CA Foundation
(New Syllabus)

Macro Economics Revision Notes

By CA Mohnish Vora (MVSIR)

These notes are in "FILL IN THE BLANKS" format

Complete these notes by watching CLASSES of MVSIR

Connect with MVSIR

Telegram

@camvsir

Instagram

@ca_mohnishvora

YouTube

@ca_mohnishvora

Website

mvsir.in

Scan the above QR codes

..........& thousands of other students who conquered Economics exams with help of MVSIR's classes

Clear CA Foundation & then study Paper 6 – FM & SM of CA Inter on online mode (live/recorded) from MVSIR on "Ultimate CA" platform.

CA Foundation
(New Syllabus)

Business Economics Revision Notes

Chapter 6
National Income
By CA Mohnish Vora (MVSIR)

These notes are in "FILL IN THE BLANKS" format
Complete these notes by watching REVISION CLASSES of MVSIR

Chp 6: Determination of National Income
Unit 1: Macro Economic Aggregates and Measurement of National Income

- The **performance of an economy** depends on ______________ of goods and services produced by it, which is measured by National Income.
- In order to calculate National Income, first we need to understand the concept of GDP.

- **Gross domestic product (GDP)** is a measure of-
  - ✓ ________________ **value** of
  - ✓ all ____________
  - ✓ ________________ goods and services,
  - ✓ _________ **of depreciation**,
  - ✓ **produced** _____________ **the domestic territory** of a country
  - ✓ **during a** _______________________________.

- **National Income** is defined as the -
  - ✓ _____ **value of**
  - ✓ **all economic goods and services**
  - ✓ **produced**
  - ✓ **within** the **domestic territory** of a country
  - ✓ in an **accounting year**
  - ✓ ______ the **net factor income from abroad**.

> Also, according to the **Central Statistical Organisation (CSO)** 'National income is the **sum total of** ________________ generated by the _____________________ of a country in the form of **wages, rent, interest and profit** in an **accounting year**'.

EXCLUSIONS FROM GDP & NATIONAL INCOME

1) ________ **Payments** (Govt. **making a payment**, **without goods** or services **received in return**)
2) __________ **transactions** **(Stocks & bonds transactions –** do **not** involve current production)
   But, **value of services accompanying sale** (e.g. fees to agents/broker) **is included**.
3) **Sale of** __________________ **goods**
4) _______________________ **output – illegal transactions.** Eg – narcotics and gambling

NOMINAL GDP vs REAL GDP

- '**Nominal GDP**' or '**GDP at** __________________________' changes due to 2 reasons-
  1) __________________________ **changes**, and/or
  2) When __________________________ **change**.

  Changes in GDP due to changes in ________ – _____ **to explain performance of economy**

- **Real GDP** or **GDP at constant prices** is an **inflation adjusted** measure of GDP
  - ✓ ______ **affected** by changes in **prices**;
  - ✓ **Changes only when** there is change in _____________________.

  Thus, Real GDP is a __________ **measure** of **economic** __________________

> **GDP Deflator**
>
> $$\text{GDP Deflator} = \frac{\text{Nominal GDP}}{\text{Real GDP}} \times 100$$
>
> $$\text{Inflation rate in Yr 2} = \frac{\text{GDP deflator in Yr 2} - \text{GDP deflator in Yr 1}}{\text{GDP Deflator in Yr 1}} \times 100$$

DOMESTIC VS NATIONAL

- 'National' → normal residents of a country who may be within or outside domestic territory of a country & is a ________________ concept compared to the term 'domestic'.
- The term 'domestic' refers to production done by people __________ the domestic territory

IMPORTANT FORMULAS

- **Net Factor income from abroad (NFIA)**

  = Factor income earned by __________factors of production employed in _________________ (-) Factor income earned by factors of production of _________________ employed in _____________ territory

- **Operating Surplus** = __ent + __nterest + __rofit ....(also add Loyalty if given in Question)

- **3 Golden Rules of NI**
1) Gross – Depreciation = Net
2) MP = FC + IDT - Subsidy ....or.... MP = FC + NIT
3) Domestic + NFIA = National

Total 8 Aggregates

1)	GDP at MP	5)	GNP at MP
2)	GDP at FC	6)	GNP at FC
3)	NDP at MP	7)	NNP at MP
4)	NDP at FC	8)	NNP at FC

- **Net Domestic Product at Factor Cost (NDP FC)**

  (aka. - Domestic Income or Factor Income earned in Domestic Territory)

  =

- **National Income (NNPFC)** = NDPfc +

- **GDP Per Capita**

✓ Measure of country's economic output per person. Indicator of standard of living of country

✓ GDP Per Capita =

- **Indirect Taxes and Subsidies**

1) **Production Taxes & Production Subsidies**

   These are ______________ of volume of actual production

2) **Product Taxes & Product Subsidies**

   Paid or received on ______________ of product

Basic Price	
=	Factor Price
+	
-	

Market Price	
=	Basic Price
+	
-	

Personal Income

Income ______________ by household sector including __________Institutions Serving Households from ____ sources

=	National Income
+	
-	

Disposable Personal Income

It is a measure of amount of money in the hands of the individuals that is available for their ____________________

=	Personal Income
-	
-	

Income from domestic product accruing to private sector

=	NDP fc
-	
-	

Private Income

It is a measure of the income (**both ________ income & ___________ income**) which **accrues to private sector** from ______ **sources** __________ & ______________ country.

	Private Income
=	Income from domestic product accruing to private sector
+	
+	
+	

Net National Disposable Income (NNDI)

The amount of G/S domestic economy has at its disposal.

