in promoting economic growth. But, when banks became over-stretched and needed to call in loans, the financial system is short of liquidity. Credit crunch drags the economy into recession. 21.5.5 Inventory cycle Some argue that there is a natural inventory cycle. For example, there are some 'luxury' goods we buy every five years or so. When the economy is doing well, people buy these luxury items causing faster economic growth. But, in a downturn, people delay buying luxury goods, and so we get a bigger economic downturn. 21.5.6 Rise in oil price Rise in oil prices cause inflation and lower spending power. 21.6 Business Cycles in the Indian Economy In the Indian history there have been four periods since 1950-51 when growth in GDP has fallen sharply. These have been in 1957-58, 1965-66, 1979-80 and 1991-92 (see Table: 21.1 & Figures 21.3 to 21.6). In each of these years the growth rate fell by 4 or more percentage points and to less than 1%. In each of these years there was observed a sharp decline in agricultural output. As the table shows GDP-Agriculture in each of these years was negative. While 1957- 58 also saw a sharp decline in growth in manufacturing which turned to negative, in 1965-66 it was mainly the drought that caused GDP Agriculture to decline by over 11 percent. 1979-80 saw a sharp fall in GDP-Agriculture by over 12 percent. GDP-Manufacturing also declined and its growth was -3.4 per cent. In 1991-92 there was a balance of payment crisis, a fall in agricultural and manufacturing growth and a decline in GDP growth.

Unit 21: Business Cycles 93 Table 21.1: Business Cycles in the Indian Economy Year GDP (Factor cost) GDP (Manufacturing) GDP (Agriculture) Peak & Trough Period-I (1957-58) 1956-57 5.69 7.51 5.44 Peak 1957-58 -1.21 3.85 -4.49 Trough 1958-59 7.59 4.95 10.08 Period-II (1965-66) 1964-65 7.58 6.91 9.22 Peak 1965-66 -3.65 0.93 -11.04 Trough 1966-67 1.02 0.79 -1.42 Period-III (1979-80) 1978-79 5.50 12.35 2.30 Peak 1979-80 -5.20 -3.22 -12.77 Trough 1980-81 7.17 0.19 12.89 Period-IV (1991-92) 1990-91 5.57 6.05 4.11 Peak 1991-92 1.30 -3.65 -1.55 Trough 1992-93 5.12 4.14 6.79 Source: Compiled by ICFAI Research Center Figure 21.3: Period-I Source: ICFAI Research Center Figure 21.4: Period-II Source: ICFAI Research Center Block IV: Macro Economics – II 94 Figure 21.5: Period-III Source: ICFAI Research Center Figure 21.6: Period-IV Source: ICFAI Research Center 21.7 Economic Stability Economic stability means the economy shows no wide fluctuations in key economic indicators, such as GDP, unemployment or inflation. A stable economy demonstrates steady, manageable growth in GDP and employment. Manageable growth means the economy grows at a sustained rate that does not spark inflationary pressures, result in higher prices and negatively affect corporate profits. 21.7.1 Policies for Economic stability When sharp swings in GDP, unemployment, inflation and other measures point to unstable conditions, governments often respond with fiscal and monetary policy measures. 21.7.2 Fiscal Policy Fiscal policy usually involves changes in taxation and spending policies. When GDP and employment declines, governments may Lower taxes and increase their spending on goods and services. Lower taxes mean more disposable

Unit 21: Business Cycles 95 income for consumers and more cash for businesses to invest in jobs and equipment. Stimulus-spending programs, which are short-term in nature and often involve infrastructure projects, can also help drive business demand by creating short-term jobs. If the economy shows instability in the other direction, expanding at a pace likely to spark inflation, governments may increase taxes and reduce their spending on goods and services. Increasing income taxes usually mean less disposable income for consumers and less demand in the economy as a result price also decreases. 21.7.3 Monetary Policy Monetary policy usually involves in adjustment of interest rates and liquidity in the banking system. When economy declines, central banks lower the interest rates for ease access to credit for businesses and individuals. Lower interest rates mean lower cost of borrowings for businesses, which encourages higher investment demand in the economy. Similarly lower interest rate encourages more individual borrowings and creates more demand in the economy. This combination usually means higher business profits and growth in the economy. To check the inflationary pressure in the economy, central banks may increase the rates as a result money supply, demand and price decreases in the economy. 21.8 Impact of Business Cycle on Economy ? A volatile business cycle is considered bad for the economy. A period of economic boom (rapid growth in GDP) invariably leads to inflation with various economic costs. This inflationary growth tends to be unsustainable and leads to a bust (recession). ? The biggest problem of the business cycle is that a recession represents a large wastage of resources. A prolonged period of unemployment can also lead to a loss of labour productivity as workers get discouraged and leave the labour force altogether. ? The uncertainty created by a volatile business cycle tends to cause lower investment, and this can lead to lower long-term economic growth. ? During the contraction phase, a small business may have a tough time riding out the slow economic times before business picks up again. This is often where small business owners shut down ? However, other economists, such as J.Schumpeter argue that the creative destruction of capitalism can be a good thing. In a recession, inefficient firms go out of business and it acts as an incentive to cut cuts. 21.9 Forecasting Business Cycles An econometric model can be defined as a set of equations that uses historical data to study the behavior of the economy. It is used to forecast business cycles. The steps to build an econometric forecasting model are as follows: ? An analytical framework of equations is developed relating to aggregate demand and supply.

Block IV: Macro Economics – II 96 ? Each equation is applied to the data by using modern econometric techniques and

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parameter estimates such as GNP growth potential, marginal propensity to consume, etc. ? Finally, the whole model is put together to run as a system of equations.

Forecasts can be made using econometric models. Econometric models are also based on theories – which historical data you look at depends on which theory you subscribe to. Predictions can be made but they are not necessarily accurate, as sometimes they usually have a big margin of error. Business forecasters in most developed economies monitor closely macroeconomic indicators such as manufacturing capacity utilization, industrial production, etc. to get advance indications as to the possible changes in economic activity. 21.10 Employment Fluctuations 21.10.1 What is unemployment? When

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able bodied persons, who are willing to work at the market wage rate,

but are unable to find one are called unemployed. The phenomenon is unemployment. 21.10.2 Keynes' concept of unemployment A situation where low-wage rate should result in higher employment levels. However, this does not happen because due to low-wage rate the economy wheels towards recession, in turn, producers facing lesser demand for their goods and services. The rate of employment is considered as a barometer that indicates the economic situation in a country. Unemployment rate indicates the non- utilization of labor resources, the condition in which members of the labor force are without jobs. Sometimes used more broadly to refer to the waste of resources, when the economy is operating at less than its full potential. Fluctuations in the rate of the employment are a result of changes in the economy. According to

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Keynesian analysis, the level of employment is determined by effective demand (

under certain circumstances, as during the depression of the 1930s). The rate of employment can be maintained at high levels by increasing the size of effective demand. Developed countries try to reduce unemployment by increasing investment by ensuring that conditions are favorable for investors. In developing countries like India, the problem of unemployment is chronic. In such economies, the unemployment is a result of inadequate capital equipment, or other complementary resources rather than deficiency in effective demand. Economists distinguish three types of unemployment- frictional, structural and cyclical. ? Frictional unemployment is the unemployment that occurs due to the constant changes in the labor market. It is caused because of: a) lack of awareness among employers about the availability of workers b) lack of knowledge among workers about existing jobs on offer from employers.

Unit 21: Business Cycles 97 ? Structural unemployment can be defined as the unemployment that occurs due to structural changes in the economy. This type of unemployment is the result of a mismatch between the types of jobs on offer and the qualifications of the workers available. ? Cyclical unemployment occurs due to the general downturn in business activity. A fall

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in the general level of demand for goods and services

is the major cause of cyclical unemployment. The exhibit below captures the impact of the Pandemic in the unemployment in the USA Exhibit 21.1: Long term Unemployment Due to Pandemic COVID -19 has rendered widespread devastation. One of the areas that was greatly impacted was the unemployment. Several people were rendered jobless. US was one the countries that faced the unemployment issue during the pandemic. By March 2021, there were 4 million Americans who were unemployed for a duration exceeding 6 months. This included 1.5 million in white collar companies. While these figures were better than that of previous year, there were still 40% of the unemployed who fall into the category of LTU (Long term unemployed) These figures raised the question of whether the unemployment created by the Pandemic is short lived or has long term impacts. An article in Harvard Business Review discusses the possibility of the long term unemployment crisis in the US, especially among the white collared. The reasons include: Age bias – People who have experience of 10 and more years and have been deprived of employment during the pandemic, may find it more difficult to find work in a short span of time. This is due to a bias among the recruiters towards older people who may be energetic and agile to take up work responsibilities efficiently Unemployment bias – Another reason is that there is a perception that people rendered unemployed are the low performers in their previous organizations Under-qualification bias – People who do have the in-demand qualifications may find it more difficult to find employment. There are some others who opine that there could structural shifts in the employment market post the pandemic, resulting in some jobs being permanently wiped off; never to return. Structural shifts may also result from the behavioural aspects related to employment such as work from home, less business travel, shift to online retail etc. Source: https://hbr.org/2021/03/

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a-crisis-of-long-term-unemployment-is-looming-in-the-u-s 21.10.3

The concept of full employment Full employment can be defined

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as the level of employment that exists, when the rate of unemployment is normal i.e. when 94 to 95 percent of the labor force

Block IV: Macro Economics – II 98 is employed. The natural rate of unemployment is the average rate of unemployment, which results from various frictional and structural changes in the labor market over a period of time. The actual rate of unemployment surges above the natural rate during a recession and falls below the natural rate when the economy is booming. The rate of unemployment or rate of employment - some measurement problems: There are some problems in measuring the rate of unemployment or employment. They are: ? Two aspects are overlooked in the concept of unemployment. One, people are excluded from the workforce though they would prefer to work. Two, people who are not seriously seeking employment are included in the workforce. ? The method of classifying part-time workers may also affects the measurement of the unemployed people. For instance, part-time workers are classified as employed even if they work for a single hour in a week. 21.10.4 Nature of unemployment and employment trends

in India The nature of unemployment in India is to a large extent, structural and disguised.

The rate of production in India is insufficient to absorb the huge growth in the population seeking employment. The population explosion has meant that more and more young people are joining the available workforce every year, but jobs are not increasing at this rate. Industrial recession has also created cyclical unemployment in the urban areas. Disguised unemployment: Disguised unemployment is common in India, especially in the agricultural sector. The national output can be increased by shifting the surplus labor from agriculture to other sectors, and this would result in positive economic growth. If the surplus labor is shifted to capital projects like irrigation, drainage, roads, railways, houses, factories, etc, the national output would increase. But shortage of capital is a major hindrance, curbing the growth of employment opportunities in these areas. Activity 21.1 Despite the overall growth in the economy of the country, India has been unable to overcome the problem of unemployment. Measures to control the growth of unemployment have not achieved much success. Why has this happened? What type of unemployment prevails in India? Explain in detail. Answer:
Unit 21: Business Cycles 99 Check Your Progress - 2 5. According to the 'demand-induced cycle' theory, what happens to the aggregate demand curve in a boom period? a. Moves towards the right b. Moves towards the left c. Remains constant d. Increases initially and later declines 6. Frictional unemployment exists in an economy due to _______________. a. Lack of trained employees b. Imperfect information about the availability of manpower and the opportunities c. Cutback on production levels by manufacturers d. Decrease in demand for products 7. Full employment does not mean that zero unemployment exists in the economy. There is always a natural rate of unemployment in an economy. What is/are the reason(s) for natural unemployment in an economy? a. Frictional changes b. Policies that encourage potential employees to reject job offers and discourage employers from offering appropriate wages c. Structural changes d. All the above 8. Which type of unemployment is caused by constant changes in the labor market? a. Regional unemployment b. Structural unemployment c. Cyclical unemployment d. Frictional unemployment 21.11 Summary ? Economies pass through various stages of the business cycle, like prosperity, recession, depression and recovery. ? Prosperity is a stage where there is an increase in production across all sectors. During recession, there is a general

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fall in prices, decline in demand for capital goods and cancellation of new projects,

and a fall in the prices. During a depression, the prolonged fall in the production of goods and services, results in widespread unemployment, with its consequent negative effects on incomes, investment and production. Recovery is a period when Block IV: Macro Economics – II 100 there are plenty of employment opportunities, and this period is characterized by an overall rise in income levels and increase in the demand for goods and services. ? Business cycles can be predicted by using econometric models, in which a set of equations that use historical data are worked out to study the behavior of

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the economy. ? Unemployment can be categorized into three types- frictional, structural and cyclical. ?

