UNIT. I. NATIONAL INCOME.

Imp B.A. II. SEMESTER. MACRO ECONOMICS

Explain the Scope and Importance of macro economics?

INTRODUCTION:- The subject matter of economics is divided into two parts i.e micro economics and macro economics. Ragner frisch has first time introduced the distinction between micro economics and macro economics in the year 1933. Marshall has developed micro economics and J.M. Keynes has developed macro economics.

Macro Economics:- Macro Economics was developed by J.M. Keynes. The term "Macro Economics" is derived from the Greek word "MAKROS" which means Large or whole. Macro Economics studies Aggregates like National Income, Total consumption, Total savings and total employement etc. Macro economics is also known as Income and employment theory. Macro Economics relates to the behaviour of whole Economic system.

Definition:- According to K.E Boulding "Macro economics studies National income instead of individual Income, General price level instead of Individual prices and National output instead of Individual output".

Scope of Macro Economics:-

The scope of macro economics can be presented in the below chart.

Scope of macro Economics

- The theory of Income employment distri-bution.
  - The theory of Consumption
  - The theory of Investments
  - The theory of Business cycle.
- The theory of General price level and inflation.
- The theory of Economic g...

Explanation:- Scope of macro Economics can be explained below:

1. Macro economics has become popular only after the publication of J.M Keynes "the General Theory of employme interest and money" in the year [1936]
2. Macro economics studies the cause of inflation and suggests measures to control it.
3. Macro Economics studies problems faced by modern Economics like poverty, unemployment and Income inequalities etc.
4. Macro economics deals with the theory of distribution like the theory of consumption. The theory of Investment etc.
5. Macro Economics studies the causes of business cycles the monetary and fiscal policies etc.
6. Macro Economics studies the general price level and its fluctuations over a period of time.

IMPORTANCE OF MACRO ECONOMICS:-

1. Macro economics study is more useful to the Governments for achievements of maximum social benefit.

The study of macro economics helps to understand the problems of poverty, unemployment, inflation etc, and suggests how to solve them.

3. The study of macro Economics helps to evaluate the overall functioning of an economy in order to distribute National income among different sections of the society.

4. Macro economics provides solutions to overcome the problems of business cycles and helps to understand their occurance.

5. Macro economics studies economic growth and suggests how developing countries can use their resources to maximize their growth.

6. Macro economics study facilitates International comparisons by examining information on National income, consumption and saving for in different countries.

Explain the differences between Micro economics and Macro economics?

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Micro Economics:- Marshall has gave much importance to micro Economics. The term "Micro Economics" is derived from the Greek word "MIKROS" which means small. Thus, micro Economics is the theory of small. Micro Economics theory studies the behaviour of the individual units, pricing of goods and services etc. Micro Economic Analysis is also termed as "price theory".

Definition:- According to K.E Boulding "Micro economics is the study of particular firms, particular, households, individual prices, wages, incomes, individual industries and particular commodities."

MACRO ECONOMICS:-

Macro economics was developed by J.M Keynes. The term "macro Economics" is derived from the Greek word "MAKROS" which means Large or whole. Macro Economics studies Aggregates like National income, Total consumption, Total savings and Total employment etc. Macro Economics is also known as Income and Employment Theory. Macro Economics relates to the behaviour of whole Economic system.

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Differences between micro and macro Economics.

MICRO ECONOMICS.	MACRO ECONOMICS.
1. The word micro is derived from the greek word 'MIKROS which means small or individual units.	1. The word Macro is derived from the greek word 'MAKROS' which means bigger large or whole.
2. It is the study of individual units of an economy.	2. It is the study of economy as a whole and it's aggregates.
3. It deals with individual income, Individual prices, Individual output, etc.	3. It's central problem is determination of level of Income and employement.
4. It's main tools are demand and supply of a particular commodity/factor.	4. It's main tools are aggregate demand and aggregate supply of the economy as a whole.
5. It helps to solve the central problem of 'what, how and for whom' to produce.	5. It helps to solve the central problem of full employement of resources in the economy
6. It discuss how equilibrium of a consumer, a producer or an industry is attained.	6. It is concerned with the determination of equilibrium level of income and employement of the economy.
7. price is the main determinant of micro economic problems.	7. Income is the major determinant of macro Economics problems.
8. It is known as price theory	8. It is known as Income and employement theory.

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5. Explain different concepts of National income.

INTRODUCTION:- The concepts of National income occupies a prominent place in economic theory. The importance of national income flows from the fact that it is the source from which people as owners of factors of production receive income. National income means the total value of all goods and services produced annually a in a country.

DEFINITIONS:-

Marshall definition:- According to marshall. "The labour and capital of a country acting on it's. Natural resources produce annually a certain net aggregate of commodities, material and immaterials including services of all kinds this is the true net annual income of a country. ~~or national~~ dividend", ~~IA th~~

A.C. Pigou definition:- According to pigou National income given included that income which can be measured in terms of money.

CONCEPTS OF NATIONAL INCOME:-

1. GROSS NATIONAL PRODUCT - GNP:- It is the total value of final goods and services produced in the economy in one years. The various components in GNP are:

1. The total amount of goods and services purchased by consumers.
2. Aggregate investment, that is total public investment and private investment.
3. The expenditure of government i.e expenditure of administration, defence and social functions.

...t income

GNP

Net income received from foreign trade.

GNP or GNI = C + I + G + (X − M) where,

C = Consumption.

I = Gross National investment.

G = Government expenditure.

X = Exports.

M = Imports.

X − M = Net foreign trade.

2. NET NATIONAL PRODUCT – NNP:- Firms use continuously machines and tools for the production of goods and services this results in a loss of value due to wear and tear of fixed capital. This loss suffered by fixed capital is called depreciation. When we substract depreciation from GNP we obtain NNP.

NNP = GNP − Depreciation.

The net value produced in a specific time period in net national income or net national income at market prices.

3. GROSS DOMESTIC PRODUCT – GDP:- The market value of the total goods and services produced in a country in one particular period ~~was~~ usually in a year is the Gross Domestic product or GDP.

It can be explained the below equation.

GDP = C + I + G.

4. NET DOMESTIC PRODUCT – NDP:- If we substract depreciation from GDP, we obtain Net Domestic product (NDP)

NDP = GDP − Depreciation

5. NATIONAL INCOME AT FACTOR COST:- National income at factor cost is the net output evaluated at factor prices

It includes income earned by factors of production through participation in the production process such as wages and salaries, rents, profits etc. It is also called National income.

It can be explained the below equation

$$NI = R + W + I + P.$$

6. **PERSONAL INCOME** :- It is the total of incomes received by persons from all sources in a specific time period.

Personal income is not equal to national income. Because social security payments, corporate taxes, undistributed profits are deducted from national income at factor cost and only the remaining received by persons. Some persons receive income even when they do not participate in productive activity, eg; old-age pension etc. They have to be added to national product as they are received by persons as income.

Personal income = National income at factor cost − undistributed profits etc. + transfer payments + corporate taxes + social security payments.

7. **DISPOSABLE INCOME** :- Personal income totally is not available for spending. Income tax is a payment which must be deducted to obtain disposable income.

Disposable income.

= Personal income − Personal taxes.

8. **PER CAPITA INCOME** :- National income when divided by nation's ~~propo~~population, per capita income is obtained.

per capita income = $\frac{\text{National income}}{\text{total population}}$

the average standard of living of a country is indicated by per capita income.

9. **REAL INCOME:-** Real income is national income expressed in terms of general prices of a particular year taken as base. National income is the current money value of goods and services produced in a year.

What are the methods of measuring National income?

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* **A.C Pigou definition:-** "According to Pigou National income included that income which can be measured in terms of money."

METHODS OF MEASURING NATIONAL INCOME:-

There are three methods of measuring national income which method is to be employed depends on the availability of data in a country and the purpose in hand.

1. **PRODUCT METHOD(output method)** :- According to this method the total value of final goods and services in a country during a year is calculated at market prices. Only the final goods and services are included and the intermediary goods and services are left out.

$$\boxed{NI = P_1Q_1 + P_2Q_2 + \text{———} + P_nQ_n,}$$

where NI = national income P = Price.

Q = Quantity 1, 2 — n = commodities.

2. **EXPENDITURE METHOD** :- In this method expenditure incurred on final goods by individuals, firms and government is considered for estimating the national income. Total expenditure made on consumption goods and investment goods by the individuals, firms and government equals the national income. According to this National income is

$$\boxed{NI = E_H + E_F + E_G \text{ where.}}$$

NI = National income

E_H = Expenditure of house holds

E_F = Expenditure of firms

E_G = Expenditure of government.

It is difficult to measure National income through this method. In a developing economy, the data on consumption expenditure is not easily available.

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INCOME METHOD:- This method consists adding together all the incomes accuring to the factors of production by way of payments in the form of wages, rent, interest and profits.

$$\boxed{NI = R + W + I + P}$$

where NI = National income
R = Rent
W = wages
I = Interest
P = profit.

This method gives us national income according to distributive shares. The data will be available from the annual reports of department of statistics and department of income tax.

What are the factors determining the National income?

INTRODUCTION:- National income can be considered as one of the parameters which suggests the economic stage of the country. There are several factors that determine the size of National income.

1. Natural Resources:- The country which has ample Natural resources will have ability to generate huge National income, if they use the resources in an efficient manner. But, some countries which have enough natural resources may remain backward because the resources are not fully utilized.

2. Labour efficiency:- The thinking ability, efficiency plays a vital role in the utilization of natural resources and if the labour utilizes the

the natural resources in an optimal ~~are~~ manner the Country can generates huge National income.

3. Capital :- The nation which has higher potential to capital will have higher ability to generate high National income. If the rate of growth of capital is high, National income may be higher. The reason for low National income in the under developed countries is the low growth rate of capital.

4. Availability of entrepreneurs :- If we see the position of United States of America, the position is very good, that ~~is~~ incompletely because of the number of entrepreneurs in that country has efficient and risk taking entrepreneurs it's National income can be higher. The National income of under-developed countries is not high because such efficient entrepreneurs are not available in adequate number.

5. Technical knowledge :- The country which is operated with high and ~~sp~~ sophisticated technology will have higher potential to raise high national income.

6. Political and social Environment :- The political and social environment should support the industries to generate high National income and the government should frame the policies which generate high National income to the country.

7. Changes in savings and investment :- changes in savings and investment determine the level of National income. If savings are more than

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investment National income will fall. If investment is greater than savings National income may increase.

Imp Explain the circular flow of income in two sector economy?

<u>INTRODUCTION</u>:- The circular flow model in the two-sector economy is a hypothetical concept which states that there are only two sectors in the economy household sector and business sector (business firms)

The household sector is the source of factors of production who earn by providing factors services, and to the business sector. The business sector refers to the firms that produce goods and services and receive income by supplying the produced goods to the household sector. The state of equilibrium in the two-sector economy is defined as a situation in which no change occurs in the levels of income (Y) Expenditure (E) and output (O) i.e $Y = E = O$.

modern economy is a money economy. Money is used in the process of exchange and it has removed the difficulties of barter system. As we know money acts as a medium of exchage. In an economy, households supply factors to the firms (producing units). Firms pay for the use of factors. so households receive

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payments from firms for their services in terms of money.

ASSUMPTIONS :-

* Neither the households from their incomes nor the firms from their profits save.
* Government does not play any part in the national economy.
* There is no export and import of goods and services by the economy. It means we have assumed a closed Economy.
* Thus, in this analysis we have not taken into account the role of foreign trade, domestic savings and the role of government.

Circular flow of income in a two sector Economy :-

As we know resources like ~~to~~ land, labour, capital and entrepreneurial ability flow from households to firms, the producing units. money flows from firms to the households as factor payments in the form of wages, rent interest, profits.

Again income received by households in money terms from the firms again flow from households to firms as consumption expenditure made by the households.

The circular process begins with the flow of economic resources from

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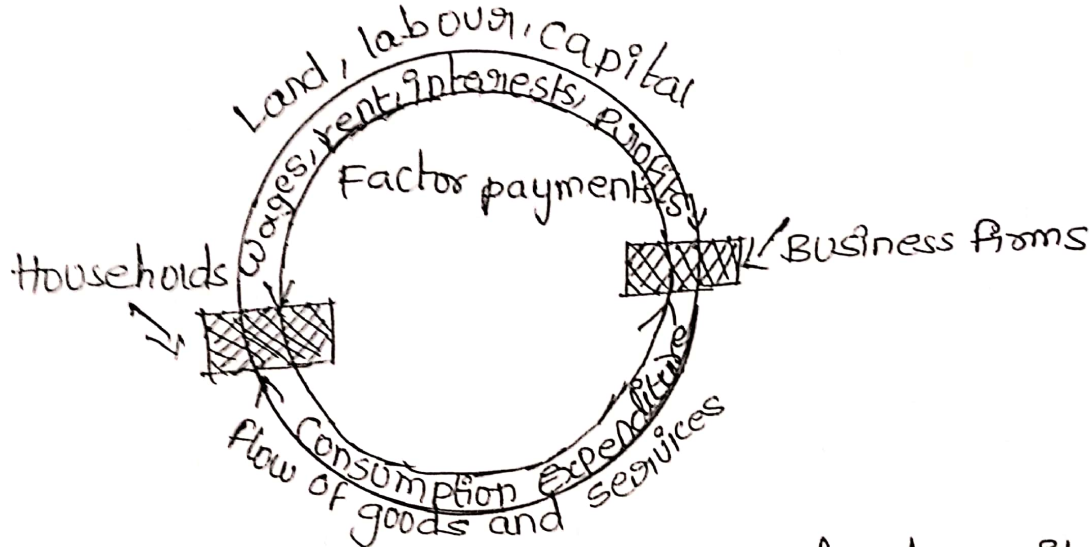
household to firms to produce and flow ~~form~~ of flows money to households in the form of factor income and again money flows from households to firms as consumption expenditure made by the households.



from fig, It is clear that labour, land, capital and entrepreneurial ability flow from households to firms (as indicated by arrow mark). In opposite direction to this, money flows from firms to households as factor payments such as wages, rent, interest and profits. In the lower part of the figure, money flows from households to firms as consumption expenditure made by the households on the goods and services produced by the firms while the flow of goods and services is in opposite direction from firms to households. We saw that money flows from firms to households as factor payments from firms to households to firms. and then again it flows from households to firms. So, there is a circular flow of income in between two-sectors-household sector the circular flow of money will continue indefinitely. In this way the economy functions. But, it is a fact that this flow of money income will not always be same.