=	National Income (NNP fc)
+	
+	

- **GNDI = NNDI + Depreciation**
- ____________ **"Govt transfer pay"** in calculation og GNDI / NNDI

Circular flow of income

Circular flow of income refers to the **continuous circulation** of- **production, income generation & expenditure** involving **different sectors** of the economy. There are 3 phases-

Production phase	
Income or Distribution phase	
Exp. or Disposition phase	

Method	Data Required	What is measured?
Value Added Method or Product Method or Industrial Origin or Net Output Method	The sum of net values added by all the producing enterprises of the country	
Factor Income Method or Factor Payment or Distributed Share	Total factor incomes generated in the production of goods and services	
Expenditure method or Income Disposal	Sum of exp. of 3 spending units- 1. government, 2. consumer households, and 3. producing enterprises (firms)	

VALUE ADDED METHOD

Step 1- Calculate GVA for each sector

	Value of Output
-	
=	

Step 2- Calculate GVAmp by adding GVA of all sectors

	GVA by Primary Sector
+	GVA by Secondary Sector
+	GVA by Tertiary Sector
=	

Step 3- Calculate NNP fc from GDP mp

NNP fc (National Inc.)
GDP mp   **(-)**   **(+)**   **(-)**

- **If "Value of Output" is not given separately, then**

Value of Output = **Sales (+)**

(where→ Change in Stock = Cl. Stock – Op. Stock)

EXPENDITURE METHOD

Step 1- Calculate GDP mp

	Private Final Consumption Expenditure (PFCE) **(C)**
+	
+	
+	
=	

Step 2- Calculate NNP fc from GDP mp

NNP fc (National Inc.)
GDP mp   **(-) Depreciation**   **(+) NFIA**   **(-) Net Indirect Taxes**

GDCF (if not given in Q)
= Gross Domestic Fixed Capital Formation (H/B/G)   (+)   (+)

INCOME METHOD

+	
+	
=	**NDP fc**
+	NFIA
=	**NNP fc (National Income)**

Comp. of Emp. does **not** include "Employ**ee**'s Contribution to PF"

NI as per Inc. Method does **not** include-
→**Int. paid by govt/firm**
→**Capital gains, windfall profits** etc

NATIONAL INCOME IN INDIA

(MoSP&I)

Reliable statistical data is ______ available → not possible to estimate India's NI wholly by one method.

Therefore, a ____________________ of methods is used.

- ________________________ method → commodity producing sectors like agriculture and manufacturing.
- In ______________________ sector → income method, &
- In ______________________ sector → expenditure method.

Method used for National Income in developed economies:
_________________ method → most suitable
But, sometimes expenditure method also used.

SYSTEM OF REGIONAL ACCOUNTS IN INDIA

_____________ **Income** or **Net State Domestic Product (NSDP)** is a measure in **monetary terms** of volume of **all G/S produced** in **state** within a given **period of time** (generally a year) accounted **without duplication**.

Per Capita State Income is obtained by **dividing the NSDP (State Income) by** the **midyear projected population** of the state.

State level estimates are **prepared by** the ___________________________ of respective State _______________ of Economics and Statistics (DESs). **CSO assists** & advices in **preparation**

Certain activities such as **railways, communications, banking and insurance and central government administration**, that _____________ **state boundaries**, and thus their **economic contribution cannot be assigned to any one state** directly are known as the '_____________________ **sectors**' of the economy. The estimates for these **compiled for economy as a whole** & **allocated to states** on basis of **relevant indicators**.

Can GDP be index of welfare?

_____, since GDP measures **exclude** the following which are **critical for the overall wellbeing** of citizens.

a) **Income** _________________

b) ________________ improvements → **technological** & **managerial innovations.**

c) **Productions** ____________ **from govt.**, → **evading taxes** or **illegal** (**drugs, gambling etc.**).

d) **Non-market production** and **Non-economic contributors** → **health**, **education levels** etc.

e) **Economic** '___________' → **crime, pollution, traffic congestion** etc which make us **worse off**.

f) _____________ **work** → **without remuneration**

g) ______________ **time**, **fairness, gender equality, security of community feeling** etc.,

Limitations And Challenges of NI

Conceptual difficulties

1) **lack** of an **agreed definition** of national income,
2) **accurate** _____________ between **final** & **intermediate** goods,
3) issue of ____________ **payments**,
4) **difficulty** of **incorporating** _____________ **of income**,
5) **valuation of a** ______ **good** at **constant prices**, and

Challenges

1) ______________ **of data** and **lack of reliability** of available data,
2) **absence** of _________ **of incomes** due to **illiteracy and ignorance**,
3) **lack** of **proper** _________________ **classification**, and
4) accurate **estimation** of **consumption of fixed capital**
5) production for **self-consumption**

Chp 6: Determination of National Income
Unit 2: The Keynesian Theory of Determination of National Income

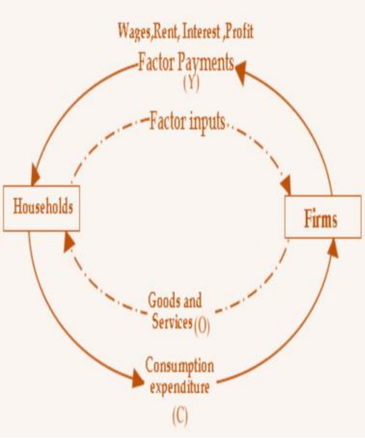
INTRODUCTION

- In **previous unit, 'ex post'** (**realized**) values were used. In this unit, __________ (**anticipated**) values are used, if we want to __________ what **equilibrium value of output or GDP** is.
- Before Keynes, **classical economists** said that **economy is ________-regulating** and is always **capable of ______________________ achieving equilibrium** at '**natural level**' of **real GDP**
- However, _______ in his "**General Theory of Employment Interest & Money**" → **markets** would ____ **automatically** lead to **full-employment equilibrium,** as **prices & wages are ______ (rigid)**, especially **downward**. This **prevents economy** from **returning to natural level** of real GDP. So, **output will remain at ___________full employment level unless** there is **insufficient _________**
- Keynesian theory of income determination is presented in **3 models**:

1) **Two-sector** = household + business,
2) **Three-sector** = household + business + government,
3) **Four-sector** = household + business + govt. + foreign

Circular Flow in a Simple Two-sector Model

- The **circular flow of income** is a process where the **national income** and **expenditure** of an economy **flow in a circular manner continuously** through time.
- Two sector economy model assumes **only two sectors** in economy viz., **households** and **firms**, with only **consumption** and **investment** outlays.
- In the figure-
  - Circular **broken lines** - factor and product flows- '___________ **flows'**
  - **Continuous line** with arrows show ___________ **flows**



Factor Payments
= Household Income
= Household Expenditure
= Value of Output
= Total Receipts of Firms

Important Concepts

1) **Consumption function**- Functional **relationship between consumption spending and disposable income** → **C = f(Y) =**

2) **Average Propensity to Consume**- Ratio of **total consumption to total income.**

APC =

Consumption is _______________ **function of income.**

3) **Marginal Propensity to Consume (MPC = "b")**- **Increment in consumer expenditure per unit of increment to income.** → **MPC = = b**

✓ Keynes **assumes** that **consumption increases with an increase in Yd**, but that

increase in consumption < increase in Yd

✓ Value of MPC is **between ___ & ___**.