Low production, the population explosion and industrial recession are some of the causes for unemployment in India. Disguised unemployment is one of the common types of unemployment that exists in India. 21.12 Glossary Disguised unemployment: Disguised unemployment is a situation when an excessive number of workers are employed than what is optimally desirable Frictional unemployment. Temporary unemployment caused by changes in individual markets. It takes time, for example, for new workers to search among different job possibilities; even experienced workers often spend a minimum period of unemployed time moving from one job to another. Net investment: Total investment during some accounting period minus the amount of depreciation during the same period. 21.13 Self-Assessment Test 1. Describe the various theories of business cycles. 2. Explain the characteristics of business cycles. 3. Explain the various phases of the business cycle. Also explain how depression is different from recession. 21.14 Suggested Reading/Reference Material 1. H.L.Ahuja. Principles of Microeconomics. 22 nd edition, S.Chand Publishing, 2019 2. Dwivedi D.N., "Microeconomic Theory and Applications", 3 rd edition, Vikas Publishing House, New Delhi, 2016 3. H.R. Appannaiah. Essentials of Managerial Economics. 3 rd edition. Himalaya Publishing House, 2021 4. D.M.Mithani. Macroeconomics. 1 st edition, Himalaya Publishing House, 2021 5. D.M.Mithani. Managerial Economics-Theory and Applications. 8 th edition. Himalaya Publishing House, 2021 6. H.L.Ahuja, "Advanced Economic Theory", revised edition, Sultan Chand Limited, New Delhi, 2017
Unit 21: Business Cycles 101 7. Gaurav Datt & Ashwani Mahajan, "Indian Economy", 70thedition, S. Chand & Company Ltd., 2016 8. Sanjiv Verma. The Indian Economy (Economic Survey 2020-21 & Budget 2021-22). Unique Academy Publishers. 2021 9. V.K.Puri and S.K.Mishra. Indian Economy. 38 th edition. Himalaya Publishing House, 2021 Additional References: 1. RBI. Handbook of Statistics on Indian Economy. 2020 https://www.rbi.org.in/scripts/AnnualPublications.aspx?head=Handbook%20of%20Statistics%20on%20Indian%20Economy 2. World Bank open knowledge repository. India Development Update. 2020. https://openknowledge.worldbank.org/bitstream/handle/10986/34367/India- Development-Update.pdf?sequence=1&isAllowed=y 3. IMF Working Paper. Make in India: Which exports can drive the next wave of Growth? 2016. 4. The World Bank Unemployment as percentage of total labor force. https://data.worldbank.org/indicator/SL.UEM.TOTL.ZS 21.15

Answers to Check Your Progress Questions 21.15.1 Model Answers to Check Your Progress Questions Following are the model answers to the Check Your Progress questions given in the Unit. 1. (
b)
Business cycle A business cycle is the period extending from a peak in economic activity to a trough and back to an upswing. Movements in business activity are explained using terms like boom, recession, depression and recovery. 2. (b) Depression When the economy moves towards depression, there is

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a substantial fall in the production of goods and services		

due to less demand in the market. This leads to an increased level of unemployment. Therefore, during depression, due to lower demand in the market, there will be a fall in the general price level. 3. (b) Business cycle

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During peak periods of a business cycle, when the economy is experiencing rapid growth in		

terms of

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real GDP, employment increases, as businesses recruit more workers to produce a higher output. If real GDP grows too quickly, it can cause price inflation. During recession, the economy experiences a decline in real GDP and unemployment rates increase.		

Thus, business cycles help analyze the relationship between various macroeconomic variables.

Block IV: Macro Economics – II 102 4. (a) Recession In recessionary periods, the consumption level falls, which results in a decline in the overall demand. This leads to economic losses to investors. This causes high economic losses to the overall economy. 5. (a) Moves towards the right During a boom, the increase in the purchasing power helps in raising the demand for goods and services in the economy, generating more employment opportunities. This makes the aggregate demand curve shift towards the right. 6. (b) Imperfect information about the availability of manpower and the opportunities Frictional unemployment is experienced in an economy because the labor market is constantly changing. Here the employer/employee may not be aware of the opportunities available in the market. Frictional unemployment exists in the market for two reasons: the employer may be unaware of the availability of the workers and their profiles, and also jobseekers may not be aware of all the jobs actually available in the market. 7. (d) All the above Frictional unemployment exists in the economy due to the changes in the labor market and the structural unemployment is due to the structural changes in the economy. An economy is said to be at full employment level when there is only natural rate of unemployment. Natural rate of unemployment includes both frictional and structural rate of unemployment. 8. (d)

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Frictional unemployment Unemployment that is caused by constant changes in the labor market is called frictional unemployment. It occurs on account of two reasons:

first, the

100% **MATCHING BLOCK 123/127** **W**

employers are not fully aware of all available workers and their job qualifications;

second, the

100% **MATCHING BLOCK 124/127** **W**

workers are not fully aware of the jobs being offered by employers. The basic cause of frictional unemployment is imperfect information. 103

Unit 22 Economic Growth, Development, & Planning Structure 22.1 Introduction 22.2 Objectives 22.3 The Process of Economic Growth 22.4 Economic Development 22.5 Economic Reforms in India 22.6 Future Economic Scenario of India 22.7 Summary 22.8 Glossary 22.9 Self-Assessment Test 22.10 Suggested Reading/ Reference Material 22.11 Answers to Check Your Progress Questions 22.1 Introduction

Till now, we have discussed different aspects of macroeconomics, like national income, consumption and investment functions, fiscal and monetary policies, inflation, banking and money supply, economic indicators, business cycles etc. In this last unit we will learn about economic development and planning. Previous unit discussed about Business Cycles. Economies pass through various stages of the business cycle, like prosperity, recession, depression and recovery. Business cycles can be predicted by using econometric models, in which a set of equations that use historical data are worked out to study the behavior of the economy. We discussed about Unemployment and the three types- frictional, structural and cyclical and the causes for unemployment in India. Disguised unemployment is one of the common types of unemployment that exists in India. The variation in the income levels of people in different countries is attributable to the varied levels of economic growth across the globe. The World Bank has classified countries into groups of low-income economies, lower middle-income economies, upper middle-income economies, and high-income economies, depending upon the average income levels. While economic growth is measured in terms of the increase in the Gross Domestic Product (GDP) or Gross National Product (GNP), economic development is a measure of the change in the living conditions of the people of country along with economic growth. Economic planning is a useful tool, mainly for the developing countries to achieve economic growth and/or economic development.

Block IV: Macro Economics – II 104 India has taken up economic reforms to set the country on the growth path. An analysis of the possible future of the Indian economy is also discussed in this unit. This unit will explain different theories of economic growth and various factors contributing to economic development. The unit will also discuss the economic reforms in India and India's future economic scenario. 22.2

Objectives By the end of this unit, students should be able to: ?

Discuss

various

economic growth theories ? Explain the concept of economic development and its determinants ? Discuss economic reforms in India ? Analyze the future of the Indian economy 22.3 The Process of Economic Growth 22.3.1 Economic Growth According to Samuelson and Nordhaus, "Economic growth represents the expansion of a country's potential GDP or national output." Figure 22.1 depicts the Production Possibility Curve (PPC) which experiences an outward shift and depicts economic growth due to the increased production of both capital and consumer goods in the economy. Figure 22.1: Production Possibility Curve Capital Goods Consumer Goods PPC after Economic Growth Source: ICFAI Research Center 22.3.2 Measurement of Economic Growth Economic growth is in general measured by the change in the Gross Domestic Product (GDP) or the Gross National Product (GNP) of a country. When GNP is used, the price changes should not be taken into account, to assess economic growth as the GNP is calculated at the current prices. According to some economists, per capita income or per capita output is a superior measure of economic growth as it indicates the standard of living in the economy.

Unit 22: Economic Growth, Development, & Planning 105 Table 22.1: Ranking of Countries based on GNP per Capita, 2020 Country Name Gross National Income (in Billion $) Rank Country Name Gross National Income per capita (in $) Ran k China 21133 1 Qatar 113133 1 United States 17997 2 Macao SAR, China 96188 2 India 8629 3 Singapore 81500 3 Japan 5115 4 Brunei Darussalam 76979 4 Germany 3850 5 Kuwait 73060 5 Brazil 2905 6 Norway 67704 6 Indonesia 2861 7 United Arab Emirates 66923 7 France 2668 8 Luxembourg 61074 8 United Kingdom 2626 9 Hong Kong SAR, China 58558 9 Mexico 2185 10 India 6446 137 Note: Both the indicators are in Purchasing Power Parity (PPP) at constant 2011 international $. Source: World Development Indicators, World Bank, 2020 22.3.3 Economic Growth Theories Economists have come up with different theories for the process of economic growth. Prominent among them are the classical model and the neo-classical model. The Classical Model Adam Smith and T.R. Malthus developed the classical model highlighting the importance of the availability of natural resources for economic growth. The classical model was set in a time when land was easily available and importance was not given to capital accumulation. According to the theory, as population increases, more land is brought under cultivation and as there is no capital formation, the national output doubles when the population doubles. With a further increase in population, land becomes scarce and the law of diminishing utility becomes applicable, resulting in a decline in the wage rate. According to Malthus, a subsistence level of wages has to be maintained to maintain the equilibrium of population. This is because when the wage level increases beyond the subsistence level, there will be an increase in population and with the wage level below the subsistence level, the mortality rate increases. Based on this explanation, Thomas Carlyle described economics as a 'dismal science'. The Neo-classical Model Robert Solow explained the effect of capital formation and changes in technology on economic growth in the neo-classical model. This model is based on the assumptions that the economy is competitive and always operates at full employment, and that technology remains constant.