The volume of flow changes, During depression, this volume of flow of money will contract and less and in prosperity it will expand with changes in national income. This circular flow of money is a measure of national income. The flow of money changes with the changes of National income.

Write the problems (or) Difficulties in measuring national Income?

NATIONAL INCOME :- National income is the value of all final goods and services produced in a country in a year.

Difficulties in the measurement of National income:-

There are many difficulties in the measurement of National income.

1. Definition of Nation :- Does the term 'National income means income produced with in the country only or should we add foreign income also ? this problem is now resolved.

2. Non - monetized Sector :- the problem of imputation:- some of the goods produced are not sold for money. The producer himself may consume a part of it. some times goods are exchanged for goods. But these goods and services exchanged for money should be included in National income.

3. Free services :- Free services like mother's services to her children, free libraries, parks etc..., provided by Government are not included in National income

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...istical information:- It is very difficult to get correct and reliable statistical information even in developed countries. The difficulty is more in underdeveloped countries.

5. problem of double counting:- How to avoid double counting is another problem. This problem is now resolved by excluding all raw materials and intermediary goods used for further production or by adopting 'value added' method. But even these method are not 'error-proof'.

6. problem of transfer payment:- Incomes like pensions, unemployement benefits are called 'Transfer payments'. Transfer payment are excluded from national income.

7. Problem of unproductive activities:- Generally income from unproductive activities like gambling is not included in national income.

8. Difficulties of camparision:- There are some difficulties in comparing the income of one country with that of another because the methods of calculation etc., may different from one another country to another.

(8) Describe the importance of National income.

Ans. National income is the value of all final goods and services produced in a country in a year.

IMPORTANCE OF NATIONAL INCOME:- National income estimates are highly useful. They are the valuable instruments of economic analysis and a guide to economic policy.

1. Growth rate of the economy:- National income figures show the growth rate of economy.

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2. Standard of living;- per capita income indicates the standard of living of the people and the changes in it from time to time.

3. Importance of different sectors;- National income estimates show the contribution made by different sectors of the economy like agriculture, industry, and services etc.

4. Distribution of income;- we can know from the national income estimates how the income is distributed among different sections of the society, the extent of inequalities of income and wealth inequalities are increasing or decreasing.

5. Planning;- National income estimates are absolutely necessary for preparation of economic plans and assessing the success of planning.

6. Future trends;- we can know the future trends in production etc, from the study of National income estimates.

7. Contributions to international bodies;- ~~International~~ ~~~~;- National income is the basis of determining the contributions to be made by the member countries to international bodies like UNO etc.

8. International comparisons;- National income estimates helps us to compare the standards of living of different countries and the growth rates.

9. Guide to economic policies;- National income estimates helps the Government to formulate

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etc

tive and suitable economic policies in the field taxation, industry exports and imports, agriculture etc. Thus, National income estimates are highly useful country without National income accounts is a ship without radar and compass.

Write about the concept of Green Accounting.

The Green Accounting system is a type of Accounting attempts to factor environmental costs into the financial results of operations. It has been argued that gross domestic product ignores the environment and therefore policymakers need a revised model that incorporates green Accounting. The terms was first brought into common usage by economist and professor peter wood in the 1980s. India's formed environment minister MR. Jairam Ramesh first time stressed the need and importance to bring Green Accounting practice to the forefront of Accounting in India.

Objectives of Green Accounting:-

- To established the linkage of physical Resource Accounts with monetary Environmental Accounts
- To Assessment of Environmental Costs and benefits.
- To Accounting for the maintenence of tangible resources
- To elaborate and measurement of indicators of Environmentally Adjusted product and income

UNIT-II 2. THEORY OF EMPLOYMENT.

① Explain the classical theory of income and employement?

Ans:-

INTRODUCTION:-

The term 'classical economists' was firstly used by karl Marx to describe economic thought of Ricardo and his predecessors including Adam smith.

The classical economist held the view that, in a capitalistic economy, there is always a stable equilibrium at the full employement level in the long run. under conditions of perfect competition. They consider full employement a general feature and unemployement is a rare phenomenon. If there is unemployement at any time, the economy has a tendency to move towards full employement ~~at any time~~, there would be automatic adjustment through the free play of market forces, provided there is no interference by the government. Thus, the classical economists ruled but any general unemployement in the long run. These views are broadly known as the classical theory of output, income and employement.

* ASSUMPTIONS *

↳ The classical theory of employement including J.B say's market law is based on the following Assumptions:-

1. There is a free enterprise economy.
2. There is perfect competition in the economy.
3. There is no government interference in the functioning of the economy. price mechanism is allowed to work freely.

4. The equilibrium process is considered from the long point of view.
5. All savings are automatically invested.
6. The interest rate is flexible.
7. The wage rate is flexible.
8. There are no limits to the expansion of the market.
9. Money acts as the medium of exchange and it has no role to play in the determination of output and employment. It is neutral

Say's Law of Market:-

Say's law of markets is the basis of the classical theory of employment. The 17th century french economist J.B. Say ~~that~~ stated that "supply creates its own demand. This is known as the say's Law of markets. Every supply of output creates equivalent amount of demand for that output. Incomes are generated in the process of production itself. and these incomes are again spent for buying the goods produced.

CRITICISM:-

Classical theory of employement has been critised especially by keynes on the following grounds.

1. Supply does not create its own demand. the reasons
(a) Investment oppurtunities may fall as economy grows
(b) Savings may be kept for future contingencies.
(c) Investment does not depend on interest rate only. It depends on expected rate of profit.

(3) It is no c
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(1) It is no changes in interest rate that bring equilibrium between savings and investment but it is changes in the level of income.

Therefore, the income created by supply may not general equivalent demand.

(2) There is no price flexibility and wage flexibility: In the real world there is no price flexibility and wage flexibility. under monopolies there is no price flexibility. trade unions oppose wage cuts.

(3) wage cuts do not increases employement:- If wages are reduced in all industries, the purchasing power of labour will fall and therefore demand will fall short of supply and it leads to unemployement.

4. It is long only a long term analysis:- In the short period aggregate demand and supply will not be equal. If at all they become equal, It may be in the long period. keynes is not interested in the long period As he says "in the long period we are all dead".

5. Full employement is not the normal condition of economic system; According to keynes, underemployment equilibrium is the normal feature, but not full employment.

CONCLUSION:- The classical theory of employement is therefore, considered to be wrong and unrealistic The chronic unemployment that existed during

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1 the Great depression of 1930 falsified the class theory.

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2 Explain Keynesian theory of Income & Employ

Ans:- INTRODUCTION:-

John Meynard Keynes, famous British economist of the 20th century rejected classical Theory of employement, proposition and argued that full employment is only a 'special' case and 'in general' there is always a less than full employment equilibrium in an economy. He considered full employment as a rare phenomenon. He stated his employment theory in his famous book entitled." The General Theory of Employment Interest and Money". published in 1936. His theory is known as the keynesian theory of employment. He called his theory, a general theory. Keynes has taken a short-term view. He used the term aggregate demand, aggregate supply and effective demand. Aggregate means total.

* AGGREGATE SUPPLY:-

Genarally speaking the term aggregate supply of all commodities produced by all the entrepreneurs, put together at a particular level of employement in an economy.

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As the level of output increases with the level of employment, the aggregate supply price also increases with every increase in the level of employment. The ~~sho~~ schedule showing the aggregate supply price at different levels of employment is called the aggregate supply function. This can be explained with the help of the TABLE 1

TABLE - 1

AGGREGATE SUPPLY FUNCTION.

Level of employment (in Lakhs of workers	Aggregate supply price (in crores of rupees)
10	500
11	550
12	600
13	650
14	700
15	750
16	800

TABLE 1 shows ~~different~~ that the aggregate supply price increases as the level of employment increases. As the level of employment gradually increased from 10 Lakhs to 16 Lakhs of workers, the aggregate supply price increased from Rs. 500 crores to Rs. 800 crores. This can be explained with a diagram also. Assuming that employment of 16 Lakhs workers represents full employment. There is no further increases

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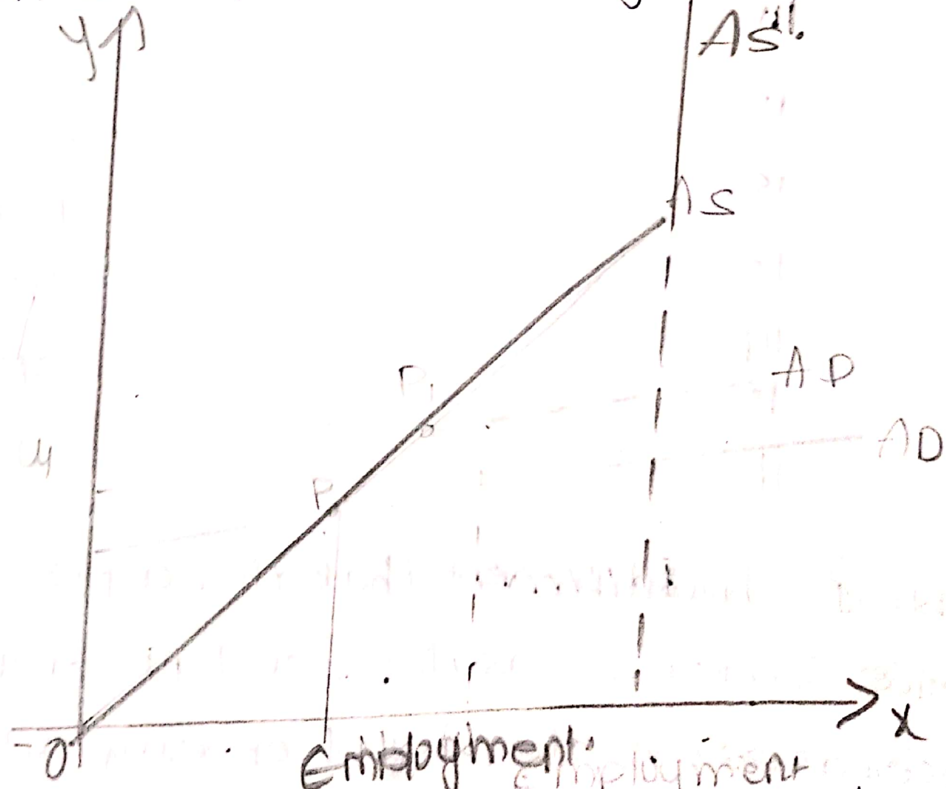
in aggregate supply price beyond Rs. 800 crores.

In Fig. 1 the aggregate supply function As can be seen sloping upward from left to right. It started from the origin which means that the aggregate supply is zero when the employement is nil. As employment level increases the As curve rises to the right. ON is assumed to be full employment level. At this level, the aggregate supply function As is parallel to Y-axis which means that the aggregate supply is perfectly inelastic. There would be no further expansion of output and employment.



Generally speaking the aggregate demand means, the total demand for all commodities in the economy at a particular level of employment.

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As the level of employment rises, the total income of the community also rises and therefore the aggregate demand price also increases. The schedule showing aggregate demand price at different levels of employment in the economy is called the aggregate demand function. This can be seen in the following table 2

AGGREGATE DEMAND FUNCTION.

Level of employment (in Lakhs of workers)	Aggregate demand price (in crores of rupees)
10	600
11	625
12	650
13	675
14	700
15	725
16	750

It can be seen in the table 2 that aggregate demand price rises as the level of employment increases. When the employment level is 10 Lakhs workers the aggregate demand price is Rs 600 crores. It gradually increased to Rs 750 crores with the increase in employment level to 16 Lakhs.

This can be explained with the help of the diagram 2 also

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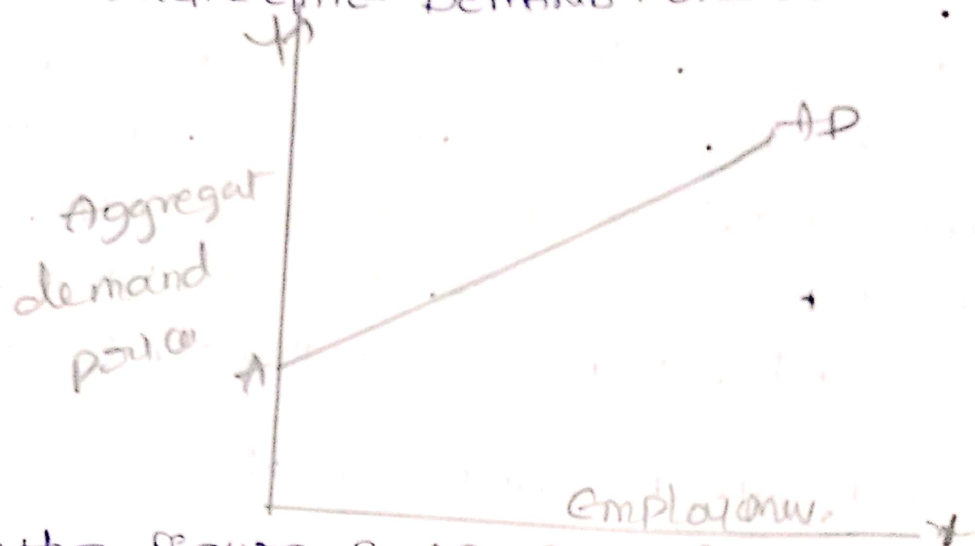
Fig.2

AGGREGATE DEMAND FUNCTION.



In the figure 2 AD curve is the aggregate demand curve. It slopes upwards from left to right. It means that the aggregate demand rises along with the rise in employment. It is starting from point A, rather than from the origin because even at zero employment and income level consumption will not be zero.

Effective demand is a point where aggregate demand equals the aggregate supply Every level of aggregate demand cannot be called effective demand. when aggregate demand is equal to aggregate supply the economy is in equilibrium.