✓ MPC is also the **__________ of consumption line**

4) **Saving function**- Functional **relationship between saving & income**→ **S = f(Y) =**

5) **Marginal Propensity to Save**

✓ **Increment in saving per unit increase in disposable income.**

MPS = = 1- b & MPC + MPS = _____ ; MPS 0 < b < 1

Also, **MPS is ___________ of savings line**

6) **Average Propensity to Save**- Ratio of **total saving** to **total income.** → **APS =**

Saving is **_______________________ function of income.**

7) **Aggregate Supply (AS)**- Ex ante or planned AS → **total supply of G/S** which firms plan on selling during a specific time period.

✓ AS = Agg. Production = Factor Payments = Factor Incomes [National Income→ Y]

8) **Aggregate Demand (AD)**- Total planned _______________________ in the economy.

9) **Equilibrium output**- **Desired amount of output demanded** = **amount produced**. **(AD = AS)**

Two Sector Model

- Household Sector & Business Sector only
- AD = C + I (I is assumed to be constant)
- AS = C + S
- Equilibrium is achieved when - AD = AS **or** C + I = C + S
or

Three Sector Model

- Household + Business + Govt Sector
- AD = C + I + G
(I & G are assumed to be constant)
- AS = C + S + T
- Equilibrium is achieved when AD = AS **or** C + I + G = C + S + T
or

Govt sector adds following flows to 2 sector model:
1)
2)
3)
4)

Four Sector Model

- Household + Business + Govt. + Foreign Sector
- AD = C + I + G + (X - M)
(I, G & X are assumed to be constant)
- AS = C + S + T
- Equilibrium is achieved when - AD = AS or C + I + G + (X – M) = C + S + T
or

Foreign sector adds following flows to circular flow of 3 sector model:
1) **exports**,
2) **imports** and
3) **net capital inflow** which is the difference between capital outflow and capital inflow

If **(X > M) is +ve** then **NI __creases**

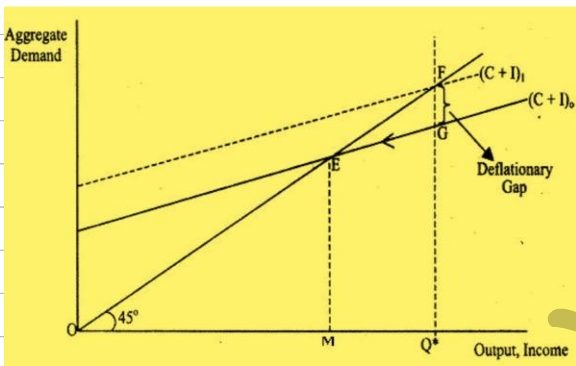
If **(X > M) is -ve** then **NI ___creases.**

LEAKAGES & INJECTIONS

- **Leakage-** ______________ **of income from circular flow→** part of income ______ **used to purchase goods**.
  - 2 sector Model : Leakages =
  - 3 sector Model : Leakages =
  - 4 sector Model : Leakages =
- **Injection-** It is an **inflow of income to the circular flow**. Due to injection, the **volume of income increases**.
  - 2 sector Model : Injection =
  - 3 sector Model : Injection =
  - 4 sector Model : Injection =

- If **AS = AD → Leakages = Inj.** NI will be in ____________________.
- If **AS > AD → Leakages > Inj.** Stock ____________ or Deficient Demand → **(NI will ______)**
- If **AS < AD → Leakages < Inj.** Stock ______________ or Excess Demand → **(NI will ______)**

DEFLATIONARY & INFLATIONARY GAP

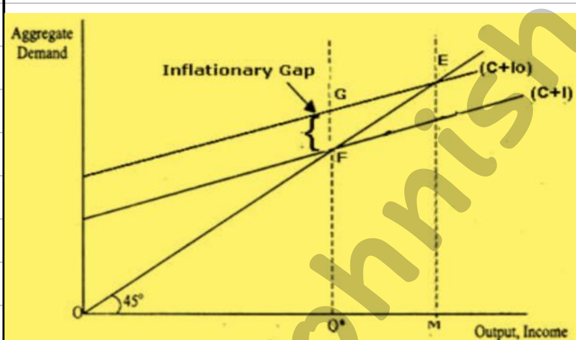


Deflationary Gap

If actual AD < **full employment level of output** → _____________ **demand**.

It leads to '____________________ **gap**' or '____________________ **gap**'. Occurs when economy is in contraction.

Firms will **experience unplanned** ________ **of inventories →** _____________ **in output & income** in future until _______**-employment equilibrium is reached at E**.



Inflationary Gap

If actual AD > **full employment level of output** → _____________ **demand**.

It leads to '**inflationary gap**',. Occurs during **expansion** & causes _______________**inflation**.

Real output will be constant, but rise in prices will cause **increase in nominal output** until **new equilibrium** is reached at **point E**.

INVESTMENT MULTIPLIER

Investment Multiplier (k) → how many times ___________________________ **increases** as result of **increase in autonomous** _____________

More the leakages → ___________ **the multiplier**

$$K = \frac{\Delta Y}{\Delta I} \text{ or } \frac{1}{1 - MPC} \text{ or } \frac{1}{MPS}$$

IMPORT

Import function is: **M =**

Marginal propensity to import -> **m =**

is assumed to be constant.

Summary of Multiplier

How to solve Numerical MCQs of National Income?

Connect with MVSIR

Telegram

@camvsir

Instagram

@ca_mohnishvora

YouTube

@ca_mohnishvora

Website

mvsir.in

Scan the above QR codes

Clear CA Foundation & then study Paper 6 – FM & SM of CA Inter on online mode (live/recorded) from MVSIR on "Ultimate CA" platform.

CA Foundation
(New Syllabus)

Business Economics Revision Notes

Chapter 7
Public Finance

By CA Mohnish Vora (MVSIR)

These notes are in "FILL IN THE BLANKS" format
Complete these notes by watching REVISION CLASSES of MVSIR

Chapter 7 – Public Finance
Unit 1 – Fiscal Functions: An Overview, Centre And State Finance

INTRODUCTION

- **Macroeconomics → study of economy as a ___________**

- **3 main macroeconomic goals for any nation.**

1) **Economic _______** → Growth of Real GDP > population → leads to higher standard of living.
2) **High levels of ___________________.**
3) **_____________ price levels**

✓ **Inflation** ____________ real incomes and purchasing power

✓ **Deflation** signals a ________________→ which cause recession & unemployment.