Block IV: Macro Economics – II 106 To study the effect of capital formation on economic growth, an assumption that homogeneous output is produced by the inputs -- labor and capital -- is made in the neo-classical model. Capital deepening, which is a process where the quantity of capital per worker increases in due course, occurs when the stock of capital grows more rapidly than the labor force. Due to this, according to the neo-classical model, with technology remaining constant, the real wages should gradually stagnate. As this does not happen in the real world, technological advancement is considered to affect economic growth along with capital deepening. Hence, the increase in the output per worker is the sum of capital deepening and technological change. New Growth Theory (Endogenous growth theory) In the late 1980s, Paul Romer and Robert Lucas observed that the neo-classical growth model has very few policy implications as this theory states that the long-run growth of an economy is determined by the external or uncontrollable factors. According to Paul Romer "from the point of view of policy advice, growth theory had little to offer. In models with exogenous technological change and exogenous population growth, it never really mattered what the government did." In contrast to the neo-classical theory the endogenous growth theory, proposed by Paul Romer, treated rate of technological change or of population growth as endogenous factors. More specifically, according to the endogenous growth theory the economic growth is determined internally by the endogenous factors such as knowledge, innovation, and technology. Further, this theory argued that the productivity is directly connected to the faster innovation and more investments in human capital. The theory concludes that to improve the economic productivity both the private and the government sector must invest in the research and innovation activities in the economy. 22.3.4 The problem of economic growth Economic growth is affected by the limited supply of natural resources and other environmental constraints. It is accompanied by an increase in the use of natural resources such as land, fuel, etc. If proper measures are not taken and if there is no technological development to ensure the maintenance of a clean environment while improving economic growth, the sustainability of economic growth in the long run would be under question. Check Your Progress - 1 1. T. R. Malthus opined that population growth will eventually lead the economy to a point where wages are at ________. a. Minimum subsistence level b. Above subsistence level c. Below subsistence level d. Level of the standard of living

Unit 22: Economic Growth, Development, & Planning 107 22.4 Economic Development Economic development is a process of economic transition involving the structural transformation of an economy through industrialization and rising GNP and per capita income. It includes a change in social attitudes, cultural set- up, and institutional framework. 22.4.1 Differences between Economic Growth and Economic Development Economic growth is a reflection of the real output or productive capacity of an economy. The concept of economic development is more comprehensive than that of economic growth and considers various aspects relating to the structure of the economy, social attitudes, cultural set-up, techniques of production, and institutional framework along with the real output or per capita income of the economy. There can be economic growth without economic development, but there cannot be economic development without economic growth. 22.4.2 Factors contributing to Economic Development The major factors which contribute to the economic development of a country are: ? Natural resources ? Human resources ? Capital formation ? Technical knowledge Natural resources The availability of natural resources in a country and their usage pattern influences its economic development to a large extent. Optimum usage of non- renewable natural resources such as oil, coal, etc., and renewable natural resources such as timber can make significant contributions to the economic development of a country. Human resources The fortune of a nation depends on the people living in that country and their contributions to the nation. The level of economic development of a country is dependent on the availability of human capital — its skill set and knowledge of the people living in the country. Capital formation Capital formation is an important element contributing to the economic development of a nation. The capacity for capital formation is related to the economic status of the country. If the country is underdeveloped or developing, people in the country will have low income levels and low savings, leading to low capital formation for investment in production, and resulting in low income levels. To break this vicious circle, developing nations borrow funds from developed nations of the world.
Block IV: Macro Economics – II 108 Technical knowledge Improvements in technical knowledge contribute largely to the economic development of a nation. The innovations and advancements with enhanced technical knowledge fuel economic development. Countries need to make huge investments in Research and Development (R&D) to attain technical expertise. Patents provided for breakthrough innovations encourage the countries to invest more in the R&D efforts. Along with these factors, the government of a country also influences its economic development by making investments in the sectors where the country has a comparative advantage. Activity 22.1 List the factors which contribute to the economic development of a country apart from the factors discussed in the unit and explain the significance of each factor in your list. Answer: 22.4.3 Human Development Index (HDI) Human Development Index is a statistical tool which measures the key dimensions of human development. It measures the average achievements in a country on three basic dimensions of human development. They are: ? A long and healthy life ? Access to knowledge ? A decent standard of living HDI is a geometric mean of normalized indices from each of these three dimensions. It is created by a Pakistani economist Dr Mahbubul Haq in 1990 and is further used by UNDP. Figure 22.2: Human Development Index (HDI) Dimensions Indicators Dimension Index Long and healthy life Knowledge Mean years Expected years of schooling of schooling A decent Standard of Living Life Expectancy Index Education Index GNI Index Human Development Index (HDI) Source: Human Development Report 2020

Unit 22: Economic Growth, Development, & Planning 109 22.4.4 Calculation of Human Development Index Dimension Index = The HDI is the geometric mean of the three dimension indices. (? ?) The HDI is ranked on a scale from 0 to 1.0, with 1.0 being the highest human development. HDI has four tiers: very high human development (0.8-1.0), high human development (0.7-0.79), medium human development (0.55-.70), and low human development (below 0.55). Most developed countries have an HDI score of 0.8 or above (in the very high human development tier). These countries have stable governments, widespread education, healthcare, high life expectancies, and growing, powerful economies. The least developed countries (LDCs) in the world have HDI scores in the low human development tiers with HDI scores below 0.55. 22.4.5 Inequality-adjusted Human Development Index (IHDI) IHDI is a latest development, which accounts for inequalities in HDI dimensions by "discounting" each dimension's average value according to its level of inequality. The IHDI will be equal to HDI when there are no inequalities and as inequalities are rising IHDI falls below HDI. 22.4.6 Human Development Index (HDI) and India As per the Human Development Index report, 2014 released by UNDP, India was ranked at 135 out of 187 countries with HDI 0.586. In the 2021 rankings India dropped one rank to being ranked at 131 spot among 189 countries. India is part of medium development countries such as Bhutan, Bangladesh, Pakistan and Nepal. India had a HDI value of 0.645 in 2019. In 2021 its value is 0.647. Table 22.2: HDI Ranks 2021 Top 5 Countries Bottom 5 Countries Rank Country Rank Country 1. Norway 185. Burundi 2. Switzerland 186. South Sudan 3. Ireland 187. Chad 4. Germany 188. Central African Republic 5. Hong Kong 189. Nigeria Source: HDR 2021 22.4.7 World Happiness Index Recently, many countries have started looking at the overall happiness of the people while formulating the development policies (Example: Gross National
Block IV: Macro Economics – II 110 Happiness (GNH) of Bhutan). Happiness is defined as "the degree to which an individual judges the overall quality of his life-as-a-whole positively". Happiness Index ranks 156 countries by how happy their citizens perceive themselves to be. World happiness Index is published in the World Happiness Report which is published annually by the united nation's Sustainable Development Solutions Network using the Gallup World Poll data. The rankings of the countries are based on a Cantril Ladder Survey. In this survey, the enumerator asks the responded to rate themselves on a 0-10 point ladder where 1 stand for complete happiness and 0 for not at all happy. Table 22.3; Happiness Rank 6 Happiness Rank 2021 Country 1 Finland 2 Denmark 3 Switzerland 4 Iceland 5 Netherlands 6 Norway 7 Sweden Source: https://worldpopulationreview.com/country-rankings/

happiest-countries-in-the-world To determine the world's happiest country, researchers analyzed comprehensive Gallup polling data from 149 countries for the past three years, specifically monitoring performance in six particular categories: Gross domestic product per capita, social support ,Healthy life expectancy, Freedom to make your own life choices ,Generosity of the general population , Perceptions of internal and external corruption levels

Exhibit 22.1 captures the main points from the world happiness report, 2021 Exhibit 22.1: World Happiness Report, 2021 The Gallup World Poll data indicates that even during the pandemic, there has been a strong resilience in how people rated their lives. The report assessed the happiness based on three subjective indicators – Life evaluations – The Poll asked the

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respondents to evaluate their current life as a whole using the image of ladder, with best possible life score as 10 and worst as 0. 1,000

respondents' data was collected. Based on their feedback, the rankings were given. Finland retained its number one rank with a score of 7.889 on the ladder. Only a small number of countries showed a variation in their rankings compared to 2019. Contd.... 6 https://worldpopulationreview.com/country-rankings/happiest-countries-in-the-world
Unit 22: Economic Growth, Development, & Planning 111 Positive emotions – Respondents were asked whether they smiled or laughed a lot during a day or experienced enjoyment. Positive emotions were in the middle ground with 22 countries showing an upside trend while 21 downside. During the pandemic, the frequency of positive emotions decreased. Negative emotions – This was measured by asking the respondents whether they experienced any specific negative emotions during a day. A regression analysis indicated that negative emotions had an average score of 0.27. The results indicated that positive emotions were three times more frequent than negative emotions. Source: https://happiness-report.s3.amazonaws.com/2021/WHR+21.pdf 22.5 Economic Reforms in India 22.5.1 Need for Economic Planning Economic planning, in general, refers to the attainment of long run goals and objectives ushering economic growth and development. According to Ragnar Nurkse, an economist, the vicious circle of poverty/underdevelopment implies a circular constellation of forces tending to act and react upon one another in such a way as to keep a poor country in a state of poverty. According to some economists, 'a country is poor because it is poor'. This is because if the country is poor, its productivity is low; due to low productivity, income levels are low and the savings are also low and hence the availability of capital for industrialization is low. Economic planning can help such economies get out of the vicious circle of poverty and underdevelopment. The other objectives of economic planning are to increase the income levels of people, to improve employment opportunities, and to remove disparities in the income levels of people. 22.5.2 Importance of Economic Planning for India For developing countries like India, economic planning is all the more important to attain economic growth which is equal to that of the developed nations. The National Planning Committee was set up by the Government of India in 1938 with the objectives of attaining a higher level of national and per capita income, reducing inequalities in distribution of income and wealth, achieving full employment for people in the country, etc. Five year plans were also commissioned by the government to improve the economic growth. The economic crisis of 1991 highlighted the need for focused economic planning in India, though planning in India had begun soon after independence, from 1950 onwards. Analysts opined that the main reasons for the crisis were the imbalance in government expenditure, which was due to the growth in unplanned revenue expenditure, high rate of inflation, etc.

Block IV: Macro Economics – II 112 The Government of India also took up economic reforms to improve the economic situation of the country. These reforms, under the auspices of the then Finance Minister, Dr. Manmohan Singh, were directed by the then Prime Minister, Shri. Narasimha Rao, in July 1991, to overcome the mounting debt crisis and prolonged balance of payment crisis. It was the famous LPG reforms – Liberalization, Privatization and Globalization. Liberalization: It refers to slackening or easing of government regulations in terms of industrial licensing policy. Many industries were taken away from the clutches of stringent licensing policy except a handful ones that were hazardous or to be maintained under the direct control of the Government. Privatization: It refers to participation of private entities in business and services. Disinvestment (transfer of ownership from public sector to private sector) in various fields was undertaken. MRTP (Monopolies and Restrictive Trade Practices) Act was repealed and made toothless. Globalization: In general, it refers to consolidation of world economies. As far as India was concerned, it opened the gates of the economy to the world for free flow of goods and services, capital, technology and later, included labour as well. 22.5.3 Economic Reforms undertaken by the Indian Government The main aim of the economic reforms in India was to attain macroeconomic stability. The major reforms were in the industrial, financial, trade, and public sectors. Reforms in Indian Industrial Policy Changes were made to the existing industrial policy of India in 1991 to facilitate trade liberalization and encourage Foreign Direct Investments (FDIs) in India. Further, the objectives of the reforms included sustaining the growth in productivity, improving employment opportunities in the country, and releasing domestic entrepreneurs from the restrictions of the Monopolies and Restrictive Trade Practices (MRTP) Act. Under the new industrial policy, up to 51 percent FDI would be allowed in high priority industries which required advanced technology and large investments. The industrial licensing requirement was restricted by the government to only certain product categories such as drugs and pharmaceuticals, petroleum, coal, cigarettes, alcohol, defense equipment, etc. Only eight industries were reserved for the public sector and some of the core industries such as air transport, electricity, and telecommunications, etc. were opened up to the private sector. The restrictions under the Monopolies and Restrictive Trade Practices (MRTP) Act were also relaxed and monopoly houses were not required to take the prior approval of the central government for expansion, mergers, takeover, and appointment of certain directors.

Unit 22: Economic Growth, Development, & Planning 113 Financial Sector Reforms There was a need to improve the operational efficiency of the banking system in India. The Government of India appointed a committee under the chairmanship of M. Narasimham to analyze the financial system of the country and make necessary recommendations. Based upon the report submitted by the Narasimham committee in December 1991, banking sector reforms such as reduction in the statutory liquidity ratio (SLR) and the cash reserve ratio (CRR) in a phased manner, revision in the format of the balance sheet and profit and loss account to reflect the true financial position of the banks, setting up of Special Recovery Tribunals to hasten the process of quicker recovery of loan arrears to banks, etc. were taken up by the Government of India. Trade Sector Reforms To encourage FDIs in India the government brought about reforms in the trade sector. Devaluation of the rupee in July 1991, liberalization of the import regime, a cut in the custom tariff rates, allowing rupee convertibility first on trade account and then for the entire current account transactions, etc. were the reforms related to the trade sector. Further, export promotion measures were taken up under the EXIM policies. Public Sector Reforms The public sector in India has contributed to the diversifying of the industrial structure of the country. But the public sector has been a failure in generating investable surpluses for further expansion. Hence, the government felt the need for reforming the public sector. Based upon the recommendations of the disinvestment committee headed by C. Rangarajan, the Government of India disinvested up to 49 percent of equity in many state-owned firms, using the strategy of retaining the management of public sector undertakings while selling a part of the ownership. 22.5.4 Impact of Economic Reforms in India The economic reforms undertaken during the 1990s in India were to a large extent instrumental in the country emerging as one of the fast growing economies of the world. The GDP growth of India, which was 3.5 percent in 1980, increased to around 6.3 percent by 2004 and is expected to be around 7 to 8 percent in the next decade. However, some economists are of the opinion that the economic reforms of India had some drawbacks such as the lack of a defined strategy for development. They also held that the reforms had been initiated without prerequisites like advances in technology in the country being fulfilled before allowing the import of capital goods. Moreover, the human development aspect was also ignored in the process of economic reforms in India, they contended.