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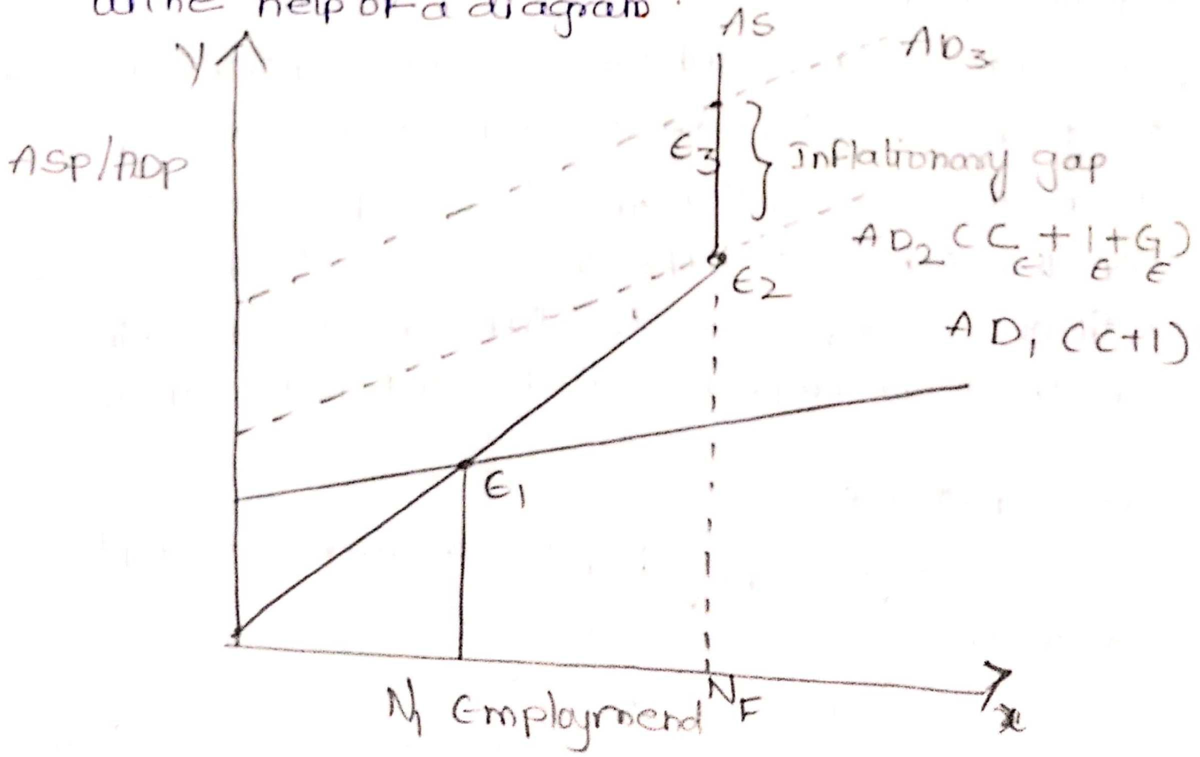
EFFETIVE DEMAND.

Level of employment (in Lakhs of workers)	Aggregate supply price (In crores of ₹)	Aggregate demand price (In crores of ₹)
10	500	600
11	550	625
12	600	650
13	650	675
14	700	700 AD=AS
15	750	725
16	800	750.

Table.3. When the level of employment is 14 lakh workers, aggregate demand price is equal to aggregate supply price i.e Rs. 700 crores, so, effective demand in the above table is Rs 700 crores.

The concept of effective demand canbe explained withe help of a diagram.



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In the fig 3 the aggregate demand price curve (AD) the aggregate supply price (curve) (AS) intersect each other at poin E_1. It shows the equilibrium point. the equilibrium has been attained at ON_1 level of employment. It is assumed that ON_1 in the above diagram does not indicate full employment as the economy is having idle factors of production. so it is considered as underemployment equilibrium.

like population not change.
(3) The habit
(4) The cons

3) Explain about consumption function?

Ans:- INTRODUCTION:- Consumption function is one of the employment important tools, of keynesian economics. The consumption function refers to income consumption relationship. Consumption is a function of disposable income. Consumption function is a "functional relationship between total consumption and gross national income" Symbolically, this can be expressed as $c=f(Y)$; where c is consumption, Y is income and f is the functional relationship. This relationship is based on the assumption of "ceteris paribus" consumption function is a schedule of the various amounts of consumption expenditure corresponding to different levels of income. Assume that consumption is a linear function of disposable income.

ASSUMPTIONS:-

Keynes psychological law of consumption is based on the following assumptions.

(1) Consumption depends upon income only.
(2) The other factor that influence consumption

like population, distribution of income, price level etc. do not change.

(3) The habits of the people regarding spending do not change

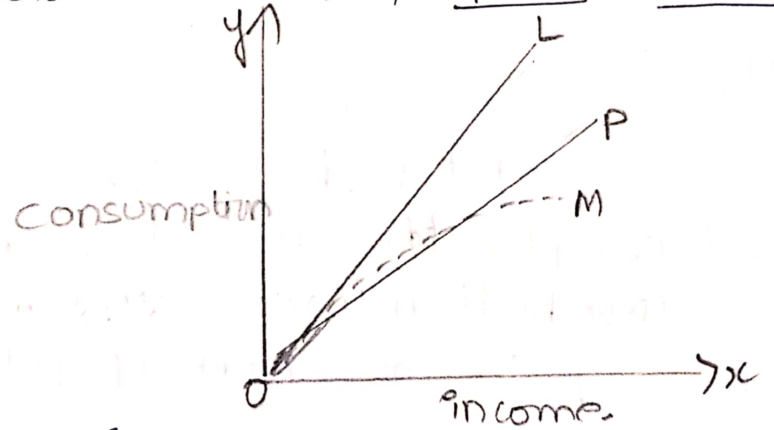
(4) The conditions are normal. There are no abnormal conditions, like wars, inflation etc.

Illustration of the law:-

Keynes psychological law is illustrated by a number example below.

Income (Crores of Rs)	Consumption (Crores of Rs)
100	75
120	90
140	105
180	135
220	165

In the table shows that as income increases, consumption also increases, but the increase in consumption is less than the increase in income. When the income increased by Rs. 20 crores (100 to 120) consumption increased only by Rs. 15 crores (75 to 90) * GRAPHIC REPRESENTATION. *



Income is shown on the Ox axis and consumption is shown on Oy axis. OL is a 45 degree line. If all the income is spent on consumption, we get this line; which is not real. It is called Y=C line. OP and OM are lines showing the propensity to consume.

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It will be a straight line in the form of OP. If consumer spend the same proportion of income on consumption as income on consumption as income increases. It will be OM, a curve, If the proportion of income spent declines as income increases, The proportion of income consumed falls progressively.

The value of marginal propensity to consume (MPC) can be known by the slope of the tangent to the income consumption curve MPC = tan <POX.

4. Explain Keynes "psychological Theory of consumption?"

Ans: J.M Keynes put forward a "psychological law of consumption" which forms the basis of consumption function. Keynesian theory consumption states that, "men are disposed as a rule and on the average, to increase their consumption as their income increases but not as much as the increase in their income" therefore, marginal propensity to consume is less than one and greater zero i.e $0 < MPC < 1$

ASSUMPTIONS:-

1. It assumes a constant psychological and institutional complex ~~the case of~~ such complexes are income distribution, tastes, and habits, social customs, price movements, population growth rate etc.
2. It assumes the ~~expectance~~ existence of normal conditions in the economy, In the case of abnormal circumstance like war, revolution a hyper inflation, the law will not operate.

• This law assumes the existence of laissez-faire capitalist economy. This law is inoperative in socialist or state controlled and regulated economics.

PREPOSITIONS OF THE LAW:-

This theory of psychological law of consumption has three related prepositions they are;

⇒ when income increases, consumption expenditure also increases, but by a smallest amount.

⇒ Increase income always leads to an increase in both consumption and savings.

write about average and marginal propensity to consume?

SF The term propensity to consume refers to the relationship between income and consumption at a particular level of income. The propensity to consume relates to two concepts. viz average propensity to consume (APC) and marginal propensity to consume (MPC). It can be said that consumption changes as income changes, but the changes in response to a given changes in income depend upon the average and marginal propensity to consume.

Average propensity to consume (APC)

The Average propensity to consume may be defined as the ratio of the amount of consumption to total income. It is obtained by dividing consumption expenditure by income sybolically, It can be written as follows.

$$APC = C/Y$$

where,

APC = Average propensity to consume

C = amount of consumption

Y = level of income.

Marginal propensity to consume (MPC)

The marginal propensity to consume may be defined the ratio of the change in consumption to the change in income or as the rate of changes. It can be obtained by dividing the change in consumption by a change in income. symbolically, this case be written as follows.

$$MPC = \Delta C/\Delta Y$$

where,

MPC = margical propensity to consume

ΔC = change in consumption.

ΔY = change in income.

MPC is never equal to one or unity, since the increase in income is always greater than the increase in consumption further, whenever there is an increase in income there will also be an increase in consumption. Hence, MPC is ~~near~~ never equal to zero but always more than zero therefore, It can be written as $0 < MPC < 1$

Diagrammatic presentation of APC & MPC

The diagrammatic presentation of APC & MPC is shown in the following figures

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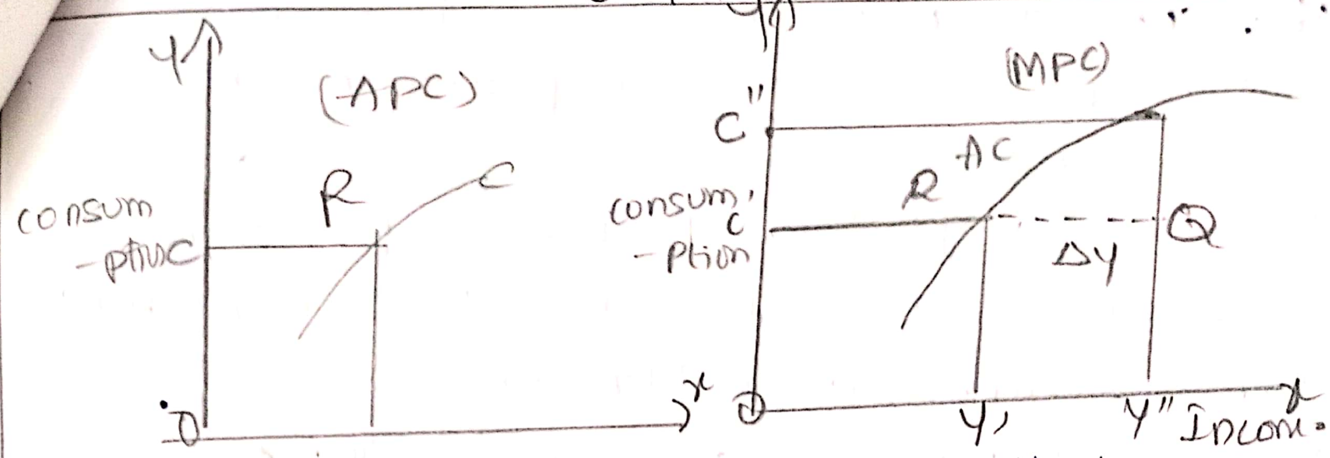
APC and MPC.



Digrammatically, the average propensity to consume at anyone point on the C curve is obesrved. In figure panel (A) point R measures the APC of the C curve which is OC'/OY' the flattening of the C curve to the right shows declining of APC. The marginal propensity to consume is measured by the slope of the curve. This is shown in figure panel (B) by NQ/RQ, where NQ is the change in consumption (ΔC) and RQ is the change in income (ΔY) or C'C''/Y'Y''.

6. Describe the factors determining consumption function.

Ans- Keynes broadly classified the factors determining consumption into two groups they are.

A. Subjective factors. B. Objective factors.

A. Subjective factors :- The subjective factors are purely personal. They included psychological characteristics of human nature such as individual tastes, habits and attitudes. These factors which influence the saving propensity of the individual determine the consumption propensity also.

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the subjective factors include those factors which include people to save some part of their income for the following reasons.

1. Pre cautionary motive :- People save part of the income to meet the unforeseen contingencies, such as illness unemployment, accidents etc.

2. To meet future needs :- People are included to say because they want to provide for the expected future needs such as education of the children, marriages of their children etc.

3. To increase the level of future income :- People wise to save from their current incomes so that they may be able to use accumulated savings for investment which will increase their future income. Investments will brings them more income in the form of more profits and interest.

4. Social status :- People are prompted to saves so that they can accumulate large wealth which will increase their social status.

5. Niggardly attitude :- Many people save due to their misely instinct and habits. The accumulation of more wealth gives them a great psychic satisfaction.

B. <u>OBJECTIVE FACTORS</u> :-

Keynes mentioned the following objective factors which influence the consumption function they are :-

1. Changes in the General price level :- This is an important factor which influences the consumption.

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If the important factor which influences the consumption. If the general price level increases, the consumption function shifts downward due to the decline of the monetary value of the money balances and financial assests held by the public, which in conversely towe.

2. fiscal policy, fiscal policy of the government especially, taxaction policy affects the propensity to consume By levying excise duties, sales tax, the government can cut down the consumption and thereby increase savings of the commounity. If the government reduces taxes, consumption of the people increases and this raises the propensity to consume.

3. Rate of interest:- It affects the propensity to consume and save as well. In the classical economic theory consumption was regarded as a negative function of the rate of interest. Other things beings equal, real consumption was inversely related to the rate of interest.

4. Stock of wealth:- This is also another important factor that determines propensity to consume, wealth includes not only "real assests" such as land, houses and automobiles but also "financial assests" such as cash balances, savings by fixed deposits with banks, stocks, and bonds possessed by households.

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6. Income distribution:- Distribution of income in a society determines the level of consumption function. If the income distribution is more favorable to rich the propensity to save will be more, while if it is more in favour of the poor and lower middle class that will increase the propensity to consume,

7. Write about the relative income hypothesis?

Ans:- INTRODUCTION:- In 1949 James Duesenberry presented the relative income hypothesis. According to this hypothesis, saving (consumption) depends on relative income. The saving function is expressed as $S_t = f(Y_t/Y_p)$, where Y_t/Y_p is the ratio of current income to some previous peak income. This is called relative income. Thus current consumption or saving is not a function of current income but relative income.