- The objective of economic system & role of govt → **improve __________________ of people.**

- **Adam Smith** was a **bold advocate of _______markets** & **____________ governmental activity.**

As per Smith, important resource allocation roles of govt.-

a) **national defense**,
b) **establishing a system of justice** to provide internal law & order
c) **establishment & maintenance of public institutions** & public works - roads, bridges, etc

RICHARD MUSGRAVE – 3 Roles of Government

- **Richard Musgrave**, in his book '**The Theory of Public Finance**' (1959), introduced **3 roles of government** in a market economy

- **_________________ functions**
  - **Allocation function** – aims to correct the sources of _______________ in the economy
  - **Re-distribution function** – ensures that the distribution of wealth and income is _________
- **_________________ functions**
  - **_____________ Function** – Monetary & fiscal policies, macro-economic stability problems

ALLOCATION FUNCTION

- **Resource allocation** → way in which **available resources** are **allocated** among various uses.

It determines _________________ of G/S will actually be produced in an economy.

- **Economic efficiency** → resources allocated in best way→ ___________waste & inefficiency.
- **Resource allocation** aims to **correct sources of inefficiency** in the economic system.

- If a **market** is **left to itself** → leads to **_______________ & __________________ of scarce resources**. Thus, market failures provide rationale for government's allocative function
- **Absence** of **govt. intervention** lead to- **Under-Production** or **Over–Production** of goods

- **Allocation instruments which govt. can use to influence resource allocation**

1) Government may ____________ **produce** an economic good
2) Government may ___________ **private allocation** through-

✓ Incentives :
✓ Disincentives :

3) Government may influence allocation through its _______________ **policies.** Eg- Competition Act 2002
4) Governments' _______________ **activities** such as licensing, minimum wages etc.
5) Government sets **legal and administrative frameworks**
6) any **mixture** of above methods

REDISTRIBUTION FUNCTION

➢ If **left to market**, **distribution of income** is likely to be ______________ & thus govt. has to **intervene** to **ensure more socially ___________ & ______________ distribution.**

➢ It is related to question → _________________**should an economy produce G/S**.

- **Redistributive Function in Govt Budgeting**

➢ **Expenditure side of budget-** Govt. may provide ___________________________ **education, healthcare**, housing, food etc to deserving people

➢ **Revenue side of budget-** Redistribution is done through ________________ **taxation**

➢ An **optimal budgetary policy** towards any distributional change should **reconcile** the **conflicting goals** of **efficiency & equity** by exercising an **appropriate trade-off (balance)**

- **Aim of Redistribution Function**

1) Achieve **equitable distribution of societal** ______________ among households
2) **Advancing** ______________ of those members of society who suffer from **deprivations**
3) Providing ____________ in income, wealth & opportunities
4) Providing ______________(fulfilment of basic needs) for people who have hardships
5) Ensuring everyone enjoys a ____________ **standard of living**

- **Examples of Redistribution function** OR **Market intervention for socio-economic reasons**

1) ________________ **taxation** of rich & **subsidy to poor**
2) **Proceeds from progressive taxes** used for **financing** __________________________
3) **Employment** _________________ to protect certain segments
4) **Unemployment benefits** & **transfer payments** to deprived sector
5) Families **below poverty line →** _______________ **aid** & **aid in** __________
6) **Regulation** of **mfg. & sale** of certain products to ensure well-being
7) ____________________________ for **backward regions** & for vulnerable sections

STABILISATION FUNCTION

- **Macroeconomic stability is said to exist when:**

1) economy's output = production capacity,
2) economy's total spending = total output
3) economy's labour resources are fully employed, and
4) Inflation is low and stable.

Stabilisation function ensures achievement of-
- **M__croeconomic ____________,**
- maintenance of ________ **levels of employment** &
- ____________ **stability**.

- **Rationale of Stabilisation Function**

- In absence of govt intervention, the **instabilities** in form of **recessions**, **inflation** etc. may be ________________ **for longer periods** causing enormous **hardships** to **poor people**.
- Also situation of ____________ (inflation + unemployment) is possible.
- Stabilization issue becomes more complex due to '**contagion effect**'.

Stabilization function is concerned with performance of aggregate economy in terms of:
1) Labour employment and capital utilisation
2) Overall output and income
3) General price levels
4) Balance of international payments
5) Rate of economic growth

Govt's stabilization intervention may be through

Monetary policy - **Controlling size of ________ ________** and ____________________, which would affect consumption, invt. & prices.

Fiscal policy – It relates to
- ____________ decisions &
- __________________ decisions of govt

Which can stimulate economic activities

Expansionary fiscal policy is adopted to alleviate recession
During **recession**, government-
- ___________ **its expenditure** or ______________ **taxes**

Contractionary fiscal policy is resorted to for controlling high inflation
During high inflation, government-
- ____________ **its expenditure** or ____________ **taxes**

Deficit budgets (Exp > Rev) are expected to ____________ economic activity

Surplus budgets (Rev > Exp) tend to ________________ economic activity.

- **Notes:**

CENTRE AND STATE FINANCE

- ______________________________ (term by **Richard Musgrave**)→ division of **govt. functions & financial relations** among different levels of govt.

- As per Musgrave, responsibility of-
  - ✓ central (union/federal) govt → **economic ______________ & income ________________**, &
  - ✓ state govt →

- India → ___ **states** & __ **union territories**.

- **Federalism** is an institutional arrangement to accommodate **two sets of government-**
  - ✓ one at **national level** and
  - ✓ other at **regional level**.

- An **independent __________** → **resolve disputes** between CG & SG on **division of power**.

- **Article ________** of Constitution of India → powers of union & states-

1) **Union list- union parliament**
2) **State list- state legislative assemblies**
3) **Concurrent list-** ____________ union & state can legislate.
   In event of **conflicting legislation** in concurrent→ law passed by ____________ prevails.

- **Union (Central) govt. can levy taxes** like- __________**tax** (on __________________ agricultural income), **customs duties**, excise duties, **corporation tax**, tax on capital value of assets, security transaction tax, central GST, taxes other than stamp duties etc

- **State governments can levy taxes** on __________________ **income**, lands & buildings, mineral rights, **electricity**, **vehicles**, tolls, professions, land revenue and impose excise duties on certain items.