Block IV: Macro Economics – II 114 NITI (National Institution on Transforming India) Aayog The New government formed at center in May 2014 under the leadership of Shri Narendra Modi as PM scrapped Planning Commission and introduced NITI Aayog in its place. The erstwhile Planning Commission has been re-christened as NITI Aayog by Prime Minister, Mr. Narendra Modi. It is an effort to move from 'mere planning' to 'transform' India towards development. The agenda involves (i) NITI to act as a think-tank or a forum aimed towards economic targets. The powers to allocate funds will henceforth be vested with the finance ministry and not the Commission. (ii) More responsibility/ significant role by the States and Union territories in shaping India, instead of them being just appendages. This would ensure better fiscal federalism and minimize malfunctioning of the States. The idea of NITI is just not bringing in structural changes alone in the economy, but also to take the nation at a higher plane – a possibility, only with combined, co-operated and coordinated efforts between the Centre and the States. The technical changes made were in the reduction of full-time members and an introduction of part-time members. This could cult in perception from different angles; and the CEO will be appointed by the Prime Minister. Check Your Progress - 2 2. The new foreign investment policy of 1991 in India allowed foreign companies to have an equity limit up to ______ percent in 35 priority sectors which require advanced technology and large investments. a. 49 b. 51 c. 60 d. 75 3. As per the industrial policy of 1991, which of the following became free from the industrial licensing requirement? a. Petroleum b. Cigarettes c. Defense equipment d. Textiles

Unit 22: Economic Growth, Development, & Planning 115 4. As per the industrial policy of 1991, which of the following industries remained reserved for the public sector? a. Air transport b. Electricity c. Atomic energy d. Telecommunications 22.6 Future Economic Scenario of India The future economic scenario of India will be influenced by factors such as globalization, population growth, foreign exchange reserves, financial system, unemployment, etc. 22.6.1 Globalization Globalization can be understood as economic integration and enhancing the economic relations between various nations of the world across geographical boundaries. India opened up to trade with foreign countries in 1991. Due to liberalization, many countries of the world came forward to develop trade relations with India. The Indian economy grew at an average rate of 5.60% per annum during the first decade (1991-2000) of the massive liberalization measures. The second decade (2001 to 2010) of liberalization witnessed even higher growth with average rate at 6.74%. Continuing on its high growth trajectory, India has posted an average growth rate of 6.82% over the last 8 years from 2011 to 2018. With this almost 3 decades of remarkable growth rate, India now aspires to become a 5 trillion dollar economy by 2024-25. The economic growth of India in the period between 1991 and 2005 was on an average at around 6 percent. Economists predict the growth rate in the coming years to be around 7 percent. Globalization has had its impact on the Indian economy. Domestic companies have faced stiff competition from foreign firms and have grown to meet international standards in operations. Globalization has brought Business Process Outsourcing (BPO) to India. Many international companies are outsourcing their non-core business activities to India in order to gain the advantages of cheap labor along with the availability of skilled personnel. Exports of software and services from India were US$13.3 billion in 2003-04. The Indian Information Technology (IT) and Information Technology Enabled Services (ITES) industry is perceived to have immense growth potential. Globalization has also influenced the life of the youth in India. With the increase in the level of disposable incomes, their lifestyle is changing. More and more malls are coming up, mainly to cater to the interests of the youth. In this way, globalization has brought about a change in the business scenario of India.

Block IV: Macro Economics – II 116 'Make in India' Initiative The government of India introduced the initiative 'Make in India' on 25 September 2014 to transform the Indian economy into a manufacturing hub. This initiative urges the local and the foreign companies to invest in India to convert it to a manufacturing powerhouse. Under this initiative the government of India aims to accelerate the manufacturing sector growth to 12-14% per annum and it is expected to bring the share of manufacturing sector to 25% of the GDP by 2025. Further, it is expected to generate 100 million additional jobs by 2022. Government is planning to implement this policy by identifying 25 key sectors and introducing skill development program especially for the rural people. Further, it is also planning to set-up 'invest India cell', which will speed up the regulatory clearance for foreign investment. The initiatives under the Make in India program has helped the Indian economy to achieve an impressive ranking (63 rd position in 2019) in ease of doing business and 58 th position in Global Competitive Index in 2018. Further, the cumulative FDI flow to the Indian manufacturing sector stood at US$ 91.20 billion during the April 2000-June 2019 period. 22.6.2 Population Growth India's population in September 2005 stood at 1.08 billion as against of the world population of 6.5 billion. By 2021, India's population 1.3927 billion. The economic growth of the country has not been transformed into development due to the high rate of population growth and the per capita income of India remains low. Analysts believe that the economic growth and development of India can be sustained only by increasing the employment opportunities while controlling the population growth. 22.6.3 Foreign Exchange Reserves Post-liberalization, the flow of Foreign Direct Investment (FDI) into India has been on the rise. The Government of India had undertaken reforms in the foreign investment policy with a view to attracting more FDI into India. The new foreign investment policy of 1991 allowed foreign companies to invest up to 51 percent in 34 high priority industries. Further, the government allowed investment up to 74 percent and 100 percent in certain cases, simplified the procedures of the Reserve Bank of India for automatic FDI approvals, etc. These measures helped India to attract more FDI. However, when compared to other developing nations like China and Brazil, FDI in India is very low and needs to improve a lot. 22.6.4 Financial System in India The development of financial system of an economy is often measured by looking at the size and depth of the sector. With a total of 1.48 lakh branches as of December 2019, India has become the country with highest number of bank

Unit 22: Economic Growth, Development, & Planning 117 branches in the world. The bank deposit to GDP ratio was reported at 64.93 % in 2017. Size of the domestic credit provided by the Indian banking sector as of 2017 (% of GDP) was at 72.08 %. India's Gross domestic Savings to GDP was measured at 29.4 % in 2018, whereas the China's domestic saving rate was at 46.6% for the same period India's financial assets including equities, bank deposits, and debt securities were $900 billion in 2005, which was only one-fifth of the stock maintained by China. In 2005, the deposits in India accounted for only 60 percent of the nation's GDP, whereas China's deposits accounted for a whopping 190 percent of its GDP. This is understood to be because of the low savings rate in India. Indians tend to invest more on physical assets such as cattle, gold, land, etc. Also, India possesses around $200 billion worth of gold, which is nearly half the nation's bank deposits. However, these assets do not form part of the country's bank deposits. To improve the financial system of India, there is a need for the Reserve Bank of India (RBI) to take measures to encourage individual savings in the country and to provide individuals incentives to gain higher returns on financial assets. A major challenge to the Indian banking sector is the mounting size of non-performing asset which is reported at 9.5% of total gross loan in 2018. 22.6.5 Unemployment The unemployment rate in India is as high as 9.2% (2004 estimate). Further, according to the World Bank, around 30 percent of the Indian population lives below the poverty line. To counter the unemployment problem, the Government of India in 2005 announced plans to pass the National Rural Employment Guarantee Bill. The bill promised to provide employment for at least 100 days a year to adult members in rural households who volunteered to take up unskilled manual work. Some analysts are of the opinion that the labor laws of India need to be reformed to bring in more flexibility in the labor market regulation and attract more foreign nation companies to operate in India. The Economic Survey 2019- 20 has proposed to generate 4 crore of well-paid jobs by 2025 and to increase it by 8 crore by 2030 Example: Some Important Points from the Economic Survey of India (2019-20) ? India has become fifth largest economy in the world in 2019 ? India aspires to become a $5 trillion economy by 2025 ? The Indian economy is projected to be grow at 6 to 6.5 percent in FY2020-21 ? Generate 4 crore well-paid jobs by 2025 and 8 crore by 2030 ? Increase the export market share by 3.5 percent by 2025 and 6% by 2030 Contd....
Block IV: Macro Economics – II 118 ? Improvement in ease of doing business rankings from 79 in 2018 to 63 in 2019 ? Consumer Price Index (CPI) Inflation in 2019 is observed at 4.1 percent ?

56% **MATCHING BLOCK 127/127** **SA** final book.docx (D143611479)

Foreign reserves stood at US$ 461.2 billion as on 10th January 2020 ? The Current Account Deficit (CAD) contracted to 1.5 per cent of GDP in

first half of 2019-20 from 2.1 per cent in 2018-19 Activity 22.2 Do you think India can beat China in terms of attracting FDI by 2010? Answer: What will the growth rate of India be in the coming five years? Answer: Will there be full employment in India by 2030? Answer: Check Your Progress - 3 5. Which of the following is necessary to sustain growth and development in India? a. Increase employment and reduce population growth. b. Maintain the level of employment and increase population growth. c. Increase employment and increase population growth. d. Bring down employment level and reduce population growth.

Unit 22: Economic Growth, Development, & Planning 119 22.7 Summary ? Economic growth represents an increase in the country's potential national output. It is measured in terms of the increase in the Gross Domestic Product (GDP) or Gross National Product (GNP). ? Economic development involves a change in social attitudes, cultural set-up, and institutional framework along with economic growth. ? Economic planning has a significant role to play in the economic growth and stability of a country. ? The economic reforms initiated in 1991 have helped India to emerge as a fast-growing economy in the world. ? The future economic scenario of India will depend to a great extent on the changes in the fronts of globalization, population growth, foreign exchange reserves, financial system in India, and unemployment. 22.8 Glossary Human capital: The stock of knowledge and acquired skills embodied in individuals. Renewable natural resources: Renewable natural resources can be replaced in a short period of time. The examples of renewable resources are animals, insects, reptiles, plants, trees, water, grass, solar and wind energy. Non- Renewable natural resources: Non- renewable resources can not be replaced as it take long time to form naturally. Examples of non renewable resources are coal, oil, natural gas, fossil fuel etc. 22.9 Self-Assessment Test 1. Explain the concept of economic growth, describing the measurement of economic growth. 2. What is the difference between economic growth and economic development? What are the major determinants of economic development? 3. In your view, what is the future economic scenario of India? 22.10 Suggested Reading/ Reference Material 1. H.L.Ahuja. Principles of Microeconomics. 22 nd edition, S.Chand Publishing, 2019 2. Dwivedi D.N., "Microeconomic Theory and Applications", 3 rd edition, Vikas Publishing House, New Delhi, 2016 3. H.R. Appannaiah. Essentials of Managerial Economics. 3 rd edition. Himalaya Publishing House, 2021 4. D.M.Mithani. Macroeconomics. 1 st edition, Himalaya Publishing House, 2021

Block IV: Macro Economics – II 120 6. D.M.Mithani. Managerial Economics-Theory and Applications. 8 th edition. Himalaya Publishing House, 2021 7. H.L.Ahuja, "Advanced Economic Theory", revised edition, Sultan Chand Limited, New Delhi, 2017 8. Gaurav Datt & Ashwani Mahajan, "Indian Economy", 70thedition, S. Chand & Company Ltd., 2016 9. Sanjiv Verma. The Indian Economy (Economic Survey 2020-21 & Budget 2021-22). Unique Academy Publishers. 2021 10. V.K.Puri and S.k.Mishra. Indian Economy. 38 th edition. Himalaya Publishing House, 2021 Additional References: 1. RBI. Handbook of Statistics on Indian Economy. 2020 https://www.rbi.org.in/scripts/AnnualPublications.aspx?head=Handbook%2
0of%20Statistics%20on%20Indian%20Economy 2. World Bank open knowledge repository. India Development Update. 2020. https://openknowledge.worldbank.org/bitstream/handle/10986/34367/India- Development-Update.pdf?
sequence=1&isAllowed=y 3. IMF Working Paper. Make in India: Which exports can drive the next wave of Growth? 2016. 22.11 Answers to Check Your Progress Questions 22.11.1 Model Answers to Check Your Progress Questions Following are the model answers to the Check Your Progress questions given in the Unit. 1. (

a) Minimum subsistence level T. R. Malthus opined that population growth will lead the economy to a point where wages are at a minimum subsistence level. According to him, if the wage rates rise above subsistence level, there will be an increase in population. And if the wage rates fall below subsistence level, there will be an increase in the mortality rate and the population declines. Thus, the population can be maintained in equilibrium only at the subsistence level of wages. 2. (b) 51 It was decided by the government of India that under the new industrial policy of 1991, foreign direct investment to the extent of 51 per cent would be approved in high priority industries, which required advanced technology and large investments.