Duesenberry pointed out that during depression when income falls consumption does not fall much. People try to protect their living standards either by reducing their past savings (or accumulated wealth) or by borrowing.

However as the economy gradually moves initially into the recovery and then into the prosperity phase of the business cycle consumption does not rise even if income increases. People use a portion of their come either to restore the old saving rate or to repay their old debt.

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Thus we see that there is a lack of symmetry in people's consumption behaviour. people find it more difficult to reduce their consumption level than to raise it. This asymmetrical behaviour of consumers is known as the ratchet effect.

Thus if we observe a consumer's short run behaviour we find a non-proportional relation between income and consumption. Thus MPS is less than APC in the short run, as keyne's absolute income hypothesis has postulated. But if we study a consumer's behaviour in the long run i.e. over the entire business cycle we find a proportional relation between income and consumption. This means that in the long run MPC = APC.

8. Write about the life cycle hypothesis?

4) INTRODUCTION:- In the late 1950's and early 1960s Franco modigliani and his co-workers Albert Ando and Richard Brumberg related consumption expenditure to demography. Modigliani, in particular emphasised that income varies systematically over people's lives and that savings allows consumers to move income from early years of earning (when income is high) to later years after retirement when income is low.

This interpretation of household consumption behaviour forms the basis of his life-cycle hypothesis

The life cycle hypothesis (henceforth LCH) represents an attempt to deal with the way in which consumers dispose of their income over time. In this hypothesis wealth is assigned crucial role in consumption decision. Wealth includes not only property (houses, stocks, bonds, savings accounts, etc) but also the value of future earnings.

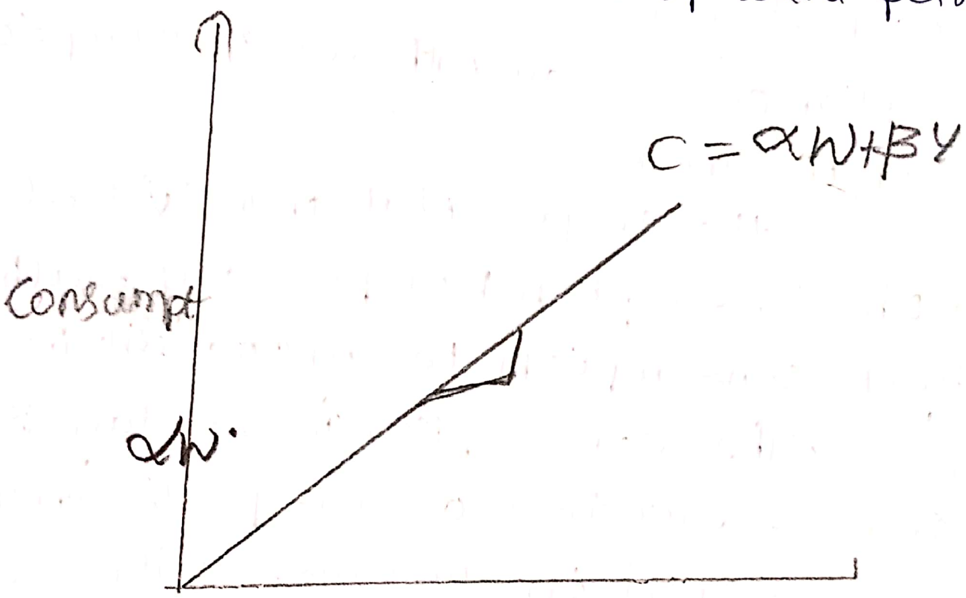
Thus consumers visualise themselves as having a stock of initial wealth, a flow of income generated by that wealth over their life time and a target (which may be zero) as their end-of-life wealth. Consumption decisions are made with the whole series of financial flows in mind.

Thus changes in wealth as reflected by unexpected changes in flows of earnings or unexpected movements in asset prices would have an impact on consumer's spending decisions because they would enhance future earnings from property, labour or both. The theory has empirically testable implications for the relation between saving and age of a person as also for the role of wealth influencing aggregate consumer spending.

Fig. shows the relationship between consumption and income in terms of the life cycle hypothesis. For any initial level of wealth W, the consumption function looks like the keynesian function.

BUT
✓

But the intercept αW which shows what would happen to consumption if income ever fell to zero, is not a constant, as is the term a in the keynesian consumption function. Instead the intercept, αW depends on the level of wealth. If W increases; the consumption line will shift up-ward parallely.



so one main prediction of the LCH is that consumption depends on wealth as well as income as is shown by the intercept of the consumption function.

Explain about permanent income Hypothesis.

INTRODUCTION:- permanent-income theory of consumer's behaviour has been put forward by a well-known american economist Milton Friedman. Though Friedman's permanent income hypothesis differs from life cycle consumption theory in details, It has important common features with the latter. Like the life cycle approach, according to friedman, consumption is determined by long-term expected income rather than current level of income.

It is this long-term expected income which is called by friedman as permanent income on the basis of which people make their consumption plans. To make his point clear friedman gives an example which is worth quoting. According to friedman, an individual who is paid or receives income only once a week, say on friday, he would not concentrate his consumption on one day with zero consumption on all other days of the week.

He argues that an individual would prefer a smooth consumption flow per day rather than plenty of consumption today and little consumption tomorrow. Thus consumption in one day is not determined by income received on that particular day. Instead It is determined by average daily income received for a period. This is on the line of life cycle hypothesis Thus according to him, people plan their consumption on the basis of expected average income over a long period which friedman calls permanent income.

It may be noted that permanent income or expected long-term average income is earned from both "human and non-human wealth". The income earned from human wealth which is also called human capital refers to the return on income derived from selling household's labour services, that is, efforts and abilities of its labourer.

This is generally referred to as labour income.

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human wealth consists of tangible assests such as saved money, debentures, equity shares, real estate and consumer durables. It is worth noting that Friedman regards consumer durables such as cars, refrigerators, air conditioners, television sets as part of household's non-human wealth. The imputed value of the flow of services from these consumer durables is considered as consumption by Friedman.

* RELATIONSHIP BETWEEN CONSUMPTION AND PERMANENT INCOME :-

Now, what is the precise relationship between consumption and permanent income (that is, the expected long period Average income). According to permanent income hypothesis, Friedman thinks that consumption is proportional to permanent income.

$$\boxed{C^P = KY^P}$$

where,

⇒ Y^P is the permanent income.

⇒ C^P is the permanent consumption.

⇒ K is the proportion of permanent income that is consumed.

The proportion or fraction K of permanent income that is consumed depends upon the following factors-

(1) Rate of Interest (i): At a higher rate of interest the people would tend to save more and their consumption expenditure will decrease. The lowering of rate of interesect will have

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opposite effect on the consumption.

2. The proportion of noun-human wealth to human wealth. The relative amounts of income from physical assests (i.e, non human wealth) and income from labour (i.e human wealth) also affects consumption expenditure. This is denoted by the term w in the permanent consumption function and is measured by the ratio of non-human wealth to income. In this permanent income hypothesis Friedman suggests that consumption expenditure depends a good deal on the wealth or assests possessed by the people. The greater the amount of wealth or assests held by an individual the greater would be it's propensity to consume and vice-versa.

3. Desire to add to one's wealth:- Lastly, households preferences for immediate consumption as against the desire to add to the stock of wealth or assests also determines the proportion of permanents income to be devoted to consumption the desire to add to one's wealth rather than to fulfil one's wants ~~tro of~~ immediate consumption is denoted by u.

Thus rewriting the consumption function based on Friedman's permanent income hypothesis we have

$C^P = K(i, W, u) Y^P$.

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above function implies that permanent consum-ption is function of permanent income. the proportion of permanent income devoted to consumption depends on the rate of interest (i) the ratio of non human-wealth to labour income (W) and desire to add to the stock of assests (u)

10. what is investment function?

Ans:- A firm makes an investment in capital goods with the object of producing goods and services in order to generate additional income to the investors. As a matter of fact the level of such investment level depends on the magnitude of expected income flow of capital goods, price of capital good and the market rate of interest that can have a say on the profitability of investment. The functional relationship between these factors and the level of investment can be called as the investment function. symbolically, it can be written as

$$I = f(I/e, Pc, r)$$

where,

I = Investment.

I/e = Expected income flow from capital good.

Pc = price of capital good.

r = market rate of interest.

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DETERMINANTS OF INVESTMENT :-

The investment demand depends mainly upon two factors.

They are:,

1. Expected rate of profits :According to keynes -this is nothing but the marginal efficiency of capital (MEC) ; and .

2. The rate of Interest.

Of the two determinants, marginal efficiency of capital or expected rate of profits is Comparitively more significant than the rate of ~~profit is~~ ~~compared~~ interest does not change ~~m~~uch in the short run; It is more or less sticky . But the changes in the expectations. of profits are highly affected by the marginal efficiency of capital, greatly affect the investment demand which Causes the aggregate demand to fluctuate very much. The changes in the marginal efficiency of capital thus plays a crucial role in bringing about changes in the . level of investment and hence the economic activity.

11. Explain the concept of " marginal efficiency of Capital "?

Ans!- (i) Marginal efficiency of capital (MEC):- Marginal efficiency of capital is the rate of return over cost expected from an additional unit of a capital asset during it's time.

In other words; It is the earning power or profitable additional or marginal unit of a capital asset.

* Calculation of marginal efficiency of capital - Discount formula :-

Marginal efficiency of capital is calculated by the following formula.

$$* \quad k = \frac{R_1}{(1+r)^1} + \frac{R_2}{(1+r)^2} + \frac{R_3}{(1+r)^3} + \frac{R_n}{(1+r)^n}$$

'k' stands for MEC (marginal efficiency of capitals); R_1, R_2, R_3, R_n = Expected income during the life time of the capital asset; r = rate of discount which makes the expected income equal to the supply price of the asset.

(B) Factors that affect MEC:-

There are several factors that influence marginal efficiency of capital. These can be divided into short term and long term factors.

SHORT TERM FACTORS:-

(1) Expected demand:- If business expect an increase in the demand for goods, MEC will be high. If they expect a fall in the demand, MEC will be below.

(2) cost :- If costs are expected to fall MEC will be high. If costs are expected to rise MEC will be below.

(3) prices :- If prices are expected to rise MEC will be high. If prices are expected to fall MEC will be below.

(4) Marginal propensity to consume :-
If marginal propensity to consume increase, demand for goods will increase. Therefore, MEC also increases. If MPC falls MEC also falls.

Long term factors :-

(1) Population growth :-
Growing population increase the demand for goods. Therefore, MEC will rise. Declining population reduces MEC.

(2) Development of new areas :-
If new areas, new towns are develop-ment, investment opportunities will increase. MEC will rise.

(3) Technological development
New methods of productions reduce costs. Lower costs due to new techno-logy encouragement investment so, MEC will rise.

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1) Explain the concept of money?

A) money is anything that is generally accepted as payment for goods and services and repayment of debts and that serves as a medium of exchange. A medium of exchange is anything that is widely accepted as a means of payments. In recent years, the importance of credit has increased in all the countries of the world. credit instruments are used on an extensive scale. The use of cheques, bills of exchange, etc, has gone up. It should however, be remembered that money is the basis of credit.

"Money is, what money does". Walker.

2. Write about Gresham's law of the Monetary systems?

A) Gresham's law states that if two coins are in circulation whose relatives face values differ from their relative bullion content, the 'dearer' coin will be extracted from circulation for melting down. The law is named after Sir Thomas Gresham (1519-79), a leading English business pay on the financial adviser to Queen Elizabeth I

In short, the principle suggests that "bad money tends to drive good money out of circulation when both are full legal tender". this principle is known as Gresham's law.

The term "bad money" does not mean worn out, clipped or coun-terfeit coins It means underweight coins. Marshall put the law in a general form as:

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" Gresham's law is that an inferior currency, if not limited in amount, will drive out the superior currency ".

Good money disappears from, circulation through the following ways:

1. Hoarding :- people hoard the good money and pass out the bad. There is a neutral tendency to retain good coins. When payments are being made the comparitively less valuable money will be issued out first. Hence, good coin tend to remain out of circulation.

2. Melting :- If the good money is a coin, the good coins will be melted down and sold as bullion. The melting of good money is highly profitable under bimetallism. Let us suppose that the government ratio between gold and silver is 1:16 while the market ratio is 1:17, In this case, gold coins will be offically undervalued and silver coins overvalued Gold coins will be good money and silver coins bad money.

3. Export to foreign countries :- The coin of one country is not legal tender in a foreign country. Hence, foreigners will not accept it as coin but only as bullion. Thus, the bad coins circulate as legal tender in the home country and the good if they are standard money are exported as bullion to foreign countries. This is especially the case under bimetallism, because the metal which is undervalued in the home country has necessarily a higher value in a

a foreign country.

* LIMITATIONS OF GRESHAM'S LAW:-

Gresham's law cannot operate in the following circumstances:-

1. when the total volume of money (currency) (good money) together with bad money) is less than what is needed by the community of ex-charge purposes. In such a situation both good money and bad money will circulate.

2. when the "bad money" is so bad that it is not accepted by the people of a country. so bad money will not circulate and cannot drive good money out.

Write about RBI's classification of money?

- The supply of money means the total stock of money (paper notes, coins, and demand deposits of bank) in circulating which is held by the public at any particular point of time.

i) currency.
ii) Demand deposits of commercial banks.

Again it needs to be noted that (like difference between stock and supply of a commodity) total stocks of money is different from total supply of money.

In india Reserve bank of India uses four alternative measures of money supply called M_1, M_2, M_3 and M_4; Among these measures M_1 is the most commonly used.

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measure of money supply because it's components these are regarded most liquid assests. Each measure is briefly explained below.

(1) $M_1 = C + DD + OD$. Here C denotes currency (paper notes and coins) held by public. DD stands for demand deposits in banks and OD stands for other deposits in RBI. Demand deposits are deposits which can be withdrawn at any time by the account deposits are included in demand deposits.