- The **property of the union** is ________________ from ________________ **taxation**.
- Similarly, the **property and income of the states** are _____ **liable** to be taxed by the **centre**.

- **Articles ___ to ___** of constitution → distribution of finances among states by central gov

FINANCE COMMISSION

- **Article ______** → "**Finance Commission**". It is responsible for-
  1) evaluating the _________________________________ of union & state govt,
  2) **recommending the ____________ of taxes** between them and
  3) **laying down ____________ determining ______________**of these taxes among states.

- While recommending transfers, the Finance Commission considers issues-
  - ✓ __________equity (deciding about the share of ___ states in revenue collected by centre) &
  - ✓ _________________ equity (allocation _____________ states their share of central revenue).

- The **15th Finance Commission was constituted on 27, Nov 2017**
  - Share of states in central taxes (vertical equity) for 2021-26 to be ______
  - This was **less than 42% share recommended by 14th Finance Commission** 2015-20.
  - The **adjustment of 1% →** _____________________________ **and** __________________

GOODS & SERVICE TAX (GST)

- GST rolled out on ______________→ made India's indirect tax regime **unitary** in nature.

- For any particular goods & service, SGST & CGST rates are _____________.

- ____________**GST (IGST)** is applied on ________**-state movement** of G/S & on **imports/exports**.
  - ✓ IGST is simply a ___________________ **of SGST & CGST**
  - ✓ administered & collected by ___________ **government**,
  - ✓ kept in a ________________ **account**,
  - ✓ & **distributed** between the __________ & __________

- GST → ______ of gross tax revenue of **union** & ______ of own tax revenue of **states**.

- As per **supreme court verdict in** ______________, Union & state legislatures have "__________, **simultaneous and unique powers**" to ___________________ **on GST** & the **recommendations of GST Council are not binding** on them.

- GST system **replaced old production-based** taxation system with a ____________ **based** one. **Manufacturing states** → provided _______________ by levying a **cess on** ____________ **goods** & _____________ **goods** → proceeds are **credited to the** _________________________________.

- **Top five GST compensation** receiving states were __aharashtra, __arnataka, __ujarat, __unjab & __amil Nadu.

EXPENDITURE DECENTRALIZATION

- **Central govt** → **nationally important areas** like __________, **foreign affairs**, foreign trade, money & banking, etc
- **State govts** → **agriculture** & **industry**, ___________________ **services** like health & education, **police protection**, **state infra**.
- **Local self governments - municipalities** & **panchayats** → ______ ______ **services** such as **water supply** & **sanitation**, **local roads**, **electricity**.

BORROWING BY GOVERNMENT

Borrowing by Govt of India & borrowing by states → **Article** ______ **&** ______.

- The **centre** may **borrow** within limits fixed by **parliament** upon **security of Consolidated Fund of India**.
- The **state** governments may **borrow within territory of India** upon **security of Consolidated Fund of State**
- The **centre** may **give loans to the states** within limits fixed under article __________
- **States need to obtain centre's** ____________ in order to **borrow** in case **state is indebted** to centre.

Chapter 7 - Public Finance
Unit 2 – Market Failure / Government Intervention To Correct Market Failure

MARKET FAILURE

It is a situation in which the **free market** leads to ____________________ of **society's scarce resources** in the sense that there is either-

- ______________________ or
- ______________________

of particular G/S leading to a __________________ **optimal outcome**.

If in all markets perfect competition exist, it leads to market efficiently, most often the **prerequisites of competition** are **unlikely to be present** in an economy

TWO TYPES OF MARKET FAILURE

1) ________________ **market failure**. This is a case of "**missing markets**" and occurs when the market **does** _________ **supply products at all** despite the fact that such products and services are wanted by people. E.g. Pure public goods.

2) ________________ **market failure** occurs when the **market does actually function**, but it **produces** either-

- **wrong** ____________ of product or
- at the **wrong** ____________.

This results in **loss of** _______________________________.

WHY DO MARKETS FAIL ? OR REASONS FOR MARKET FAILURE

I) MARKET POWER

Market power or monopoly power is **ability of a firm** to **profitably** ______________________ of a G/S **over its** _______________________, thereby earning ____________ economic profits.

Market power→ cause markets to be **inefficient** because-

- producers ______________ **output,** &
- keep **price** _____________ **than Perfect Comp**

Thus, market fails to produce right quantity of G/S at the right price. Leading to __________**-production** and thus **market failure.**

II) EXTERNALITIES

Sometimes, the actions of either consumers or producers result in **costs or benefits** that **do __________ reflect as part of the market price**.

Such costs or benefits which are **not accounted for by ________________** are called **externalities** because they are "______________" to the market.

Externalities are also referred to as

'____________________ **effects**', OR '_____________________ **effects**'

'_____________________ **effects**' OR '_____________________',

as the ________________ of the externality **imposes costs or benefits on others** who are _____ **responsible for initiating** the effect.

- Since it occurs outside price mechanism, it has not been compensated for, or it is ______________________ or cost (benefit) of it is not borne (paid) by the parties.
- **Externalities can be-**
- **Negative externalities** → action of one party **imposes** _________ on another party.
- **Positive externalities** → action of one party **confers** _________ on another party.

NEGATIVE PRODUCTION EXTERNALITY

- A negative externality
  - ✓ **initiated in** ________________
  - ✓ which **imposes an** ______________________ on others
  - ✓ may be **received** by another in _____________ or _____________

- **NPE received in ____________________**

  Eg-

- **NPE received in ____________________**

  Eg-

NEGATIVE CONSUMPTION EXTERNALITY

- A Negative Externality
  - ✓ **initiated in** ________________
  - ✓ which **imposes an** ______________________ on others
  - ✓ may be **received** by another in _____________ or _____________

- **NCE Received In ____________________**

  Eg-

- **NCE Received In ____________________**

  Eg-

❑ **POSITIVE PRODUCTION EXTERNALITY**

➢ A positive externality

✓ **initiated in** ____________________

✓ that confers ____________________ on others

✓ may be **received** in ________________ or in ________________.

➢ Compared to NPE, **PPE** are ______________.

➢ **PPE received in** ________________

✓ Eg- **Firm offers training** to employees → **positive benefits for other firms** when they hire such workers as they change their jobs.

➢ **PPE received in** ________________

✓ Eg- An **individual raises an attractive garden** → **persons walking by enjoy** the garden

❑ **POSITIVE CONSUMPTION EXTERNALITY**

➢ A positive externality

✓ **initiated in** ____________________

✓ that confers ____________________ on others

✓ may be **received** in ________________ or in ________________.