Unit 22: Economic Growth, Development, & Planning 121 3. (d) Textiles Under the industrial policy of 1991, industrial licensing requirement was restricted to only certain product categories which include drugs and pharmaceuticals, petroleum, coal, cigarettes, alcohol, defense equipment, industrial explosives, hazardous chemicals, sugar, animal fats and oil, plywood and other wood based products, paper and newsprint, aerospace, entertainment, electronics, tanned or dressed fur skins, asbestos and asbestos based products. Therefore, industrial production of all other product categories apart from these specified categories is free from licensing requirement. 4. (c) Atomic energy The government of India decided to change the industrial licensing policy in 1991. The government reserved only eight industries for the public sector. They included industries like coal and lignite, mineral oils, mining of iron ore and allies, mining of copper and related metals, minerals specified in the schedule of the Atomic Energy Order, 1953, arms and ammunition, atomic energy, and railway transport industries. 5. (a) Increase employment and reduce population growth. For developing nations like India, population growth is likely to slow down the economic growth resulting in decline of per capita income and resources. Increasing population invariably increases the labor force, but it also aggravates the unemployment problem. So, increase in employment levels and reduction of population growth is necessary to sustain growth and development in India.

Economics for Managers Course Components Block I Microeconomics – I Unit 1 Introduction to Microeconomics Unit 2 Theory of Demand and Supply Unit 3 Consumer Behavior Unit 4 Production Function Unit 5 Analysis of Costs Block II Microeconomics – II Unit 6 Perfect Competition Unit 7 Imperfect Competition Unit 8 Rent and Wages Unit 9 Interest and Profit Unit 10 Forecasting and Decision-Making Block III Macroeconomics – I Unit 11 Introduction to Macroeconomics Unit 12 National Income Unit 13 Consumption and Investment Function Unit 14 Classical and Keynesian Economics Unit 15 Fiscal Policy and Budget Deficit Unit 16 Banking and Money Supply Block IV Macroeconomics – II Unit 17 Monetary Policy Unit 18 Inflation Unit 19 International Trade and Balance of Payments Unit 20 Economic Indicators Unit 21 Business Cycles Unit 22 Economic Growth, Development and Planning

Hit and source - focused comparison, Side by Side

Submitted text As student entered the text in the submitted document.

Matching text As the text appears in the source.

1/127 SUBMITTED TEXT 40 WORDS	100% MATCHING TEXT 40 WORDS
of Monetary Policy 17.4 Instruments of Monetary Policy 17.5 Problems in Monetary Policy 17.6 Monetary Targeting 17.7 Monetary Policy in a Developing Economy 17.8 Monetary Policy in an Open Economy 17.9 Link between Monetary Policy and Fiscal Policy 17.10	of Monetary Policy • Instruments of Monetary Policy • Problems in Monetary Policy • Monetary Targeting • Monetary Policy in a Developing Economy • Monetary Policy in an Open Economy • Link between Monetary Policy and Fiscal Policy

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2/127	SUBMITTED TEXT 38 WORDS	98% MATCHING TEXT 38 WORDS
	Monetary policy can be defined as “the deliberate effort by the central bank to influence economic activity by variations in the money supply, in availability of credit or in the interest rates consistent with specific national objectives.”	Monetary Policy can be broadly defined as "the deliberate effort by the Central Bank to influence economic activity by variations in the money supply, in availability of credit or in the interest rates consistent with specific national objectives."
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3/127	SUBMITTED TEXT 18 WORDS	66% MATCHING TEXT 18 WORDS
	the value of a particular country's currency in terms of another currency. Instability in the exchange rate	the value of a currency in terms of another currency. Fluctuations in the exchange rate
W	http://www.tdcorrige.com/doc/6794.doc	

4/127	SUBMITTED TEXT 19 WORDS	100% MATCHING TEXT 19 WORDS
	Open market operations Open market operations refer to the buying or selling of securities by the Central Bank.	Open Market Operations Open market operations refer to the buying or selling of securities by the Central Bank.
W	http://www.tdcorrige.com/doc/6794.doc	

5/127	SUBMITTED TEXT 17 WORDS	100% MATCHING TEXT 17 WORDS
	the rate of interest at which the Central Bank rediscounts approved bills of exchange. This policy	the rate of interest at which the Central Bank rediscounts approved bills of exchange. This policy
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6/127	SUBMITTED TEXT	11 WORDS	100% MATCHING TEXT	11 WORDS
bank rate leads to a reduction in other interest rates			bank rate leads to a reduction in other interest rates.	

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7/127	SUBMITTED TEXT	16 WORDS	73% MATCHING TEXT	16 WORDS
repo rate. Repo rate is the rate at which RBI lends money to commercial banks				

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8/127	SUBMITTED TEXT	16 WORDS	96% MATCHING TEXT	16 WORDS
The Central Bank can regulate money supply by changing the reserve requirements of commercial banks.			The Central Bank can regulate money supply by simply changing the reserve requirements of commercial banks.	

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9/127	SUBMITTED TEXT	23 WORDS	54% MATCHING TEXT	23 WORDS
reserve requirements decreases the amount of demand deposits that banking system can support, thus reducing the money supply, and vice-versa. 17.4.7			reserve requirements are increased, the amount of demand deposits that banking system can support will be reduced and which in turn, reduces the money supply or vice-versa.	

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10/127	SUBMITTED TEXT	13 WORDS	87% MATCHING TEXT	13 WORDS

Rationing of credit: This is used to prevent excessive expansion of credit.

rationing of credit is used to prevent excessive expansion of credit.

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11/127	SUBMITTED TEXT	11 WORDS	100% MATCHING TEXT	11 WORDS

Changes in margin requirements are used to curb speculative activities.

Changes in margin requirements are used to curb speculative activities.

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12/127	SUBMITTED TEXT	20 WORDS	61% MATCHING TEXT	20 WORDS

money supply in the economy 17.4.8 Statutory Liquidity Ratio (SLR) Statutory Liquidity ratio (SLR) is the portion of

SA Macroeconomics Lesson 6.doc (D158590404)

13/127	SUBMITTED TEXT	13 WORDS	100% MATCHING TEXT	13 WORDS

to put pressure upon the lending activities of commercial banks through exhortations

to put pressure upon the lending activities of commercial banks through exhortations

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14/127	SUBMITTED TEXT 15 WORDS	100% MATCHING TEXT 15 WORDS
	banking system has reserves of Rs 400 crore and the reserve requirement is 10%.	banking system has reserves of Rs 500 crore and the reserve requirement is 20

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15/127	SUBMITTED TEXT 48 WORDS	59% MATCHING TEXT 48 WORDS
	Banking system has reserves of Rs 400 crore and the reserve requirement is 10%. The banking system can support demand deposit up to Rs 400 crore / 0.10 = Rs 4000 crore. The reserve requirement is increased to 20%. Now the banking system can support demand	banking system has reserves of Rs 500 crore and the reserve requirement is 20 percent. So, the system can support demand deposits up to the limit of 500/0.2 = 2,500 crore. If the reserve requirement is increased to 25 percent, the system will support demand

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16/127	SUBMITTED TEXT 16 WORDS	100% MATCHING TEXT 16 WORDS
	banking system has reserves of Rs. 500 crore and the reserve requirement is 20 percent,	banking system has reserves of Rs 500 crore and the reserve requirement is 20 percent.

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17/127	SUBMITTED TEXT 18 WORDS	90% MATCHING TEXT 18 WORDS
	banking system has reserves of Rs 500 crore and the reserve requirement is 20 percent. If the	banking system has reserves of Rs 500 crore and the reserve requirement is 20 percent. So, the

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18/127	SUBMITTED TEXT 18 WORDS	100% MATCHING TEXT 18 WORDS
	rate is the rate of interest at which the central bank rediscounts approved bills of exchange.	rate is the rate of interest at which the Central Bank rediscounts approved bills of exchange.
	W http://www.tdcorrige.com/doc/6794.doc	

19/127	SUBMITTED TEXT 14 WORDS	100% MATCHING TEXT 14 WORDS
	Problems in Monetary Policy 17.5.1 Lags in monetary policy There is a	Problems in Monetary Policy 4.4.1. Lags in Monetary Policy There is a
	W http://www.tdcorrige.com/doc/6794.doc	

20/127	SUBMITTED TEXT 24 WORDS	97% MATCHING TEXT 24 WORDS
	time between the point at which the need for a particular monetary policy is felt and the time at which the aggregate demand	time difference between the point at which the need for a particular monetary policy is felt and the time at which the aggregate demand
	W http://www.tdcorrige.com/doc/6794.doc	

21/127	SUBMITTED TEXT 15 WORDS	100% MATCHING TEXT 15 WORDS
	time gap between the recognition of the need, and the implementation of the policy.	time gap between the recognition of the need and the implementation of the policy.
	W http://www.tdcorrige.com/doc/6794.doc	

22/127	SUBMITTED TEXT 18 WORDS	64% MATCHING TEXT 18 WORDS
	Monetary Targeting Monetary targeting can be defined as the practice of formulating monetary policy in terms of	Monetary Targeting Monetary targeting refers to the practice of formulating monetary policy in terms of

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23/127	SUBMITTED TEXT 52 WORDS	100% MATCHING TEXT 52 WORDS
	target growth of money stock. Keeping in view the need to regulate money supply in line with increases in output, a committee set up to review the working of the monetary system in India recommended that the Reserve Bank adopts a system of monetary targeting with feedback. The Reserve Bank should	target growth of money stock. Keeping in view the need to regulate money supply in line with increases in output, a committee set up to review the working of the monetary system in India recommended that the Reserve Bank adopts a system of monetary targeting with feedback. The Reserve Bank should

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24/127	SUBMITTED TEXT 27 WORDS	90% MATCHING TEXT 27 WORDS
	the expected rate of growth of the real sector and an acceptable order of increase in prices. The target may be modified, if the real sector	the expected rate of growth of the real sector and a tolerable or acceptable order of increase in prices. The target may be modified if the real sector

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25/127	SUBMITTED TEXT 17 WORDS	92% MATCHING TEXT 17 WORDS
	between recognition of the need and the implementation of the policy is known as ________.	between the recognition of the need and the implementation of the policy. This is known as

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26/127	SUBMITTED TEXT	31 WORDS	67% MATCHING TEXT	31 WORDS

The monetary policy has been primarily acting through the availability of credit d. The cost of credit has been adjusted upward in the past to meet inflationary situations 17.7

the monetary policy has been primarily acting through the availability of credit, the cost of credit has also been adjusted upward in the past to meet inflationary situations.

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27/127	SUBMITTED TEXT	29 WORDS	100% MATCHING TEXT	29 WORDS

Direct involvement of the central monetary authority in the allocation of credit to the non-government sector has become an important element of the national economic policy. ?

direct involvement of the central monetary authority in the allocation of credit to the non-government sector has become an important element of the national economic policy.