(2) $M_2 = M_1$ (detailed above) + saving deposits with post office saving banks.

(3) $M_3 = M_1 +$ Net time deposits of banks.

(4) $M_4 = M_3 +$ Total deposits with post office saving organisation (excluding NSC).

4. Write about the functions of central bank?

A) The main function of a central bank is to act as government of the machinery of credit in order to secure stability of prices.

It regulates the volume of credit and currency, pumping in more money when market is dry of cash and pumping out money when there is excess of credit.

In India RBI have two departments, namely Issue department and banking department.

Main functions:-

1) Issue of currency :- The central bank is given the sole monopoly of issuing currency in order to secure control over volume of currency and credit.

these notes, circulate thoroughout the country as legal tender money. It has to keep a reserve in the form of gold and foreign securities as per statuary rules against the notes Issued by it.

2. Banker to Government :- central bank functions as a banker to the government both central and state governments It carries out all banking business of the government, Government keeps their cash balances in the current account with the Central bank. Similarly, central bank accepts receipts and makes payment on behalf of the government.

3. Bankers bank and supervisor :- there are usally hundreds of banks in a country. there should be some agency to regulate and supervise their proper functioning. This duty is discharged by the central bank.

Central bank acts as banker's bank In three capacities:

(i) It is the custodian of their cash reserves. Bank of the country are required to keep a certain percantage of their deposits with the central bank, and in this way the central bank is the ultimate holder of the cash reserves of commercial banks.

4. Controller of credit and money supply :- central bank controls credit and money supply through it's monetary policy which

consists of two parts currency and credit. central bank as monopoly of issuing notes Expect one rupee notes, one-rupee coins and the small coins issued by the government and hereby can control the volume of currency.

5. Exchange control:- Another duty of a central bank to see that the external value of currency is maintained For Instance, in India, the reserve bank of India takes steps to ensure external value of rupee. It adopts suitable measures to attain this object. The exchange control system is one such measure.

6. Lender of last resort:- When commercial banks have exhausted all resources to supplement their funds at times of liquidity crisis, they approach central bank as a last resort. As lender of last resort, central bank guarantees, solvency and provides financial accomadation to commercial banks.

7. Custodian of foreign exchange or balances:- It has been mentioned above that a central bank is the custodian of foreign exchange reserves and nations gold. It keeps a close watch on external value of it's currency and undertake exchange management control. All the foreign currency receive received by the citizens has to be deposited with the central

bank and if citizens want to make payment in foreign currency they have to apply to the central bank. central bank also keeps gold and bullion reserves.

8. clearing House function:- Banks receive cheques drawn on the other banks from their customers which they have to realise from drawee banks. ~~from their customers~~. Similarly cheques on a particular bank are drawn and passed into the hands of other banks which have to realise them from the drawee banks.

9. collection and publication of data:- It has also been entrusted with the task of collection and compilation of statistical information relating to banking and other financial sectors of the economy.

Explain the functions of commercial Banks.

① A Bank is an institution which deals with money and credit.

② It accepts deposits from the public, makes the funds available to those who need them, and help in the remittance of money from one place to another.

FUNCTIONS OF COMMERCIAL BANKING SECTOR

they are several types in the commercial banking sector.

A) PRIMARY FUNCTIONS:

the primary functions of a bank are the receipt of deposits repayable and pro-vision of credit facilities to merchants and manufactures of productive purposes.

i) FIXED DEPOSIT ACCOUNT:

Money in these accounts, is deposited for fixed period of time (say one, two or five years) and cannot be withdrawn before the expiry of that period.

Fixed deposits is also called time depo-sits. it is called "time liability of the Bank"

ii) ~~fixed~~ current deposit account:

these accounts are generally maintained by trade and businessmen who have to make a number of payments every day

* current deposits are also called "demand deposits or demand liabilities."

iii) saving deposit account:

the main of these account is to encourage thrift and mobilize small savings of the public. certain restrictions are impo-sed on the depositors regarding the num-ber of withdrawals and the amount to be withdrawn in a given period of time.

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iv) **Recurring Deposit Account** :-
The purpose of these account is to encourage regular savings particularly by the fixed income group. Generally money in these accounts is deposited in monthly installme -nts for a fixed period.

ii **ADVANCING OF LOANS** :-
* the second important function of a bank is advanting of loans to the public.
* After keeping cash reserves, the bank lend their deposits to the needy borrowe -rs.

i) **Money - at - call and Short - Notice** :-
Such loans are for very short period and can be called back by the banks at a every short notice, say one day to fourtee -n days. these loans are inter - banks.

(ii) **Cash - credit** :-
It is short period loan granted to a custom -er for period of one year or less. It may be renewed after the expiry of the period. Interest is charged only on the amount uti -lized Banks may impose commitment char -ges on the utilized portion.

(iii) **over Draft** :-
Sometimes, the bank provides over Draft the faci -lities to its customers through which they are allowed to withdraw more than their deposits.

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the customer is allowed to draw more th the balance in his account.

iv) Loans :-

Loans is given for a fixed period at an agreed rate of interest. It is made normally against security. In addition to personal security, collateral security has to be provided by the borrower.

v) collections of dividends on shares :-

Bank collects dividends and interest on shares and debenture for their customers.

vi) cash Management services :-

It is a service to improve liquidity of funds of customers. Banks render collection and payment services through faster access to their fund and control of their funds through customized Management Information service.

6. Critically examine "Irving fisher's Quantity Theory of money".

Ans INTRODUCTION :- The value of money ~~d~~ first stated by Jean Bodin in the 16th century itself. it was refined and formulated by Prof. Irving fisher in the 20th century. The Quantity theory of money states that the value of money depends on it's Quantity. If the Quantity of ~~method~~ money falls. if the quantity of money decreases the value of money rises.

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other things remaining the same.

According to Irving fisher states as follows ;" A change in the Quantity of money most normally and ultimately cause a proportionate and direct change in the price level".

*** ASSUMPTIONS :-** fisher's theory is based on the following assumptions :-

① Theory assumes that velocity of circulation of money 'V' remains constant ; It is not affected by changes in the Quantity of money or the price level.

② It assumes that the volume of goods and services 'T' remains constant ; T depends on natural resources, climate, techniques of production etc. and these factors have nothing to do with changes in the Quantity of money

③ It assumes that price p is a passive factor ; price level p is determined by the other factors in the equation but it does not determine them.

④ Fisher considers a long period of time and assumes V and T to be constant over such a period.

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(5) He also assumes that there is full employment

Fisher's equation of exchange - Transactions approach

prof. fisher expressed his theory in the form of an equation is known as equation of exchange.

equation of exchange :-

$$\boxed{PT = MV + M'V' \text{ (or) } P = \frac{MV + M'V'}{T}}$$

In the above equation,

P = price level

T = Number of transactions of the volume of good to be exchanged.

M = Legal tender money.

V = velocity of circulation of legal tender money

'M' = Bank money or bank deposits.

'V' = velocity of circulation of bank money

It can also be written as

$$MV + M'V' = PT$$

money includes not only legal tender money but also bank money. velocity of circulation of money means the number of times a unit of money changes hands in a given period of time for transaction purpose.

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Therefore, to know the effective quantity of money we have to multiply the legal tender and the bank money by their velocity of circulation.

PT = Demand for money :- According to fisher, money is demanded for buying and selling goods services only, that is, for transaction purpose only. Therefore, the total demand for money will be equal to the total value of goods the services bought and sold during a given period

MV + M'V' = supply of money :- Legal leader money and bank money multiplied by their velocity of circulation is the supply of money. It is MV+M'V'.

PT = MV + M'V' :- According to fisher, money has only one use and that is to help buy and sells goods and services. people do not require to keep money for any other purpose except for transaction purposes. Since whatever money available to the people will be spent for transaction purposes, the value of transactions itself is the supply of money.

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As people demand money for transactions purp... only the total value of transactions is the deman... for money also, thus, we arrive at the equation $PT = MV + M'V'$. It can also be written as $MV + M'V' = PT$. In other words, the total quantity of money given in exchange for the available goods and services is the supply as well as the demand for money, because according to fisher money is used for no other purpose except for buying & selling goods and services.

$$P = \frac{MV + M'V'}{T}$$

From the equation $PT = MV + M'V'$ it follows the $P = \frac{MV + M'V'}{T}$. If the quantity of money $MV + M'V'$ is divided by the volume of transactions T, we get the general price level P.

Fisher assumed that money is demanded only for transaction purposes and not for it's own sake, therefore, his approach is called as Transaction approach.

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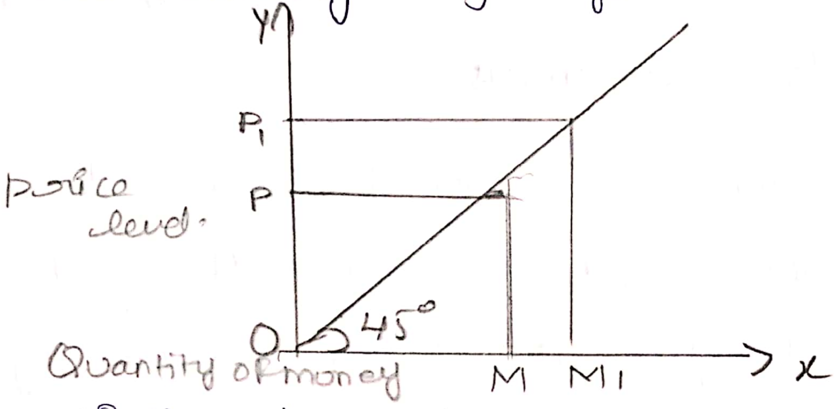
3. Diagram:-

The Quantity theory of money can be shown in the following diagram:-



The 45° line shows that if the quantity of money is doubled price level also will be doubled. When the quantity of money increased from OM to OM1 price level also increased from OP to OP1.

The proportionate increase of MM1 and the proportionate increase of PP1 are same.

4. Criticism:- The Quantity theory of money is criticised on the following grounds:

1. V and T do not remain constant.
2. It does not explain the trade cycles.
3. It does not really useful to know the purchasing power.
4. It does not explain the chain of causation.

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paper no 15

(6) It divorces the theory of money from the general theory of value.

(7) Explain the different equations given by Cambridge economists.

Ans- The cambridge economists explained their cash-balance approach to the quantity theory of money by formulating equation known as 'Cambridge equations.

(a) Marshallian cash-Balance equation :- Marshallian cash balance equation is expressed as follows;

$M = KPY$; where M is the quantity of money (currency plus demand deposits), P is the price level, Y is aggregate real income and K is the proportion of real income which people desire to hold in money form.

Similarly, the price level can be found out by dividing the money supply (M) by the amount of goods which the community wants to hold (Ky) Thus,

$$\boxed{P = \frac{M}{Ky}}$$

The cash balance approach also implies that the price level (p) is directly proportional to the money supply (M) and it is indirectly proportion of the real income which individuals choose to keep in the form of money (k) , M and y are constant, p falls with the increase in k and rises, with the decrease in k, similarly, k and y remaining unchanged, if M increases prises and if M decrease p falls.

(b) Pigou's equation:-

pigou's cash balance equation is as follows.

$$\boxed{P = \frac{kR}{M}}$$

where, p is the price level and $\frac{1}{P}$ is the purchasing power, R is the total real income or the real resources, k is the proportion of total money supply.

Since money is held by the community not merely in the form of cash but also in the form of bank deposits. pigou, extented his equation by dividing cash into two parts. i.e, cash with the equation as :

$$P = \frac{kR}{M}\left[c + h(1-c)\right]$$

where c is the proportion of cash which people keep with them, (1-c) is the proportion of bank balances held by the people and h is the proportion of cash reserves to deposits held by the banks.

(c) Robertson's equation :- Robertson's cash-balance equation is similar to that of pigou but with a slight difference that in place of pigou's real resources (R) he includes total transactions (T). Robertson's equation is as follows

$$M = KPT$$

where p is the price level, M is the money supply, T is the total amount of goods and services to be purchased during a year, and K is the proportion of T which people wish to hold in the form of cash.

The equation clearly shows that p changes directly with the inversely with K and T. Robertson's equation is general preferred to that of pigou. because it is comparable with Fisher equation.

(d) Keyne's equation :- Keynes gave his real balance quantity equation as a improvement over the other cambridge equations. According to keynes, the demand for money is with reference only to consumer goods. In other words, people hold money to buy or to represent only goods and services, keynes equation is as follows

$$N = PK \text{ or } P = \frac{n}{K}$$

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where 'n' is the cash held by the general public, 'p' is the price level of consumer goods and 'k' is the real balance or the proportion consumer goods over which cash (n) is kept.

Assuming 'k' to be constant, there is a direct and proportional ~~of~~ ~~consumer~~ relationship between 'n' and 'p'. In order to consider bank deposits, keynes extended the equation as follows.

$$\boxed{p = \frac{n}{k + rk'}}$$

where r is the cash reserve ratio of the banks 'k'' is the real balance held in the form of bank money.

Again assuming k, k' and r to be constant, the same conclusion emerges, i.e. there is direct and proportional relationship between 'n' and 'p'.

Explain the innovations in banking Sector in India (or) Recent ~~trad~~ trends in banking?

5b After initiation of reform measures, major changes and shifts i.e innovations have been taking place in the banking sector.

paper nor 29.

The introduction of new technology has been changing the satire of banking. The brick and morter banking is slowly giving place to click of the banking. The other trends emerging are move banking. retail banking as a major banking banking. The activity. Universal banking is the order of the day. moreover, Indian banks are now resorting to off shore banking.

(i) electronic banking:- The delivery of bank's services to a customer at his office or home by using electronic delivery channels may be called electronic banking. It is the application of electronic technology for transfer of funds, through an electronic terminal, computer or magnetic tape and to conduct various transactions like cash receipts, payment, transfer of funds etc. It is any where, anytime, banking 24 hours in day and 7 days in a week.

Thus the delivery of banking products / services by electronic channels may be defined as electronic banking. It started with the introduction of computers and ATM in 1970s. The next step was telephone banking in 1980s and now internet banking.