➢ **PCE received in** _____________

✓ Eg-

➢ **PCE received in** _____________

✓ Eg-

How Externalities Cause Inefficiency And Market Failure ?

➢ **Private cost** is money cost of production incurred by __________ i.e. wages, raw materials, etc, which ____________ **for production**, & would ________ **in firm's accounts**.

➢ **Supply curve** here corresponds to only ________________________________.

➢ **Social costs** → **total costs to** _________ on account of **production or consumption** activity.

➢ **Social Cost =**

➢ External costs are _______ included in firms' costs or consumers' decisions.

➢ Firms do not have to pay for damage from pollution which they generate. As a result, each **firm's cost**, considers **only** _________ **cost** & would **not incorporate** _____________

- ➢ Such prices send ________________ signals to producers & consumers → cause either over-production or under-production.
- ➢ Thus, here a **competitive market will produce a level of output** which is **not socially optimal**, leading to **market failure**.

III) PUBLIC GOODS

- ➢ __________________________ gave the concept of '**collective consumption good**' in his paper '**The Pure Theory of Public Expenditure**'

- ➢ **A public good** (aka. collective consumption good or social good) is defined as one which-
  - ✓ _____ **enjoy in** ______________
  - ✓ **each individual's consumption** of such a good leads to ____________________ from any **other individuals' consumption of that good**.

❑ CHARACTERISTICS OF PUBLIC GOODS

1) Consumption is ___________ in nature.
2) ______________________ : It means that **consumption** of a public good **by one** individual **does** ______ **reduce** the **quality or quantity available for all other.**
3) ______________________: If the good is provided, one individual __________ **deny other individuals**' consumption, **even if** they have ___________ for it.
4) ______________________: Each individual may **consume all** of good i.e. **total amount consumed is same for each** individual.
5) Once provided, **additional resource cost of another person** consuming it is '_________'
6) _______ **direct payment** by the consumer is involved
7) ______ **vulnerable** to issues → **externalities**, **inadequate property rights**, & **free rider** problem. No incentive for people to pay for it, as they can consume it without paying.

- ➢ If **left to the market**, public goods will **not be produced** at all or will be **grossly __________-produced**. Thus, leading to **market failure**

❑ **Private goods** are _________ & anyone who wants it, must ___________ them at a _______.

- ➢ They do _______ face **free-rider problem**.
- ➢ They are '________________' i.e. it is **possible** to **exclude** consumers who have **not paid.**
- ➢ Consumption is '____________' that is consumption by one, prevents another individual from consuming it.

- ➢ Normally, markets ______________ **allocate resources** for the production of private goods.
- ➢ Eg- food items, clothing, movie ticket, television, cars, etc

IV) INCOMPLETE INFORMATION

- **Perfect information** → both **buyers & sellers have complete information** about anything that may influence their decision making.

However, above **assumption is not fully satisfied in real markets** because of

- _______________ **of G/S** (e.g. cardiac surgery, mutual funds etc.),
- **difficulty of getting ________________ information**, and
- **deliberate ___________________ by interested parties** (e.g. persuasive advertisements).

- Information failure leads to –
  - **A. asymmetric information,**
  - **B. adverse selection** and
  - **C. moral hazard**

Which **affects ability of markets to efficiently allocate resources** and therefore lead to **market failure** because **party with better information** has a **competitive advantage**.

A) Asymmetric Information

- Asymmetric Information which means **imbalance in information**, i.e when ________ **knows more than ________ or** _______________. This can **distort choices** and lead to market failure.
- For eg,
  - ✓ the **landlords** know more about their **properties** than the tenants,
  - ✓ a **borrower knows more about their ability** to repay a loan than the lender etc.

B) Adverse Selection

- Asymmetric information **generates adverse selection**.
- When **one party** to a contract, say X, **possesses information** relevant to the contract that **other party Y does _____ have** → **expected value** of **transaction** is **known more accurately to** ___ due to asymmetry of information. Then, X (having more information) may ________ ___________________ Y's ignorance & this could **put the ignorant party _____ at a ______**

- Thus, asymmetric information leads **party __________ relevant knowledge** to **make _____- ______________ decisions** and suffer **adverse effects**.

- For eg, **insurers** know less about health conditions of buyers → thus **unable to differentiate** between **high-risk** & **low-risk** persons. This **forces the price of insurance to _______**, so that **more healthy people**, aware of their low risks, **choose _____ to be insured**. It also further **increases proportion of __________________ people** among insured, thus **raising price up more**.

❑ **Lemons Problem (given by ____________________)**

- **Sellers know ________ about car quality** than buyers, often __________ **defects**.
- **Buyers offer __________ prices** to offset the risk of getting a 'lemon'.
- ________ **car owners** then _________ **selling**, leaving mostly __________ in the market.
- The result is **market distortion** with lower prices and lower average quality of cars.
- Thus, asymmetric information leads to _____________ **of high-quality goods from market.**
- Economic agents end up either-
  - ✓ **selecting a** ______________ product (lemon), or
  - ✓ ______________ the market altogether.

C) Moral Hazards

- It is about **informed person's taking advantage** of a ______________________ **person** through an __________________________________.
- It occurs when **one party** to an agreement **knows that he need** ______ **bear the consequences of his** ________________ & that consequence, if any, would be borne by the _______ party. Therefore, he **engages in** _______ **behaviour** or **fails to act in** ____________
- For eg,

GOVERNMENT INTERVENTION TO CORRECT MARKET FAILURE

I) Minimize Market Power

- Market power leads to ____________ → as it ____________ **output** which results in ______________ **prices** thus leading to _____________________________.

- **Governments intervene by establishing rules** & regulations designed to ____________ **competition** & ____________ actions that may restrain competition.
- These **legislations differ from country to country**.
- India- **Competition Act, 2002** ;
- USA- Antitrust Laws

- **Other measures include:**

1) **Market** __________________ → introducing competition in previously monopolistic sectors
2) **Controls on** ____________________________________ → if possible market domination.
3) ________________ to consumer associations
4) Tough **investigations into** _____________ & unfair practices → collusion & predatory pricing
5) **Reduction in** ______________________________
6) __________________________
7) **Price** ____________________ and **price** ____________________
8) **Restrictions on monopsony power** of firms
9) **Profit or rate of return regulation** - Govt's regulatory agency determines an _____________ price→ to ensure a ______ rate of return → called rate-of return regulation.