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28/127	SUBMITTED TEXT	24 WORDS	65% MATCHING TEXT	24 WORDS

Containment of inflationary pressures without adversely affecting the growth potential has been one of the main objectives of monetary policy. ?

containment of inflationary pressures without adversely affecting the growth potential has been the main objective of the monetary policy.

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29/127	SUBMITTED TEXT	37 WORDS	95% MATCHING TEXT	37 WORDS

flexibility, promoting a competitive environment and imparting greater discipline and prudence in the operations of the financial system. 17.8 Monetary Policy in an Open Economy Central banks in open economies manage reserve flows, and monitor

flexibility, promoting a more competitive environment and imparting greater discipline and prudence in the operations of the financial system. 4.7. Monetary Policy in an Open Economy Central Banks in open economies manage reserve flows, exchange rates and monitor

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30/127	SUBMITTED TEXT	12 WORDS	100% MATCHING TEXT	12 WORDS
is decided by the Policy Board at Monetary Policy Meetings.			is decided by the Policy Board at Monetary Policy Meetings (	

W https://www.boj.or.jp/en/mopo/outline/index.htm/

31/127	SUBMITTED TEXT	28 WORDS	71% MATCHING TEXT	28 WORDS
referred to as “Strengthening the framework for Continuous Powerful Monetary Easing Framework”. The changes included adoption of a forward guidance with regard to two policy rates –			referred to these adjustments as “Strengthening the Framework for Continuous Powerful Monetary Easing Framework.” The justification was an adoption of the forward guidance with regards to two policy rates (10-	

W https://www.adb.org/sites/default/files/publication/469246/adbi-wp896.pdf

32/127	SUBMITTED TEXT	12 WORDS	100% MATCHING TEXT	12 WORDS
Insulation of domestic money supply from international reserves is called sterilization.			Insulation of domestic money supply from international reserves is called sterilization.	

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33/127	SUBMITTED TEXT	21 WORDS	64% MATCHING TEXT	21 WORDS
The role of the exchange rate system The exchange rate system has a significant role in a country’s financial system.			The Role of the Exchange Rate System The exchange rate system is an important element in any country's financial system.	

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34/127	SUBMITTED TEXT	30 WORDS	100% MATCHING TEXT	30 WORDS
Exchange rate systems are of two types: floating and fixed. In a floating exchange rate system, the exchange rate is determined by the market forces of supply and demand;			Exchange rate systems are of two types: floating and fixed. In a floating exchange rate system, the exchange rate is determined by the market forces of supply and demand	

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35/127	SUBMITTED TEXT	26 WORDS	62% MATCHING TEXT	26 WORDS
The foreign desk The Central Bank assists the national government in the international financial market by buying and selling currencies on behalf of the treasury.			The Foreign Desk The Central Bank works as a government arm in the international financial market. It buys and sells currencies on behalf of the treasury.	

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36/127	SUBMITTED TEXT	34 WORDS	74% MATCHING TEXT	34 WORDS
refers to the policies pursued by the RBI to regulate the growth of money and credit in the economy. The two policies are interrelated as the fiscal policies determine the direction of monetary			refers to the policies pursued by the RBI to regulate the growth of money and credit in the economy. However, the two policies are interdependent that fiscal policies of the government determine the directions of the monetary	

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37/127	SUBMITTED TEXT	15 WORDS	89% MATCHING TEXT	15 WORDS
A common feature in both policies is that they deal with regulatory mechanisms and			a common feature in both the policies is that in general, they deal with regulatory mechanisms and	

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38/127	SUBMITTED TEXT	40 WORDS	98% MATCHING TEXT	40 WORDS

Monetary policy can be defined as “the deliberate effort by the central bank to influence economic activity by variations in the money supply, in availability of credit or in the interest rates, consistent with specific national objectives.” ?

Monetary Policy can be broadly defined as "the deliberate effort by the Central Bank to influence economic activity by variations in the money supply, in availability of credit or in the interest rates consistent with specific national objectives."

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39/127	SUBMITTED TEXT	11 WORDS	100% MATCHING TEXT	11 WORDS

monetary policy are price stability, exchange stability, full employment and

monetary policy are: price stability, exchange stability, full employment and

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40/127	SUBMITTED TEXT	51 WORDS	89% MATCHING TEXT	51 WORDS

When the central bank sells securities, it reduces the quantity of money and credit as well. Most people save their money in bank accounts. When the central bank sells securities, they withdraw money from their accounts to buy securities, which in turn reduce the cash reserves of banks. 3. (

When the Central Bank sells securities, it reduces the quantity of money and credit as well. Most people now save their money in bank accounts and when the Central Bank offers to sale securities, they withdraw money from their accounts to buy securities which in turn reduces the cash reserves of banks.

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41/127	SUBMITTED TEXT	17 WORDS	81% MATCHING TEXT	17 WORDS

floating exchange rate system, the exchange rate is determined by the market forces of supply and

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42/127	SUBMITTED TEXT	21 WORDS	100% MATCHING TEXT	21 WORDS
The bank rate is the rate of interest at which the central bank rediscounts approved bills of exchange. 4. (			The bank rate is the rate of interest at which the Central Bank rediscounts approved bills of exchange.	
W http://www.tdcorrige.com/doc/6794.doc				

43/127	SUBMITTED TEXT	49 WORDS	98% MATCHING TEXT	49 WORDS
reserve requirements The central bank stipulates the statutory limits of cash reserve requirements for commercial banks. It asks banks to maintain a minimum percentage of their deposits as reserves. The central bank can regulate money supply by simply changing the reserve requirements of commercial banks. 5. (			Reserve Requirement Changes The Central Bank stipulates the statutory limits of cash reserve requirements for commercial banks. It asks banks to maintain a minimum percentage of their deposits as reserves. The Central Bank can regulate money supply by simply changing the reserve requirements of commercial banks.	
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44/127	SUBMITTED TEXT	45 WORDS	100% MATCHING TEXT	45 WORDS
take time in recognizing that there is a need to alter monetary policy. This is known as recognition lag. Similarly, there may be some time gap between the recognition of the need and the implementation of the policy. This is known as action lag.			take time in recognizing that there is a need to alter monetary policy. This is known as recognition lag. Similarly, there may be some time gap between the recognition of the need and the implementation of the policy. This is known as action lag.	
W http://www.tdcorrige.com/doc/6794.doc				

45/127	SUBMITTED TEXT	40 WORDS	98% MATCHING TEXT	40 WORDS
	Outside lag happens because monetary authorities can change money market conditions but there are other entities in the economy – consumers, firms, government, etc. which take some time to change their plans to cope with the changes. 6. (		outside lag. This happens because monetary authorities can change money market conditions but there are other entities in the economy – consumers, firms, government, etc. which take some time to change their plans to cope with the changes.	

W http://www.tdcorrige.com/doc/6794.doc

46/127	SUBMITTED TEXT	36 WORDS	92% MATCHING TEXT	36 WORDS
	the fiscal policy The monetary policy measures in India have generally been in response to fiscal policy. It is particularly so when a sizable increase in RBI credit to government is a normal phenomenon.		the monetary policy in India The monetary policy measures in India have generally been in response to fiscal policy. It is particularly so when a sizable increase in RBI credit to government is a normal phenomenon.	

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47/127	SUBMITTED TEXT	40 WORDS	100% MATCHING TEXT	40 WORDS
	In India, the monetary policy always aims at price stability and growth. This requires arriving at a balance between these two objectives, depending on the evolving situation but also making sure that the inflation remains within reasonable limits.		In India, the monetary policy always aims at price stability and growth. This requires arriving at a balance between these two objectives, depending on the evolving situation but also making sure that the inflation remains within reasonable limits.	

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48/127	SUBMITTED TEXT	37 WORDS	100% MATCHING TEXT	37 WORDS

Exchange rate systems are of two types: floating and fixed. In a floating exchange rate system, the exchange rate is determined by the market forces of supply and demand while in a fixed exchange rate system

Exchange rate systems are of two types: floating and fixed. In a floating exchange rate system, the exchange rate is determined by the market forces of supply and demand while in a fixed exchange rate system;

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49/127	SUBMITTED TEXT	29 WORDS	100% MATCHING TEXT	29 WORDS

a common feature in both the policies is that in general, they deal with regulatory mechanisms and with maneuvering the economy in periods of inflation and recession. 17.14.2

a common feature in both the policies is that in general, they deal with regulatory mechanisms and with maneuvering the economy in periods of inflation and recession.

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50/127	SUBMITTED TEXT	32 WORDS	86% MATCHING TEXT	32 WORDS

banking system has reserves of Rs. 500 crore and the reserve requirement is 20 percent. So, the system can support demand deposits upto the limit of 500/0.2 = Rs 2,500 crore.

banking system has reserves of Rs 500 crore and the reserve requirement is 20 percent. So, the system can support demand deposits up to the limit of 500/0.2 = 2,500 crore.

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51/127	SUBMITTED TEXT	55 WORDS	95%	MATCHING TEXT	55 WORDS

banking system has reserves of Rs 500 crore and the reserve requirement is 20 percent. So, the system can support demand deposits upto the limit of 500/0.2 = 2,500 crore. If the reserve requirement is increased to 25 percent, the system will support demand deposits only to the extent of 500/0.25 = 2,000 crore.

banking system has reserves of Rs 500 crore and the reserve requirement is 20 percent. So, the system can support demand deposits up to the limit of 500/0.2 = 2,500 crore. If the reserve requirement is increased to 25 percent, the system will support demand deposits only to the extent of 500/0.25 = 2,000 crore.

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52/127	SUBMITTED TEXT	26 WORDS	58%	MATCHING TEXT	26 WORDS

banking system has reserves of Rs 2000 crore and the system can support demand deposits to an extent of Rs 10,000 crore. The reserve requirement

banking system has reserves of Rs 500 crore and the reserve requirement is 20 percent. So, the system can support demand deposits up to the limit of 500/0.2 = 2,500 crore. If the reserve requirement

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53/127	SUBMITTED TEXT	17 WORDS	81%	MATCHING TEXT	17 WORDS

floating exchange rate system, the exchange rate is determined by the market forces of supply and

SA 179E1150-International Economics-(SLSM).doc (D165627856)

54/127	SUBMITTED TEXT	26 WORDS	92%	MATCHING TEXT	26 WORDS

Types of Inflation 18.4 Sources of Inflation 18.5 Measuring Inflation 18.6 The Economic Impact of Inflation 18.7 Phillips Curve 18.8 Measures to Control Inflation 18.9

Types of Inflation • Sources of Inflation • Measuring Inflation • The Economic Impact of Inflation • Philips Curve • Measures to Control Inflation

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55/127	SUBMITTED TEXT 17 WORDS	100% MATCHING TEXT 17 WORDS
	Keynes, “inflation refers to a rise in price level after full employment level has been achieved.”	Keynes, "Inflation refers to a rise in price level after full employment level has been achieved."

W http://www.tdcorrige.com/doc/6794.doc

56/127	SUBMITTED TEXT 15 WORDS	100% MATCHING TEXT 15 WORDS
	as increase in money supply, the government budget deficit, increase in export earnings, etc.	as increase in money supply, the government budget deficit, increase in export earnings, etc.

W http://www.tdcorrige.com/doc/6794.doc

57/127	SUBMITTED TEXT 15 WORDS	76% MATCHING TEXT 15 WORDS
	real balances effect causes an inverse relationship between real output and price level.	real balances effects cause an inverse relationship between real output and price level

W http://www.tdcorrige.com/doc/6794.doc

58/127	SUBMITTED TEXT 19 WORDS	97% MATCHING TEXT 19 WORDS
	Interest rate effect: Changes in price level affect the demand for loans, which in turn affect interest rates.	Interest rate effect: Changes in price level affect the demand for loans which in turn, affect the interest rates.

W http://www.tdcorrige.com/doc/6794.doc

59/127	SUBMITTED TEXT	19 WORDS	58%	MATCHING TEXT	19 WORDS
The slope of the aggregate supply curve is always positively upward. The upward slope of the supply curve			the upward slope of the aggregate supply curve. Cost effects: Another reason for the upward slope of the aggregate supply curve		

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60/127	SUBMITTED TEXT	23 WORDS	70%	MATCHING TEXT	23 WORDS
will increase the output only when the price of the output increases at as much as the cost of production is increasing.			will increase the output only when the prices of the output increases at least at the rate cost of production is increasing. 6.5.		