Facets of Electronic Banking:- the facets of electronic banking are: (a) Computerisation (b) telephone banking (c) Automatic teller machine. - (ATM)

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(d) personal computer banking. (e) e-mail banking
(f) online banking or network banking (g) electronic funds transfer.

The development and use of communication networks has helped in the banking industry to gain in terms of important banking service of customer.

(2) online or internet banking :-

It is the latest wave in information technology. It is another electronic delivery channel. in simple terms internet banking means any user with a personal computer and a browser can get connected to his his bank's website to perform any of virtual banking of functions (electronic delivery of services) there is no human operator present in a remote location to respond to his needs such as in telephone banking, in a call centre. The bank has a centralised. permitted on the internet are displayed in menu. Any service can be selected and further interaction is dicated by the nature of service.

(3) Virtual banking :-

The term virtual banking is associated with electronic delivery of services, basically it means that customer is not interacting with bank staff across the counter, more and more customers are now using electronic delivery channels.

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associated with virtual banking. they now use instruments such as credit cards, tele banking. ATMs, retail electronic funds transfer and electronic clearing services.

under virtual banking, the different types of services are (i) ATMs - ATM networks - shared ATM Network. (ii) Electronic funds transfer at point of sales. (iii) Remote or home banking. iv) smart cards or chip cards (v) stored value card. vi) super smart card. (vii) internet banking.

(4) Automated teller machine - ATM -

ATM means Automated teller machine. this machine is designed to perform the most important functions of bank i.e providing cash facility. ATM is operated by plastic card. with it's special features. The plastic card is replacing cheque, personal attendence of the customer, banking hours, restrictions and paper based verification. These are debit cards. ATM are used as spring board for electronic fund transfer, point of sale has taken many functions performed by cashiers. ATM itself can provide information about customer's account and also receive instructions from customers. ATM card holders.. An ATM is an electronic fund transfer terminal capable of handling cash deposits transfer between accounts, balance enquiries cash with drawals and pay bills, It may be on-line or off-line the on-line ATM confined to that particular ATM Assigned. Any customer possessing ATM card issued by the shared payment network system (SPNs) can go to any ATM linked to SPNs and perform his transactions.

ATM are established in important places by a bank in cities and important towns. Indian Railways gave a mandate to 10 leading bank to host ATMs at Railway stations.

ATM usage in india is growing at 300 percent but still the ATM density in relation to population stands at more 4 ATMs per million population by the begining at 2002.

(5) Credit card facility :- Indian banks introduced credit card facility in 1980 s since then, credit card has become increasingly popular among the banks as well as the public.

The Latest generation cards available now, in india facility include ATM cards, kisan credit cards, change cards, phone cards, pre-paid mobile sim cards, smart cards. electronic smart card is the next development in the field.

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(6) **Mobile banking:-** The delivery of bank's services to a customer through mobile / cell phone is called mobile banking. Mobile banking can take the form of SMS banking. GSM-SIM tool kit and WAP (wireless Application protocalls)

(7) **Off-shore banking:-** Off-shore banking is financial intermediation performed (primarily) for non-resident borrowers and depositors. It is a special category of financial services but its functions are narrower the main attraction of an off shore banking centre is simply the absence of expensive regulations by the host country, including taxation and portfolio decisions of the banking industry - Domestic residents may occasionally participate in an off shore market centre but the domestic financial market in insulated from off-shore banking activity by are array of capital and exchange controls, thus, the offshore banking facilities are confined to non-resident leaders and borrowers.

9. Write about credit control methods followed by central bank? (or) Reserve Bank of India?

A) Credit control is the regulation of credit by the central bank for achieving some definite objective.

modern economy is a credit economy becaeause credit had come to play a major role in setting all kinds of monetary and business transactions in the modern economic system. changes in the volume of credit influence the level of business activity and the price level in the economy.

methods of credit control: The various methods or instruments of credit control used by the central bank can be broadly classified into two categories: (a) Quantitative or general methods and (b) Qualitative methods.

(a) Quantitative or General methods: The methods used by the central bank to influence the total volume of credit in the banking system, without any regard for the use to which it is put are called Quantitative or general methods. The important Quantitative method of credit control are (i) Bank rate (ii) Open market operations (iii) Cash reserve ratio.

(2) **Bank rate policy:-** The bank rate policy is the traditional method of credit control used by a Central bank. The bank rate or the discount ~~the~~ ~~first~~ class ~~bill~~ s. ~~the~~. rate is the rate at which a central bank is prepared to discount the

first class bills of exchange. In the capacity as lender of last report, the central bank helps the commercial banks by rediscounting the first class bills. The rate of interest, at which the central bank charges from the commercial banks for rediscounting the bills is called bank rate.

ii) Open market operations:- Open market operations refers to the deliberate and direct buying and selling of securities in the money market by the central bank. In the narrow sense, open market operations refers to the purchase and sale by the central bank of government securities in the money market

iii) Variable cash reserve ratio:- The method of variables cash ratio or changing minimum cash reserve to be kept with the central bank by the commercial banks is comparitively a new method of credit control used by the central banks. This method ~~of~~ was first adopted by the federal reserve system of the USA in 1935 to prevent injuries of credit expansion or contraction.

while the bank rate policy and the open market operations due to their limitations, are appropriate only to produce marginal changes in the cash reserves ratio is a more direct and more effective method in dealing with the abnormal situations.

(b) ~~Quan~~ **Qualitative or selective methods** :- The methods, used by the central bank to regulate the flow of credit into particular directions of the economy are Qualitative or selective methods. The important Qualitative methods are (i) margin requirements (ii) Regulation of consumer credit (iii) control through directives (iv) credit rationing (v) moral suasion and ~~prob~~ publicity (vi) Direct action.

(iii) Margin requirements :- The method of regulating margin requirements of security loans was first used in the USA under the securities exchange Actor 1934. Control over margin requirements means control over down payments that must be made in buying securities on credit. The marginal requirement is the difference between the market value of the security and it's maximum loan value.

(ii) Regulation of consumer credit - this method was first used in the USA in 1941 to regulate the terms and conditions under which the credit repayable in installments should be extended to the consumer credit system a certain percentages of the price of the durable goods is paid

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by the consumers in cash. The balance is financed through the bank credit which is repayable by the consumer in installments.

iii) <u>Rationing</u> <u>of credit</u>:- credit rationing is a selective method of controlling and regulating the purpose for which credit is granted by the commercial banks.

iv) <u>moral suasion</u>:- In many countries with only handful of commercial bank the central bank relies heavily on moral suasion to accomplish it's objectives. moral suasion means advising, requesting and persuading the commercial bank to cooperate with the central bank in implanting it's general monetary policy.

v) <u>publicity</u>:- The central banks also use publicity as a method of credit control. Through publicity, the central bank seek to influence the credit policies of the commercial banks to educate people regarding the economic and monetary conditions of the country and to influence the public opinions in favour of it's monetary policy.

vi) <u>direct action</u>:- The method of direct action is most extensively used by the central bank

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to enforce both quantitative, as well as qualitati-ve credit controls. this method is not used in isolation. It is often used to supplement other methods of credit control. direct action refers to the directions issued by the central bank to the commercial banks regarding their lending and investment policies.

• Explain the functions of non-banking finance companies (NBFCs)

→ INTRODUCTION :- The principal business of NBFC is that of receiving deposits in any form as under any scheme and advance loans in securities, provide hire purchase finance or equipment leasing. These companies are just like banks since they perform the basic functions of receiving deposits from the public and giving loans. But, they can not be regarded as banks as they need not follow CRR, SLR, etc.

the NBFCs may also undertake investment in securities equipment leasing, hire purchasing etc. Loan companies also came under non-banking finance companies. There are also residual NBFCs which receive deposits

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A) they are able to attract deposits of huge amounts by offering attractive rates of interest and other incentives, about half of the deposits are below 2 years time period.

B) They can also give loans without any security, Hence they are able to charge 24 to 36 percent interest rate.

C) they give loans of wholesale and retail merchants, small industries, self employment schemes.

(D) they own chit funds, discount hundies, provide hire purchase, leasing finance, merchant banking activities.

The NBFCs are able to fill credit gaps by providing lease finance, hire purchase and instalment buying. they provide loans to buy durable consumer goods. such extension of function makes them almost commercial banks. the only difference is that NBFC cannot introduce cheque system. This is the difference between the two.

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UNIT-IV. INFLATION AND TRADE CYCLE

B.A. II SEMESTER.

① Explain the types of Inflation ?

INTRODUCTION :-

Inflation is one of the Serious macro economic problems confronting all the economies in the world today. It affects the economic lives and the welfare of the people in many ways. It has impact on production and distribution. Inflation disturbs the budgetary allocations of the government. Sometimes it threatens the stability of the governments also.

Definitions of Inflation :-

1. Crowther definition :- Crowther defined inflation as "a state in which the value of money is falling, that is the prices are rising.

2. Ackley definition :- Ackley "Inflation is a persistent and appreciable rise in the general price level or average of prices."

Types of Inflation :-

Inflation is divided into different types based

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on its rate of inflation and the causes of infl
They are detailed below.

A. Based on the rate of inflation, it may be categoriz-ed into four types as follows :-

1. **Creeping inflation** :-

when rise in the prices is very slow and small, it is called creeping inflation.

2. walking inflation :-

This is the second stage of inflation. The inflation rate will be between 2% and 4%.

3. Running inflation :-

when the rate of inflation is the range of 4-10 per cent per annum, it is called running inflation.

4. Galloping inflation or Hyper inflation

If the inflation rate exceeds 10 per cent, galloping inflation occurs. It may also be called hyper inflat-ion.

B. On the basis of the cause, inflation is classified into two types :-

1. Demand-pull inflation :-

The inflation represents a situation whereby by " The

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pressure of aggregate demand for good and services exceeds the available supply of output." In this such situation, the rise in price level is the natural consequence.

2. Cost - push inflation :-

prices of the ~~[illegible]~~ commodities may increase due to increase in the cost of production. Inflation caused by the rise in cost of production is called cost - push inflation.

Even through there is no increase in aggregate demand, prices may still rise. This may happen if costs, particularly the wage costs, go on rising.

(2) Explain the Causes and measures to Control Inflation.

INTRODUCTION :-

Inflation is one of the serious macro economic problems confronting all the economies in the world today. It affects the economic lives and the welfare of the people in many ways. It has impact on production and distribution. Inflation disturbs the budgetary allocations of the government. Sometimes it threatens the stability of the government also:

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Definitions of Inflation

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The main causes of inflation :-

1. INCREASE IN MONEY SUPPLY :- Inflation is caused by an increase in the supply of money which leads to increase in aggregate demand. The higher the growth rate of the nominal money supply, the higher is the rate of inflation.
2. INCREASE IN DISPOSABLE INCOME :- when the disposable income of the people increases, it raises their demand for goods and services. Disposable income may increase with the rise in national income.
3. INCREASE IN PUBLIC EXPENDITURE :- Government activities have been expanding due to developmental activities and social welfare programmes. This is also a cause for price rise.

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4. **INCREASE IN CONSUMER SPENDING :-**

The demand for goods and Services increases when they are given credit to buy goods on hire-purchase and installment basis.

5. **CHEAP MONEY POLICY :-** Cheap money policy or the policy of credit expension also leads to increase in the money supply which raises the demand for goods and services in the economy.

6. **DEFICIT FINANCING :-**

In order to meet its mounting expenses, the government resorts to deficit financing by borrowing from the public and even by printing more notes. This raises aggregate demand in relation to aggregate supply, thereby leading to inflationary rise in prices.

7. **BLACK-ASSESTS, ACTIVITIES AND MONEY :-**

The existence of black money and black assests due to corruption, tax evasion etc, increase the aggregate demand.

8. **REPAYMENT OF PUBLIC DEBT :-** Whenever the government repays its past internal debt to the public, it leads to increas to increase in the money supply with public. This tends to raise the

aggregate demand for goods and Services.

9 Increase in Exports :-
When Exports are encouraged, domestic Supply Of goods decline. So prices rise.

Measures to Control the inflation:—

Inflation has to be controlled Other wise, the Extent of damage done to the Economy will be Substantial and the Economy would take a long time to recover from the Effects of inflation.

Inflation is a Complex phenomena. It Should be attacked from various angles. The methods of Controlling inflation and mitigating its Severity Can be classified into the following.

1. Monetary measures to Control inflations :-

Since too much money will be the fundamental problem in the Economy. the Central banking authorities use various weapons available in its armory to Combat inflation throught reduction of money supply and Credit. The various methods available are:-

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* changing the bank-rate
* open-market operations
* Increasing the reserve ratio of commercial banks
* placing effective curbs on advances made by the commercial banks.

By these methods the available money in the economy will be reduced.

2. FISCAL MEASURES TO CONTROL :-

By adopting suitable measures in taxation, public expenditure and borrowing the government can effectively curb inflation, In order to reduce the disposable income with the people, the tax rates could be introduced by which a sizeable portion of the purchasing power of the community could be reduced.

3. physical and Direct method :-

The two methods states above are only indirect methods under direct method the government will resort to actual control of supply of money and credit in the country wage freeze and income freeze will be imposed wages salaries and profit margins could be controlled. price control and rationing of essential commodities would be resorted to reduce evils of black-mark eting. hoarding and profiteering and also to ensure equitable distribution.

Honest implementation of these policies will reduce inflationary pressures in the country. However, with stringent penal measures the government can make effective policies in controlling inflation of a country.

③ write about philips curve.

INTRODUCITON :- The phillips curve given by A.W. phillips shows that there exist an inverse relationship between the rate of unemployment and the rate of increase in nominal wages. The phillips curve examines the relationship between the rate of unemployment and the rate of money wages changes. Known after the British economist A.W. phillips who frist identified it, it ex-presses an inverse relationship between the rate of unemployment and the rate of increase in money wages. Basing his analysis on data for the united Kingdom, phillips derived the empirical relationship that when unemployment is high, the rate of increase in money wages rates is low.