II) a) Government intervention to correct Negative Externalities

- **Direct Controls**

- Direct controls, (aka ____________________________), ______________ **activities that create negative externalities** or require that negative externality be ___________ to a certain level.

- For example,

- _________ **amt of pollutants released** or make it mandatory to **use pollution control devices**.
- **Licensing, production quotas** & **mandates** regarding acceptable production processes.
- Production, use & sale of some commodities can be _______. Eg- Smoking at public places
- _________ to alleviate effects of neg. externalities. Eg- Environment (Protection) Act, 1986
- **Fix** _________________________________ → legal limit on how much pollutant a firm can emit. If firm exceeds limit→ _________________________________.
- The firms have to **install pollution-abatement mechanisms** → **rise in firm's** _______________.
- **Charge an** _____________________ which is levied on each unit of a firm's emissions.
- **Form** ______________/ **boards**→ **Ministry of Environ. & Forest**, **Pollution Control Board of India**

❑ **Market Based Policies**

➢ Market-based policies **provide economic ________________** so that ____________________ of market participants would **achieve the socially optimal solution**.

➢ It focus on generation of a market price for pollution, achieved by-

✓ **Setting price directly**- by ______________________________

- The key to ________________ **an externality** (both external costs and benefits) is to ensure that **those who** the externalities ____________ **them while making decisions**.

✓ **Setting price indirectly**- by ______________________________

- Second approach to **establishing prices indirectly** is '____________________________' (carbon credits)

❑ **POLLUTION TAX**

➢ The size of pollution tax **depends on the** _______________________________ a firm produces.

➢ Aka. ____________________ **taxes** after A.C. Pigou

➢ These taxes, by '**making the polluter pay**', seek to _________________ the external costs **into the price** of a product or activity.

➢ Tax **increases** ___________ & ____________ **output** of good which creates –ve externality.

➢ **Proceeds from tax**→ used for **projects** that _______________________________ **environment**.

❑ **Problems in administering an efficient pollution tax**

1) Difficult to _____________ & ______________ → **complex & costly administrative procedures**

2) If **demand for good** is _______, such tax will an ______________ **effect in reducing demand**. In such case, producers will easily ________________________ in form of higher prices.

3) **Negative consequences** on **employment** & **investments** → high pollution taxes may encourage producers to ________ their factories to those countries with _________ taxes.

❑ **TRADABLE EMISSION PERMITS**

➢ The use of **tradable permits to limit emissions** is often called '__________________________'

➢ Tradable permit → license that allows a company to release a unit of pollution over some time. **By issuing a** ___________ **number of permits,** the **government determines total level of pollution** that can be _____________ **emitted** during each period (the 'cap').

➢ A firm that generates emissions above allowed limit is ___________ with substantial fines.

➢ Firms can also _____ their permits to other firms → permits are ___________ (the firm can sell for a price), a polluting firm faces an opportunity cost → for each unit of pollution → it must either _________________, or _________________ it could earn by selling permit

➢ Firm producing **less pollution →** ______ **permits &** ______ **money.**

➢ **High polluters** have to _______________ **permits**→ increasing their costs, and makes them less competitive and less profitable. Thus, firms will have incentive not to pollute.

- **In 1994, USA** began a **cap & trade system** for ____________________ **emissions that cause acid rain** by issuing permits to power plants.
- In India, ________________________________ **(PAT) scheme**, carbon tax in the form of a cess on coal, lignite and peat,.
- **In __________ , coal cess was abolished and replaced by the GST compensation cess.**
- __________________________ (Amendment) Bill, 2022 empowers the central government to specify a **carbon credit trading scheme** and to **stipulate energy consumption** standards.

II) b) Government intervention to correct Positive Externalities

- Positive externality is **associated with external benefits** → still **market failure** as, left to market, there will be __________________ **optimal output**.
- Since they **promote welfare**, govt implement policies → ________ positive externalities.
- Govt may intervene to correct Positive Externalities by–
  - ✓ **corrective subsidies to __________** → for increasing supply. (Eg- **fertilizer subsidy**)
  - ✓ **corrective subsidies to __________** → increasing demand (Eg- Subsidy on education fee → consumption subsidy)
- A corrective _____________________________ **involves government paying part of cost to firms** to _____________ production of goods having positive externalities. This is in fact a _____________________ policy as **subsidies** to **producers would ________ cost of production**.
- In case of goods whose externalities are vastly positive, ____________ **enters market directly** as entrepreneur to **produce & provide** them. Eg- **Public education, health care etc**
- Governments also engage in direct production of ____________________________________. Eg- **afforestation**, **reforestation, protection of water bodies**, **treatment of sewage etc.**

III) a) Government intervention in case of merit goods

- **Merit goods**→ goods having **substantial positive externalities** & are **socially desirable**.
- They are **under-____________** & **under- ____________** through the market mechanism so that **social welfare will ________ be maximized**.
- **Eg**- education, health care, welfare services, waste management, public libraries, museum
- Govt responses→ regulation, subsidies, direct government provision & combination of govt provision & market provision.

1) **Regulation**→ how private activity may be conducted. Eg, way in which **education is imparted** is government regulated.
2) Govt can ____________ some type of activities, set standards and issue mandates. Eg, govt may make it **compulsory to avail insurance protection**, compulsory vaccination etc
3) Govt could also use **legislation to ___________________________________ of a good which generates positive externalities**. E.g. **use of ______________**, seat belts etc.

4) Govt can __________ **individuals** to consume good generating external benefit. The **Right of Children to Free & Compulsory Education Act, 2009** which mandates free & compulsory education for every child of the age of 6 to 14 years.

5) The **ultimate encouragement → make good completely ______**. Eg- **freely available hospital treatment** for various diseases.

III) b) Government intervention in case of demerit goods

- Demerit goods are **socially undesirable**. Eg- cigarettes, alcohol, intoxicating drugs etc. The **consumption** of which **imposes negative externalities.**
- **Production & consumption** of demerit goods→ ______________ **optimal** under free markets.
- _______ that consumers pay for cigarettes is market determined and **does _____ account for the social costs** that arise due to externalities.

- However, **all goods with negative externalities are ______ demerit goods**; e.g. Production of **steel** causes pollution, but steel is ______ a socially undesirable good.

How do governments correct market failure resulting from demerit goods ?