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61/127	SUBMITTED TEXT	114 WORDS	83%	MATCHING TEXT	114 WORDS
the shift in the AD curve towards right indicates an excess demand for goods and services at existing prices. The AD increases to Y 1 from Y o because of the shift in the AD o curve to AD 1 . But at the price level P o , the AS is Y o . Therefore the excess demand is Y 1 -Y o . To eliminate the excess demand, the price level increases to P 1 , where AD and AS are equal at Y 2 . Figure 18.1: Demand-Pull Inflation			the rightward shift in the AD curve means an excess demand for goods and services at existing prices.the AD increases to Y1 from Y0 because of the shift in the AD0 curve to AD1. But at the price level P0, the AS is Y0. Therefore, the excess demand is Y1-Y0. To eliminate the excess demand, the price level increases to P1, where AD and AS are equal at Y2. Figure 6.3: Demand-Pull Inflation		

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62/127	SUBMITTED TEXT	15 WORDS	75%	MATCHING TEXT	15 WORDS
Aggregate demand (AD): Aggregate demand is the total demand for all goods and services					

SA Camilla_White_5010032___Economic_Environment_AS3_5010032_811629_1.docx (D157520007)

63/127	SUBMITTED TEXT 20 WORDS	97% MATCHING TEXT 20 WORDS
	The factors causing a shift in the AD can be classified into real and monetary factors. The real factors:	The factors causing a shift in the AD can be classified into real and monetary factors. Among the real factors
	W http://www.tdcorrige.com/doc/6794.doc	

64/127	SUBMITTED TEXT 32 WORDS	93% MATCHING TEXT 32 WORDS
	rightward shift in an AD curve are – an increase in the government expenditure with no change in tax receipts, a decrease in the tax receipts with no increase in government	rightward shift in an AD curve are – an increase in the government expenditure with no change in tax receipt, a decrease in the tax receipts with no increase in the government
	W http://www.tdcorrige.com/doc/6794.doc	

65/127	SUBMITTED TEXT 15 WORDS	90% MATCHING TEXT 15 WORDS
	rightward shift in the consumption function, investment function and/or export function. The monetary factors:	rightward shift in the consumption function, investment function and export function. The monetary factors:
	W http://www.tdcorrige.com/doc/6794.doc	

66/127	SUBMITTED TEXT 26 WORDS	100% MATCHING TEXT 26 WORDS
	A decrease in the demand for money or an increase in the supply of money causes a rightward shift in the AD curve. 18.4.3	A decrease in the demand for money or an increase in the supply of money causes a rightward shift in the AD curve.
	W http://www.tdcorrige.com/doc/6794.doc	

67/127	SUBMITTED TEXT	16 WORDS	80% MATCHING TEXT	16 WORDS
	an increase in the cost of factors of production results in decrease in the supply. (		an increase in the cost of factors of production or a decrease in the supply	

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68/127	SUBMITTED TEXT	18 WORDS	100% MATCHING TEXT	18 WORDS
	There are three types of cost-push inflation – wage-push inflation, profit-push inflation and supply shock inflation.		there are three types of cost-push inflation: Wage-push inflation, Profit-push inflation and Supply-shock inflation.	

W http://www.tdcorrige.com/doc/6794.doc

69/127	SUBMITTED TEXT	27 WORDS	100% MATCHING TEXT	27 WORDS
	Supply shock inflation 6. ________ arises from an increase in the cost of raw materials or shortages that occur as a result of natural calamities.		Supply shock inflation arises from an increase in the cost of raw materials or shortages that occur as a result of natural calamities	

W http://www.tdcorrige.com/doc/6794.doc

70/127	SUBMITTED TEXT	25 WORDS	64% MATCHING TEXT	25 WORDS
	Price Index (WPI) The wholesale price index measures the variations in the price levels of commodities that flow through the wholesale trade intermediaries. The		Price Index. The wholesale price index is an indicator designed to measure the changes in the price levels of commodities that flow into the wholesale trade intermediaries. The	

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71/127	SUBMITTED TEXT	21 WORDS	72% MATCHING TEXT	21 WORDS
The Office of the Economic Adviser (OEA) in the Ministry of Industry is responsible for compiling the wholesale price index.			The Office of the Economic Adviser (OEA) in the Ministry of Industry has been the pioneer in compiling the wholesale price index.	

W http://www.tdcorrige.com/doc/6794.doc

72/127	SUBMITTED TEXT	18 WORDS	76% MATCHING TEXT	18 WORDS
continuous monitoring of the price level is possible. The non-commodity producing sector i.e. services and non-tradable commodities			continuous monitoring of the price level is possible. The duration is usually one week. It does not cover non-commodity producing sector i.e., services and non tradable commodities. 6.7.2.	

W http://www.tdcorrige.com/doc/6794.doc

73/127	SUBMITTED TEXT	54 WORDS	83% MATCHING TEXT	54 WORDS
Consumer Price Index The consumer price index indicates the cost of living of a particular group in the population. CPI is measured on the basis of the changes in retail prices of selected goods and services on which a particular income group of consumers spend their money. There are several consumer price indices			Consumer price index (CPI) The consumer price index reflects the cost for living of a particular group in the population. CPI is measured on the basis of the changes in retail prices of selected goods and services (essential goods) on which a particular group of consumers spend their money based on their income. There are, in fact, several consumer price indices.	

W http://www.tdcorrige.com/doc/6794.doc

74/127	SUBMITTED TEXT	20 WORDS	97%	MATCHING TEXT	20 WORDS

The aggregate demand curve slopes downward because of real balance effect, foreign trade effect and interest rate effect. Aggregate

The aggregate demand curve slopes downward because of real balance effect, foreign trade effect and interest rate effect. Figure 6.1: Aggregate

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75/127	SUBMITTED TEXT	12 WORDS	90%	MATCHING TEXT	12 WORDS

Aggregate demand is the total demand for all goods and services

SA Camilla_White_5010032___Economic_Environment_AS3_5010032_811629_1.docx (D157520007)

76/127	SUBMITTED TEXT	15 WORDS	75%	MATCHING TEXT	15 WORDS

David Ricardo, an English economist developed the theory of comparative advantage. Ricardo opines that

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77/127	SUBMITTED TEXT	27 WORDS	48%	MATCHING TEXT	27 WORDS

the production of all products. The theory advocates that a country should be involved in the production of those goods in which it has comparative advantage.

SA 179E1150-International Economics-(SLSM).doc (D165627856)

78/127	SUBMITTED TEXT	45 WORDS	37%	MATCHING TEXT	45 WORDS

country A incurs 10 man hours to produce 1 ton of cotton and 15 man hours to produce 1 ton of wheat, and country B incurs 20 man hours to produce 1 ton of cotton and 16 man hours to produce 1 ton of

SA ECM-408 AMU.docx (D142324730)

79/127	SUBMITTED TEXT	20 WORDS	57%	MATCHING TEXT	20 WORDS

of India's Balance of Payments for January to March 2021 Table 19.2: Major items of India's Balance of Payments

SA Aparna Rane_MMS_2020-22.pdf (D111583178)

80/127	SUBMITTED TEXT	4 WORDS	100%	MATCHING TEXT	4 WORDS

https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=51820

https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=48982 39

W https://openknowledge.worldbank.org/bitstream/handle/10986/34367/India-Development-Update.pdf?seq ...

81/127	SUBMITTED TEXT	74 WORDS	100%	MATCHING TEXT	74 WORDS

Credit Debit Net A. Current Account 173.4 181.5 -8.1 1. Goods 91.3 133.0 -41.7 Of which: POL 8.0 28.7 -20.7 2. Services 56.0 32.5 23.5 3. Primary Income 5.2 13.9 -8.7 4. Secondary Income 20.9 2.1 18.9 B. Capital Account and Financial Account 162.7 153.8 8.8 Of which: Change in Reserves (Increase (-)/Decrease (+)) 0.0 3.4 -3.4 C. Errors & Omissions (-) (A+B) 0.7 -0.7

SA Aparna Rane_MMS_2020-22.pdf (D111583178)

82/127	SUBMITTED TEXT	25 WORDS	61%	MATCHING TEXT	25 WORDS

Trade and Balance of Payments 53 19.7.1 Distinction between Balance of Trade (BoT) and Balance of Payments (BoP) Both are related terms but

SA Unit 14- Balance of Payment.docx (D103423476)

83/127	SUBMITTED TEXT	15 WORDS	78%	MATCHING TEXT	15 WORDS

Balance of trade refers to the difference in value of exports and imports of

SA Unit 14- Balance of Payment.docx (D103423476)

84/127	SUBMITTED TEXT	42 WORDS	60%	MATCHING TEXT	42 WORDS

value of exports exceeds value of imports, a country is said to experience export surplus or a favourable balance of trade. If the value of imports exceeds exports, then the country experiences an adverse or deficit balance of trade.

SA Unit 14- Balance of Payment.docx (D103423476)

85/127	SUBMITTED TEXT	11 WORDS	100%	MATCHING TEXT	11 WORDS

intensity of reciprocal demand for products of different countries differs,

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86/127	SUBMITTED TEXT	22 WORDS	90%	MATCHING TEXT	22 WORDS

terms of trade of a country may set differently with different nations. Under multi-trade transactions which may lead to disequilibrium in

SA TYBCom Sem VI Business Economics Paper VI (English version).pdf (D163511825)

87/127	SUBMITTED TEXT	15 WORDS	70%	MATCHING TEXT	15 WORDS

to surrender their foreign exchange earnings and it is rationed among importers. The license-holder

SA Term paper.docx (D61628708)

88/127	SUBMITTED TEXT	11 WORDS	100%	MATCHING TEXT	11 WORDS

maximum quantity or value of a commodity to be imported.

SA Term paper.docx (D61628708)

89/127	SUBMITTED TEXT	25 WORDS	58%	MATCHING TEXT	25 WORDS

Determination of Exchange Rate The exchange rate is determined by the market forces in the foreign exchange market. The equilibrium exchange rate is

SA 179E1150-International Economics-(SLSM).doc (D165627856)

90/127	SUBMITTED TEXT	31 WORDS	58%	MATCHING TEXT	31 WORDS

a systematic record of all economic transactions between the residents of the reporting country and the residents of the rest of the world over a specified period of time. ?

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91/127	SUBMITTED TEXT	30 WORDS	64%	MATCHING TEXT	30 WORDS

record of all economic transactions between the residents of the reporting country and the residents of the rest of the world over a specified period of time. ? When

SA Term paper.docx (D61628708)

92/127	SUBMITTED TEXT	23 WORDS	65%	MATCHING TEXT	23 WORDS

one country has absolute advantage in all products and the other country does not have absolute advantage in any product. According to

SA ECM-408 AMU.docx (D142324730)

93/127	SUBMITTED TEXT	2 WORDS	100%	MATCHING TEXT	2 WORDS

industrial-production-iip-data-news- government-releases-factory-output-data-for-july-2021-iip-at-11-5-2536633

Industrial Production (IIP) Data News: Government Releases Factory Output Data For July 2021: IIP At 11.5% •

W https://www.ndtv.com/business/industrial-production-iip-data-news-government-releases-factory-out ...

94/127	SUBMITTED TEXT	40 WORDS	95% MATCHING TEXT	40 WORDS
Capacity Utilization in India averaged 74.79 percent from 2008 until 2019, reaching an all-time high of 83.20 percent in the first quarter of 2011 and a record low of 69.10 percent in the third quarter of 2019.			Capacity Utilization in India averaged 73.24 percent from 2008 until 2022, reaching an all time high of 83.20 percent in the first quarter of 2011 and a record low of 47.30 percent in the second quarter of 2020.	