The phillips concluded on the basis

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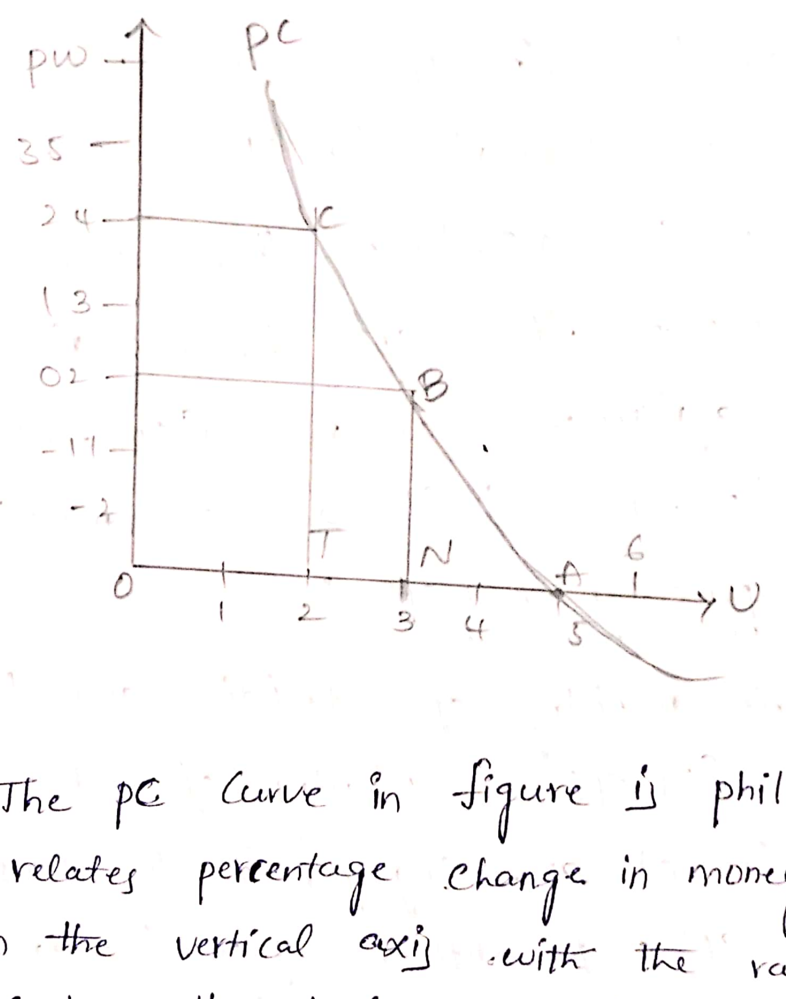
of the rate

of the above arguments that the relation between rates of unemployment and a change of money wages would be highly non-linear when show on a diagram. Such a curve is called the phillips curve.

Diagram



The PC curve in figure is phillips curve which relates percentage change in money wage rate (W) on the vertical axis with the rate of unempolyment (U) on the horizontal axis. The curves is convex to the origin which shows that ~~the~~ the percentage change in money wages rises with decrease in the employment rate. In the figure, when the money wage rate is 2 percent, the unempolyment rate is 3 percent.

4. Explain the CPI and WPI (or) Describe about measurement of inflation.

There are two main set of inflation indices for measuring price level changes in india – the wholesale price Index (WPI) and the consumer price Index (CPI). The WPI, where prices are quoted from wholesalers, is constructed by office of Economic Affairs, ministry of Commerce and Industries. In the case of CPI (prices quoted from retailers), there are several indices to measure it; CPI for industrial labource (CPI - IL), agricultural labourers (CPI - AL) and rural labourers (CPI - RL) besides and all India CPI.

1. Consumer price Index (CPI) :-

Two ministries ministry of statistics and programme Implementation (MOSPI) and ministry of labour and Employment (MOLE) are Engaged in the construction of difference CPIs for different groups / sectors. CPI inflation is also called as retail inflation as the prices are quoted from retailers. following are the various CPIs.

a. CPI by MOSPI (CSO) :- The CSO, which comes under MOSPI, is constructing the rural, urban and

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the combined CPIs. They are published from 2011 onwards of these, the CPI combined is the most important of all the CPIs as it is relevant for all categories of people.

b. CPIs by MOLE (labour Bureau):

The labour Breau, ministry of labour and Employment (MOLE) is preparing different indices for various categories of people. These were CPI for Rural laborares (CPI-RL) CPI for Aagricultural laborares (CPI-AL) and CPI for Industrial workers (CPI-IW).

Since these CPIs were for Specific categories of workers, it lacked the quality of an all India index.

2. The wholesale price Index (WPI):-

The WPI is published by the office of Economic Adviser ministry of commerce and Industry. It is in use since 1942 and is being published from 1947 regularly. It has a long history for serving as the nation wide inflation indicator till the Emergence of the combined CPI in 2011. An important feature of the WPI which separate it from the CPI is that prices are collected from wholesalers.

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(5) Explain the concepts of the Deflation Reflation. Stagflation.

1. **Deflation** :- When the overall price level decreases so that inflation rate becomes negative, it is called deflation. It is the opposite of the often-encountered inflation.

A reduction in money supply or credit availability is the reason for deflation in most cases. Reduced investment spending by government or ~~di~~ individuals may also lead to this situation. Deflation leads to a problem of increased unemployment due to slack in demand.

Central banks aim to keep the overall price level stable by avoiding situations of severe deflation/inflation. They may infuse a higher money supply into the economy to counter balance the deflationary impact.

2. **Reflation** :-

~~Refl.~~ Reflation is fiscal or monetary policy designed to expand output, stimulate spending, and curb the effects of deflation, which ~~but~~ usually occurs after a period of economic uncertaintry or a recession.

Reflation methods :-

Reflation policies typically include the following :

Reducing taxes :-

Paying lower taxes makes Corporations and Employees wealthier.

* Lowering interest rates :- makes it cheaper to borrow money and less rewarding to stow Capital away.

* Changing the money Supply :-

When Central banks boast the amount of Currency and other liquid instruments in the banking System the cost of money falls.

* Capital projects :-

Large investment projects create jobs, boosting Employment figures and the number of people with spending power.

3. Stagflation :-

Stagflation is a new term which has been added to Economic literature in the 1970s. It is a paradoxical phenomenon where the Economy Expendience's Stagnation as well as inflation. The word Stagflation is the Combination of Stag plus 'flation' taking 'Stag' from Stagnation and 'flation' from inflation.

Stagflation is a situation when recession is accompanied by a high rate of inflation. It is therefore, also called inflationary recession. The principal cause of this

this phenomenon has been Excessive demand in Commodity markets, thereby Causing prices to at the same time the demand for labour is deficient, thereby Creating unemployment in the Economy.

(6) what is Trade cycle ? Explain phases of Trade cycles.

INTRODUCTION :- The trade cycles Can also be Called as Business Cycles. The Business cycles had its own Effect on the Business. This may be good or bad Effects. In a period of bad trade. output, Employment and prices are low. In the period of good trade the output Employment and prices are high. Such rhythmic Cyclical fluctuations in the level of Economic activity during short periods are called trade or business cycles.

phases of Business. Cycles :-

Business cycles pass through Certain well defined phases. mitchel identifies four phases. They are revival, Expression, recession and Contraction. The peak and through represent two Critical points in the cycle. The Expansion phase Extends from through.

These four stages are shown in below diagram.

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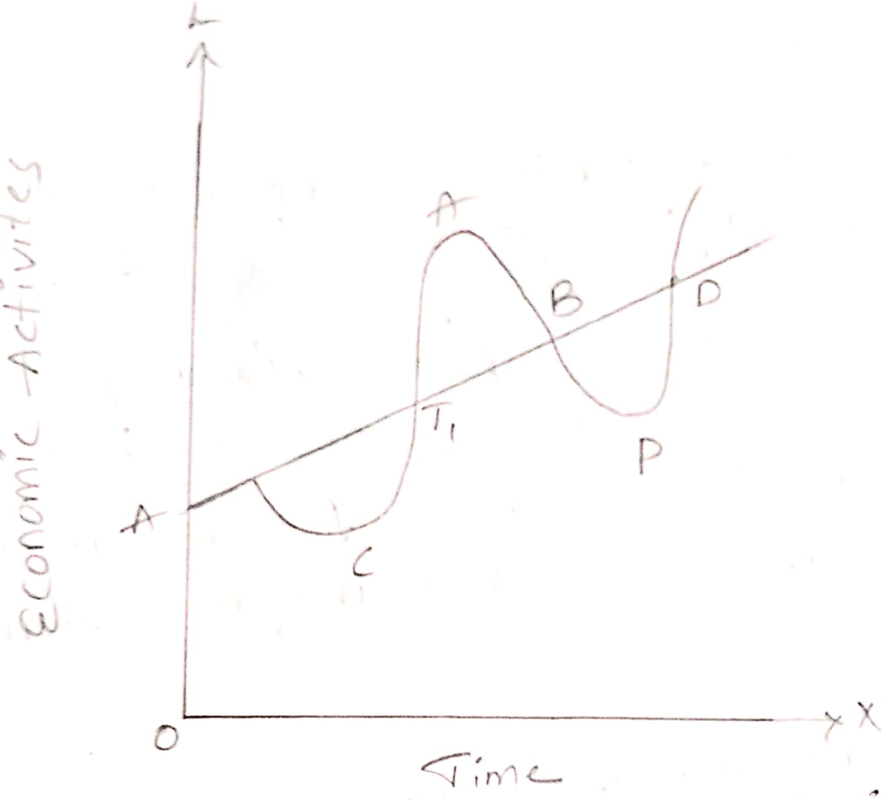
Diagram :-



a) prosperity :- As output increases, prices began to rise. In order to increase output, manufacturers demand more raw materials. since the supply of raw materials is inelastic their prices go up. Thus bottlenecks begans to develop. This would rise prices and costs. producers are likely to over-Estimate profits and venture goes into risky enterprises. Thus, a boom sets in.

b) Recession :-
After a brief spell of hectic activity, business house begin to totter. Businessmen Expand by borrowing money from banks. Capital projects may reach a temporary state. There may not be possibilities for further investment. whatever may be the reason, a crisis brings

reversing the whole up-ward movement.

c) Depression

The recession degenerates into depression. The forces that cause contraction finally win over the forces that cause expansion. The depression may last for a very long time unless. Steps are taken to limit it. unemployment increases, incomes fall and output decreases. prices also fall discouraging enterprise.

d) Revival

frist, starting from the bottom of depression comes of period of revival characterized by a feeling of confidence favourable to enterprise. manufactures finding their sales increasing employ more workers to increase output workers spend more out of their increased income.

(7) What is Trade Cycle. Explain its features.

-A trade cycle refers to fluctuations in economic activities specially in employment, output and income, prices, profits etc. It has been defined differently by different economists. According to mitchell, "Business cycles. are of fluctions in the economic activities of organized communities. The adjective 'business' restricts the concept of fluctuations in activities which are systematically conducted on commercial

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basis.

Features of a Trade cycle :-

* A Business cycle is synchronic. when cyclical fluctuations start in one sector it speards to other sectors.

* In a trade cycle, a period of prosperity is is followed by a period of depression.

* Business cycle is recurrent and rhythmic; prosperity is followed by depression and vice versa.

* A trade cycle is cumulative and self-reinforcing

* A trade cycle is asymmetrical. The prosperity phase is slow and gradual and the phase of depression is rapid.

* The impact of a trade cycle is differential. It affects different industries in different ways.

8. Explain the ~~Control of the~~ effects of inflation.

INTRODUCITON :- Inflation is one of the serious macro economic problems confronting all the economies in the world today. It affects the economic lives and the welfare of the people in many ways. It has impact on production and distribuation. Inflation disturbs the budget tary allocations of the government. Sometimes it threatens the stability of the government also.

Effects on production:- when the inflation is very moderate, it acts as an incentive to trades and producers. This is particularly prior to full Employment when resources are not fully utilized.

* However, hyper-inflation results in a serious depreciation of the value of money and it discourages savings on the part of the public
* Inflation also leads to hoarding of essental goods both by the traders as well as the consumers and thus leading to still higher inflation rate.
* Inflation encourages investment in speculative activities rather than productive purposes.

Effects on Distribution

(i) Deborts and Creditors:- During inflation, debtors are the gainers while the creditors are losers. The reason is that the deborts had barrowed when the purchasing power of money was high and now repay the loans when the purchasing power of money is low due to rising prices.

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(ii) **Fixed - income Groups:-** The fixed income groups are the worst hit during inflation because there income being fixed donot bear any relationship with the rising cost of the living examples are wage, salary, pension, interest, rent etc.

(iii) **Entrepreneur:-** Inflation is the boon to the entrepreneur whether they are manufactures, traders merchants or businessmen, because it serves as a tonic for business enterprise.

(iv) **Investors:-** The investors, who generally invest in fixed interest yielding bonds and securities have much to lose during inflation. on the contrary those who invest in shares stand to gain by rich dividends and appreciation in value of shares.

9 Explain the Causes of Trade cycles.

INTRODUCTION :- The trade Cycles Can also be Called as Business cycles. The Business Cycles had its own Effect on the Bussiness. This may be good or bad Effects.

Causes of Business Cycles :- There are number of theories of Business Cycles. Each theory attempts to Explain the causes of occurrence of business cycle.

I. Non - monetary Theories :-

The Non - monetary Theories are analyzed as follows.

1. Climatic theories :- This theory was associated with a famous Economist jeavons. According to him ups and downs in the climatic conditions are the reason for fluctuation in the Economic activity.

2. psychological Theories :- The psychological theory of trade cycle was associated with A.C. pigou. According to this theory the psychology like pessimism and optimism among business men, bankers, investors will cause the fluctuations in Economic activity.

3. Innovation theory :- Innovations are the root cause of fluctuation in the business activity. This theory was associated with a famous Economist J.A. Schumpeter.

According to this theory business men play an important role in bringing about changes in investment by introducing innovation in a group, when this happens this leads to boom or prosperity when there is a glut of goods creating keen competition between old and new products may set in.

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1. What are financial Assets. Explain the different types of financial Assets.