W https://tradingeconomics.com/india/capacity-utilization

95/127	SUBMITTED TEXT	13 WORDS	100% MATCHING TEXT	13 WORDS
Office of the Economic Adviser. Department for Promotion of Industry and Internal			OFFICE OF THE ECONOMIC ADVISER DEPARTMENT FOR PROMOTION OF INDUSTRY AND INTERNAL	

W https://eaindustry.nic.in/wpi_press_release_archive.asp

96/127	SUBMITTED TEXT	22 WORDS	50% MATCHING TEXT	22 WORDS
profits and real incomes, and high unemployment. When the economy recovers from recession, and the recovery is very strong, there may			profits and real incomes and rising unemployment. In course of time, the economy recovers and if the recovery is very strong it may	

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97/127	SUBMITTED TEXT	14 WORDS	76% MATCHING TEXT	14 WORDS
In this unit, we will explain the various phases of the business cycle			In this chapter, we will analyze the various phases of the business cycle	

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98/127	SUBMITTED TEXT	22 WORDS	91% MATCHING TEXT	22 WORDS
	fall in demand for credit, interest rates also fall. According to Joseph Schumpeter, there exist four stages in		fall in demand for credit, interest rates also fall. According to Joseph Schumpeter, there are four stages in	

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99/127	SUBMITTED TEXT	16 WORDS	100% MATCHING TEXT	16 WORDS
	fall in prices, decline in the demand for capital goods and cancellation of new projects		fall in prices, decline in the demand for capital goods and cancellation of new projects.	

W http://www.tdcorrige.com/doc/6794.doc

100/127	SUBMITTED TEXT	13 WORDS	83% MATCHING TEXT	13 WORDS
	Initially, the demand for consumer goods remains the same, but slowly it		Initially, the demand for consumer goods will remain the same, but slowly it	

W http://www.tdcorrige.com/doc/6794.doc

101/127	SUBMITTED TEXT	22 WORDS	52% MATCHING TEXT	22 WORDS
	GDP Gross domestic product (GDP) is the value of the total final output of all the goods and services produced within			

SA Economic_Environment____assignment_3_2544090_756749_1.docx (D145424540)

102/127	SUBMITTED TEXT 13 WORDS	83% MATCHING TEXT 13 WORDS
	depression, there is a fall in the production of goods and services,	depression and there is substantial fall in the production of goods and services

W http://www.tdcorrige.com/doc/6794.doc

103/127	SUBMITTED TEXT 18 WORDS	100% MATCHING TEXT 18 WORDS
	is characterized by a fall in production, increased unemployment and a fall in the general price level.	is characterized by a fall in production, increased unemployment and a fall in the general price level.

W http://www.tdcorrige.com/doc/6794.doc

104/127	SUBMITTED TEXT 12 WORDS	95% MATCHING TEXT 12 WORDS
	helps to understand the relationship between real GDP, unemployment, and inflation.	helps us to understand the relationship between real GDP, unemployment, and inflation.

W http://www.tdcorrige.com/doc/6794.doc

105/127	SUBMITTED TEXT 22 WORDS	90% MATCHING TEXT 22 WORDS
	in the economy will lead to fall in prices, decline in the demand for capital goods and cancellation of new projects.	in the economy will lead to liquidation of bank loans, fall in prices, decline in the demand for capital goods and cancellation of new projects.

W http://www.tdcorrige.com/doc/6794.doc

106/127	SUBMITTED TEXT	29 WORDS	98%	MATCHING TEXT	29 WORDS

Thus, for a constant volume of investment to be maintained, output must grow at a certain rate. To generate cycles, two more ingredients are necessary. There must be

Thus, for a constant volume of investment to be maintained, output must grow at a certain rate. To generate cycles, two more ingredients are necessary. There must a be '

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107/127	SUBMITTED TEXT	154 WORDS	99%	MATCHING TEXT	154 WORDS

a 'ceiling' beyond which real output cannot grow. This is provided by full employment of the labor force. There must also be a 'floor' that is provided by the fact that gross investment cannot be negative. A disturbance such as an accidental increase in investment will cause a cumulative upward movement of output. This continues till output hits the full employment ceiling, beyond which it cannot grow. Since output stops growing, it is not necessary to add to capital stock. Thus, net investment falls. But this leads to a decrease in output. This continues till gross investment falls to zero, below which it cannot go. Income then stops falling. Once excess capacity has been reduced, there is no need for further negative net investment i.e., reduction of capital stock. Net investment rises from the negative level, pulls up income and starts the economic upturn again. 21.4.2 Demand induced cycles Business cycles can

a be 'ceiling' beyond which real output cannot grow. This is provided by full employment of the labor force. There must also be a 'floor' that is provided by the fact that gross investment cannot be negative. A disturbance such as an accidental increase in investment will cause a cumulative upward movement of output. This continues till output hits the full employment ceiling, beyond which it cannot grow. Since output stops growing, it is not necessary to add to capital stock. Thus, net investment falls. But this leads to a decrease in output. This continues till gross investment falls to zero, below which it cannot go. Income then stops falling. Once excess capacity has been reduced, there is no need for further negative net investment i.e., reduction of capital stock. Net investment rises from the negative level, pulls up income and starts the economic upturn again. 7.3.2. Demand Induced Cycles Business cycles can

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108/127	SUBMITTED TEXT	17 WORDS	87% MATCHING TEXT	17 WORDS

AD curve shifts towards right and output reaches the potential GDP or may even be higher.

AD curve shifts to the right and output reaches the potential GDP or may even be higher

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109/127	SUBMITTED TEXT	16 WORDS	100% MATCHING TEXT	16 WORDS

Figure 21.2: A Decline in Aggregate Demand Leads to an Economic Downturn ? ?

Figure 7.3: A Decline in Aggregate Demand Leads to an Economic Downturn

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110/127	SUBMITTED TEXT	29 WORDS	94% MATCHING TEXT	29 WORDS

parameter estimates such as GNP growth potential, marginal propensity to consume, etc. ? Finally, the whole model is put together to run as a system of equations.

parameter estimates such as GNP growth potential, marginal propensity to consume etc. Then the whole model is put together to run as a system of equations.

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111/127	SUBMITTED TEXT	14 WORDS	76% MATCHING TEXT	14 WORDS

able bodied persons, who are willing to work at the market wage rate,

able persons who are willing to work at the prevailing wage rate

SA final book.docx (D143611479)

112/127	SUBMITTED TEXT	12 WORDS	100% MATCHING TEXT	12 WORDS
	Keynesian analysis, the level of employment is determined by effective demand (		Keynesian analysis, the level of employment is determined by effective demand.	

W http://www.tdcorrige.com/doc/6794.doc

113/127	SUBMITTED TEXT	11 WORDS	100% MATCHING TEXT	11 WORDS
	in the general level of demand for goods and services		in the general level of demand for goods and services	

W http://www.tdcorrige.com/doc/6794.doc

114/127	SUBMITTED TEXT	3 WORDS	100% MATCHING TEXT	3 WORDS
	a-crisis-of-long-term-unemployment-is-looming-in-the-u-s 21.10.3		A Crisis of Long-Term Unemployment Is Looming in the U.S.	

W https://hbr.org/2021/03/a-crisis-of-long-term-unemployment-is-looming-in-the-u-s

115/127	SUBMITTED TEXT	26 WORDS	72% MATCHING TEXT	26 WORDS
	as the level of employment that exists, when the rate of unemployment is normal i.e. when 94 to 95 percent of the labor force		as the level of employment that results when the rate of unemployment is normal. Most economists believe that full employment exists when 94 to 95 percent of the labor force	

W http://www.tdcorrige.com/doc/6794.doc

116/127	SUBMITTED TEXT	17 WORDS	62% MATCHING TEXT	17 WORDS
in India The nature of unemployment in India is to a large extent, structural and disguised.			in India The nature of unemployment in India is mostly structural and disguised.	

W http://www.tdcorrige.com/doc/6794.doc

117/127	SUBMITTED TEXT	15 WORDS	96% MATCHING TEXT	15 WORDS
fall in prices, decline in demand for capital goods and cancellation of new projects,			fall in prices, decline in the demand for capital goods and cancellation of new projects.	

W http://www.tdcorrige.com/doc/6794.doc

118/127	SUBMITTED TEXT	17 WORDS	76% MATCHING TEXT	17 WORDS
the economy. ? Unemployment can be categorized into three types- frictional, structural and cyclical. ?			the economy. Unemployment can be of three types: frictional, structural and cyclical.	

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119/127	SUBMITTED TEXT	11 WORDS	100% MATCHING TEXT	11 WORDS
a substantial fall in the production of goods and services			a substantial fall in the production of goods and services	

W http://www.tdcorrige.com/doc/6794.doc

120/127	SUBMITTED TEXT	16 WORDS	100% MATCHING TEXT	16 WORDS
During peak periods of a business cycle, when the economy is experiencing rapid growth in			During peak periods of a business cycle, when the economy is experiencing rapid growth in	

W http://www.tdcorrige.com/doc/6794.doc

121/127	SUBMITTED TEXT	40 WORDS	88% MATCHING TEXT	40 WORDS
real GDP, employment increases, as businesses recruit more workers to produce a higher output. If real GDP grows too quickly, it can cause price inflation. During recession, the economy experiences a decline in real GDP and unemployment rates increase.			real GDP, employment will increase, as businesses recruit more workers to produce a higher output. If real GDP grows too quickly, it can cause price inflation. During recession, the economy will experience a decline in real GDP and unemployment rates will increase.	

W http://www.tdcorrige.com/doc/6794.doc

122/127	SUBMITTED TEXT	26 WORDS	100% MATCHING TEXT	26 WORDS
Frictional unemployment Unemployment that is caused by constant changes in the labor market is called frictional unemployment. It occurs on account of two reasons:			Frictional Unemployment Unemployment that is caused by constant changes in the labor market is called frictional unemployment. It occurs on account of two reasons:	

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123/127	SUBMITTED TEXT	14 WORDS	100% MATCHING TEXT	14 WORDS
employers are not fully aware of all available workers and their job qualifications;			employers are not fully aware of all available workers and their job qualifications;	

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124/127	SUBMITTED TEXT	28 WORDS	100% MATCHING TEXT	28 WORDS
workers are not fully aware of the jobs being offered by employers. The basic cause of frictional unemployment is imperfect information. 103			workers are not fully aware of the jobs being offered by employers. The basic cause of frictional unemployment is imperfect information. 7.6.2.	

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happiest-countries-in-the-world To determine the world's happiest country, researchers analyzed comprehensive Gallup polling data from 149 countries for the past three years, specifically monitoring performance in six particular categories: Gross domestic product per capita, social support ,Healthy life expectancy, Freedom to make your own life choices ,Generosity of the general population , Perceptions of internal and external corruption levels		happiest country in the world. To determine the world's happiest country, researchers analyzed comprehensive Gallup polling data from 149 countries for the past three years, specifically monitoring performance in six particular categories: gross domestic product per capita, social support, healthy life expectancy, freedom to make your own life choices, generosity of the general population, and perceptions of internal and external corruption levels.	

W https://worldpopulationreview.com/country-rankings/happiest-countries-in-the-world

126/127 SUBMITTED TEXT	27 WORDS	82% MATCHING TEXT	27 WORDS
respondents to evaluate their current life as a whole using the image of ladder, with best possible life score as 10 and worst as 0. 1,000		respondents to evaluate their current life as a whole using the image of a ladder, with the best possible life for them as a 10 and worst possible as	

W https://happiness-report.s3.amazonaws.com/2021/WHR+21.pdf

127/127 SUBMITTED TEXT	27 WORDS	56% MATCHING TEXT	27 WORDS
Foreign reserves stood at US$ 461.2 billion as on 10th January 2020 ? The Current Account Deficit (CAD) contracted to 1.5 per cent of GDP in		foreign reserves were comfortably placed at US$461.2 billion as on 10th January, 2020. The improvement in BoP was anchored by narrowing of current account deficit (CAD) from 2.1 per cent in 2018-19 to 1.5 per cent of GDP in	

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