Ans. INTRODUCTION :- Financial assets are the intangible assets i.e., they cannot be physically touched but are the liquid assets whose values are derived from the contractual claims. i.e. a contract is made between two parties where one entity that invests its money will get some contractuale right to receive returns in the form of divided, interests etc.

Types of financial Assets.

1. Cash and the Cash Equivalents :- These are the financial assets that are highly liquid current assets of the business such as the cash balance of the business, balance in the bank accounts of the business, etc....

2. Fixed Deposits :- Fixed deposits refer to the amount that the business deposit with some other entity in the expectation of earning returns on such money deposited in the form of interest.

3. Equity Shares :- Equity shares are the financial assets

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of the Company when that company purchases equi[illegible] shares issued by another Company.

4. Debentures :-

Debentures are the financial assets that given the debenture holders the right to receive the interest at a pre-determined rate and on the specified due dates on the amount invested by them.

(2) write about financial instruments.

Ans. INTRODUCTION :- A financial instrument is defined as a contract between individuals / parties that holds a monetary value. They can be created, traded, sattled or modified as per the involved parties requirement.

Some Examples of financial instrument are cheques, shares, stocks, bonds, futures, and options contracts.

Types of financial Instruments :-

financial instruments are classified intwo types namely.

1. Cash Instruments :-

The value of the cash instruments are directly influenced and determined by the markets. These are the kind of securities which are easily transferred.

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2. Derivative Instruments :- The value and characteristics of derivative instruments are based on the underlying components such as assets rates or indices.

Types of financial Instruments in india :-

1. Equities :- It is a types of security that represents the ownership of a company. Equities are traded in stock in markets. It can also be purchased through Initial public offerings (IPO). whenever a company issues shares to the public for the first time.

2. Mutual funds :-

In India, mutual funds are top-rated becauses the initial investment amount is very less and the risk is diversified. mutual funds allow a group of individuals to invest their money together.

3. Bonds :-

Bonds are fixed income instruments which are issued to raise working capital.

4. Deposits :-

Investing the money in banks or post-office is one of the standard method of savings followed in india.

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③ write about financial markets. (or) Explain the functions of markets.

Ans. INTRODUCTION :- Financial market refers to a market place, where creation and trading of financial assets Such as shares, debentures, bonds, derivatives, currencies etc. take place. It plays a crucial role in allocating limited resources, in the Country's Economy.

Functions of financial market :-

1. It facilitates mobilisation of savings and puts it to the most productive uses.
2. It helps in determining the price of the Securities.
3. It provides liquidity to tradable assets, by facilitating the Exchange.
4. It saves the times, money and Efforts of the parties, as they don't have to waste resources.

Classification of financial market :-

1. By Nature of claim :-

a. Debt market :- The market where fixed claims or debt instruments, such as debentures or bonds are bought and sold between investors.

b. Equity market :- Equity market is a market wherein the investors deal in equity instruments. It is the markets for residual claims.

2. By Maturity of claim :-

a. Money market :-

The market where monetary assets such as commercial paper, certificate of deposits, treasury bills, etc. which mature within a year, are traded is called money market.

b. Capital market :- The market where medium and long term financial assets are traded in the capital market. It is divided into two types.

(i) primary market :-

A financial market, wherein the company listed on an exchange, for the first time, issues new security or already issued securities are traded between investors, such as individuals.

(ii) Secondary market :-

Alternately known as the stock market, a secondary market is an organised market place, wherein already issued securities are traded between investors, such as individuals.

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3. By Timing of Delivery :-

a) Cash market :- The market where the tran[sactions] between buyers and sellers are settled in real-ti[me].

b) futures market :- futures market is one where the delivery or settlement of commodities takes place ~~at~~ a future specified date.

4. By organizational structure :-

a. Exchange - Traded market :- A financial market which has a centralised organisation with the standardise procedure.

b. over - the - counter market :-

An OTC is characterised by a decentralised organisation, having customised procedures.

(4) what is money market. Explain the functions of money market.

Ans. INTRODUCTION :- money markets is the market for short - term loanable funds, as distinct from the capital mar-ket which deals in longterm funds.

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Functions of money market :-

following are the functions performed by the money market

1. worthwhile use of Balance Capital :-

It facilitates to use of the balance capital funds efficiently for a short period by the financial as well as the non-financial institution and the government.

2. Aids in monetary progress :-

for fulfilling the working capital requirements of the various financial institutions, a money market provides Short-term Capital to them.

3. Helps the Banks :-

The Commercial bank rather than borrowing from the RBI can borrow some loans from the existing money market, as the interest rate of the money market is lower than the RBI.

4. Helps the Government :-

By issuing Treasury bills, the government can obtain short-term capital from the money market at a minimal rate of interest rather than financing from RBI.

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5. Balance amongst demand and Supply of ~~cap~~ funds :-
By way of transfer of Savings into investments, the money market grants money to be used in a balanced way.

6. Competent application of ~~money~~ monetary policies :-
By its monetary policies, RBI may effectively regulate its banking System and can given guidance to the development of commerce and industry.

7. Effective use of money :-
money market aids the development of commerce and industry as it manages the money assets and money can easily be relocated from one place to another.

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(5) What is Capital market. Explain ~~the~~ the functions of capital market.

Ans. INTRODUCTION :- Capital market for borrowing and lending of long-term finance that it for a period of more than one year. It is an organized financial market where saving and investment are channeled between the one who has sufficient money and one who is in need of money.

functions
1. mobilization

functions of Capital market :-

1. mobilization of Savings :- Capital market is an importance Source for mobilization idle Saving from the Economy. It activates the ideal monetary resources and puts them in proper investments.

2. capital formation :- Capital market helps in capital formation. Capital formation is the 'net addition to the Existing Stock of Capital in the Economy.

3. Speed up Economic Growth and development :- Capital market Enhances production and productivity in the national Economy. As it market funds available for a long period of time.

4. proper Regulation of funds :- Capital market also helps in proper allocation of these resources. It Can have regulation over the resources so that it can direct funds in a qualitative manner

5. Continuous Availability of funds :- Capital market is a places where the investment avenue is continuously available for long-term investment.

6. foreign capital :- Capital market make possible to generate foreign capital. Indian firms are able to generate.

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Capital funds from overseas markets by ways of ... and other Securities.

7. Easy liquidity :- with the help of Secondary market investors can sell off their holdings and convert them into liquid cash.

8. Minimises Transaction Cost And Time :- The Capital market facilitates the trading of long-term Securities. It reduces the overall cost and time involved in the whole trading process.

6. Explain the functions of stock Exchange market.

Ans. INTRODUCTION :- The Secondary market is in from of stock Exchange. It plays an importance role in the Economic development of the country. It is channelizing the savings of the people and making them available for investment purpose.

functions of stock Exchange :-

1. Continuous market for Securities :- The Investors are able to invest in good Securities and in case of any risk, it enables people to switch over from one Security to another. So stock market provides a ready and continous opportunities for Securities

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Bonds

2. Evaluation of Securities :- If the Stock Exchange, the prices of Securities clearly indicate the performance of the Companies. It integrates the demand and supply of securities in an Effective manner.

3. Mobilizes Savings :- The Savings of the public are mobilizes through mutual funds, investments trusts and by various other securities.

4. Healthy Speculation :- The stock Exchange Encourages healthy speculation and provides opportunities to shared businessmen to speculate and reap rich profits from fluctuations in security prices.

5. Mobility of funds :- The stock Exchange Enable both the investors and the companies to sell or buy Securities and there by Enable the availability of funds.

6. Stock Exchange protect investors :- As only genuine Companies are listed and the activities of the stock Exchange are Controlled, the funds of the investors are very much protected.

7. Liquidity in Stock Exchange :- Institutions like banks Can invest their idle funds in the stock Exchange and earn profit even within a short period.

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8. Attracts foreign capital :- Due to its dynamisms and higher return on capital, the stock exchange is capable of attracting more foreign funds.

9. Monetary and fiscal policies :- The monetary policy and the fiscal polical of the government have to be favorable to businessment and producers.

10. Control on Companies :- one of the major functions of stock exchanges is that it has control on companies. The companies listing their securities in the stock exchange has to submit their annual report and audited balance sheet to the stock exchange.

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(7) What is SEBI. Explain its objectives, functions and powers of SEBI [Securities and Exchange Board of India]

Ans. INTRODUCTION :- The Securities and Exchange Board of India is the regulatory body which deals in matter related to the development and regulation of securities market in india. It was Established on 12th April in 1988 but it got statutory status in 1992.

organizational structure of SEBI :-

SEBI is managed by the six members - one chairman (nominated by the chairman), two members from office

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of Central ministries, one from RBI, and remaining to members are nominated by the Central government.

Objectives of SEBI :-

1. monitors important acquisition of Shares and takeover of Companies.
2. protect the interest of investors.
3. promoting the development of securities market and regulating the business.
4. They also check that the investors are Educated about the intermediaries of the securities market.
5. They also keep a close check that no fraudulent or unfair practices are done related to the securities market.
6. It also controls the operations of participants, credit rating agencies, and custodians of securities.

Functions of SEBI :-

1. SEBI creates a suitable and favourable atmosphere required for raising money from the capital market.
2. It functions in a way to restore the trust of investors and particularly to safeguard the interest of the small investors.
3. It prohibits insider trading in securities.
4. It promotes research and development activities.
5. Regulates business in stock exchanges and any other securities market.

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6. It ensures regulating substantial acquisition of and takeover of companies.
7. It develops proper infrastructure so that the market automatically facilitates expansion.
8. SEBI educates investors and makes them aware of their rights in clear and specific terms.
9. It registers and regulates the functioning of collective investment schemes such as mutual funds.
10. performs such functions as assigned by the Central government under Securities Contracts (Regulations) Act, 1956.

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⑧ write about NIFTY.

Ans. INTRODUCTION :- NIFTY is a market index introduced by the National Stock Exchange. It is a 'blended word - National stock Exchange and fifty coined by NSE on 21st April 1996. NIFTY 50 is a benchmark based index and also the flagship of NSE, which showcases the top 50 equity stocks traded in the stock Exchange out of a total of 1600 stocks.

Eligibility Criteria for NIFTY Index listing :-

① The Company must be a domicile of India and registred with the National stock Exchange.

(2) Stocks must possess high liquidity, which is measured by their average impact cost.

(3) The Company should have a trading frequency of 100% during the previous six months.

(4) It should have an average free-floating market Capitalisation, which is 1.5 times higher than the smallest constituent in the index.

(5) Shares which have differential voting Rights or DVR are also eligible for the index.

9. write about SENSEX.

Ans. INTRODUCTION :- A stock market analyst Mr Deepak mohoni introduced the term sensex. The term sensex is a portmanteau of sensitive and index. The sensex is an index that reflects the Bombay Stock Exchange (BSE)

The sensex Index comprises 30 stocks on BSE. These stocks are the largest and most actively traded stocks on the BSE. The criterial for selecting stocks is as follows.

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* Listed on BSE
* It should be a large to mega - cap stock.
* Relatively liquid stocks.
* Revenue generated from core activities.
* A diversified and balanced sector involvement in line with the India equity market.

Sensex is the portmanteau between sensitive and index and is the market index of the Bombay Stock Exchange (BSE) It also known as S&P BSE Sensex.

10 Define Insurance? Explain the types of Insurance.
(or)
Explain the Life Insurance and General Insurance.

Ans. INTRODUCTION :- Insurance is a means of protection from any unforeseen losses and contingencies. It is a risk - management technique used for hedging against various uncertain losses. Insurance is a contractual agreement between two parties in which one party promise to protect another party from uncertainties and losses.

Types of the Insurance :-

Insurance covers different types of risks. All contracts of insurance can be broadly classified as ~~affo~~ follows.

Life Insurance (or) Life Assurance

(ii) General Insurance.

I **Life Insurance** :- A Life Insurance policy was introduced as a protection against the uncertainty of life.

Life Insurance, usually refferred to as "Life assurance" insures the insured against the happenings of certain event i.e. death through the time when it may happen is uncertain.

Types of the Life Insurance policies :-

1. **whole life policy** :- It runs throughout the life time of the policy holder. premium is low and covers high risk. The premium will be payable for a fixed period (20 to 30 years) or for the whole life is the assured.

2. **Endowment life assurance policy** :- The policy ~~is~~ taken up for a specific period. The policy will mature at the expiry of a specific period or attainment of particular age or on the death of the insured whichever is earlier.

B/.

3. **Joint life policy** :- A policy may be taken up jointly on the lives of two more persons. on the death of any one person, the policy is paid to other surving policy holder as the case maybe.

4. **Annuity policy** :-

under this policy an insured would deposit a lump sum amount which the insurance company.

5. **Children's Endowment policy** :- This policy is taken by a person for his/her children to meet the expenses of their education or marriage.

(ii) **General Insurance** :- A General Insurance policy is a non-life insurance product that includes a range of general insurance policies. Common forms of general insurance are automobiles, mediclaim, homeowners insurance, marine, travel, and others.

Types of General Insurance Policies :-

1. **Fire Insurance** :- fire insurance is an agreement between the insurer and the insured whered by the insurance having received premium undertake to make good the financial loss of the extents of specified amount suffered by the insured as a result of damage or destruction.

marine Insurance :- marine Insurance is the oldest from of insurance. It is concerned with overseas trade conducted through sea. routes. It covers a large number of risks. pertaining to the ship or cargo such a sinking of ship. burning of ship. standing or going astray of the ship, accident, collision of ships, etc.

3. Motor Insurance :- motor insurance covers all demages and liability to a vehicle against various on-road and off-road. Emergencies.

4. Health Insurance :- Health care costs are increasing every year. Sedentary lifestyle and stress at work negatively affect health and can result in a capital illness or medical emergency.

5. Travel Insurance :- International travel, whether on vacation or business, can turn into a nightmare if one experiences contingencies.

6. Liability Insurance :- This types of policy covers the risk of ~~lab~~ liability for the injury or death of sometime else. These are two main forms as (i) employers liability. (ii) public liability - covers the

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liability of individuals and business for members of public visiting their premises.

7. property Insurance :- conveys a wide variety of items from goods in transit or in store to building or contents. Applies to both the business persons and the private householders.

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