1) Enforce **complete ________** on a demerit good. e.g. Intoxicating drugs
2) Effect of total ban is _________ realized in form of ____________________of demerit good; conversely such goods are **secretly driven ____________** & traded in ____________ **market**
3) Imposing **unusually ________ taxes**

- But, **demand** for demerit goods is **highly ___________**, so any increase in price due to additional tax causes a less proportionate decrease in demand. Also, sellers can ________ **taxes to consumers by ____________________________** without losing customers.

4) Government can **fix a ______________ price ________ which the demerit good should not be exchanged**. (Price __________)
5) Through _____________ , achieved by _________ **advertising campaigns** which emphasize dangers with consumption of demerit goods Eg- Mukesh- iss shehar ko ye hua kya hai
6) Through **legislations** ____________________ of demerit goods Eg- Alcohol ads- music cds
7) Strict regulations- to ________________ to good→ by vulnerable groups – children.
8) ______ **restrictions** e.g. smoking in public places, sale of tobacco to be away from schools

IV) Government intervention in case of Public goods

- ________________________ of public good by government → overcome **free-rider problem**.
- Important public goods- Eg- **defence**, **establishment** & **maintenance of legal system**, **disease prevention** etc are provided by the government.
- _______________ **public goods** can be provided by govt & same can be **financed through** ____________.
- **Grant ____________ to private firms** to build a public good facility→ goods will be provided to public on paying entry fee. Govt ____________ **level of entry fee** & keeps **strict _________ on functioning of licensee** to guarantee equitable distribution of welfare.

- Some public goods are provided by ______________ **contributions** and private donations by corporate entities and NGOs.
- Certain goods are produced and **consumed as public goods** and services **despite the fact** that they **can be produced or consumed as** ____________ **goods**. As, left to the markets and profit motives, these may prove ____________ to society. Eg-
  1) scientific **approval of** ________,
  2) production of **strategic products** such as ________________________,
  3) provision of ___________________________________ etc

V) Price Intervention: Non-Market Pricing

- Price intervention → form of price controls which are _______________________ **on price.**
- Price controls may take the form of either-

❑ **Price Floor** (a _____________ price buyers are required to pay) or

✓ Eg- **Minimum Support Price (MSP),** to guarantee steady and assured incomes to farmers.

❑ **Price Ceiling** (a ______________ price sellers are allowed to charge)

✓ **Eg- Fixing of** ______________________ & ______________________

✓ When **prices of certain** __________________________________ **rise excessively**, government resort to **price ceilings** for making commodity available to all at reasonable prices. Eg- **maximum prices of food grains** and essential items are set by government during times of _____________

VI) Correcting Information Failure

1) Make it mandatory→ **accurate** ____________ & __________ **disclosures** by producers. Eg. Labelling on cigarette packets, _______________________________ in food packages.
2) **Mandatory** _______________ of information Eg: **SEBI** requires accurate information be provided to prospective buyers of new stocks. (prospectus)
3) **Public** ______________ **of information** to improve knowledge
4) **Regulation of** ____________ and setting of advertising _____________ to make advertising more responsible, informative and less persuasive.

VII) Equitable Distribution

Redistribute incomes so that there is **equity and fairness in the society.**

Some common policy interventions include

1) _____________ income tax,
2) _____________ **budgetary allocations**
3) ____________________ compensation
4) _________ **payments**, **subsidies**, social security schemes, job ____________, etc.

Government Failure

- When govt intervention in economy to correct market failure __________ inefficiency & leads to misallocation.
- Government failure occurs when:

1) **intervention is** _______________ causing wastage of resources expended for the intervention
2) **intervention produces** _______ **& more serious problems.**

Chapter 7 – Public Finance

Unit 3 - THE PROCESS OF BUDGET MAKING: SOURCES OF REVENUE, EXPENDITURE MANAGEMENT AND MANAGEMENT OF PUBLIC DEBT

I) Basics	II) The Process Of Budget Making	III) Sources Of Revenue	IV) Public Expenditure Management	V) Public Debt Management

I) Basics

- Budget is a powerful policy instrument → to regulate & restructure a country's priorities.

- The **need for budgeting** arises from the need to-
  - ✓ **efficiently ________________ limited resources** to ensure maximum social welfare.
  - ✓ to ensure ________________ **of income** and wealth.
  - ✓ reduce/**eliminate economic** ________________ & bring in ________________,
  - ✓ sustainable **increase in** ______________ and
  - ✓ **reduction in** ____

- In simple terms, a **budget**-
  - ✓ Is a statement showing '**where money** ______________' & '**where the money** ________'
  - ✓ Is a ____________ of **entire revenues & exp.** that govt expects to receive & plans to spend during following year.
  - ✓ contains **estimates** of govt's accounts for **next fiscal year** → ___________ **estimates**.
  - ✓ includes **projections** of economy & its **various sectors** → agri, industry, and services.
  - ✓ is the **most** ______________________ **report** of **government's finances**.

II) The Process Of Budget Making

- **Budgetary process** is means by which **executive & legislative branches** together **formulate** a coherent set of **taxing & spending proposals**.
- Finances of govt of India have traditionally been controlled by __________________________.
- The budget is **prepared by** _________________________ in consultation with _______________ & other relevant ministries.
- Budget must be **presented & approved by** _______ **houses** of parliament before beginning of the fiscal year (April 1 to March 31).
- The term 'budget' has ______ **been used** in the **Indian Constitution**, the **process of making it** is referred to as **budgeting**.
- **Article** _____ **of** the constitution → for every financial year '___________ shall cause to be **laid before** _____ **houses** of parliament a **statement** of _____________ **receipts & expenditure** of the government for that year, referred to as "_______________________________________".

- The **budgetary procedures** are –
  - i. **Preparation** of the budget
  - ii. **Presentation** & **enactment**
  - iii. Execution of the budget.

Budget process consists of two activities:

1. **Administrative process**→ **budget** along with accompanying documents are _______________
2. **Legislative process** wherein the budget is ________ **by the parliament** after discussions.

PROCESS OF BUDGET (SUMMARY)

Aug-Sep '25 — 1/4/26 — FY 26-27 — 31/3/27

Budget Prep start

National Institution for Transforming India

Budget is prepared by MoF in consultation with NITI Aayog

1) MoF → Budget ______ →

→ Budget
- Detailed instructions & formats for preparing estimates of exp ← Ministries, State, UTs, Autonomous Bodies

2) Pre-Budget consultations
- Union FM → State FM, Industry Associations, Representatives from various sectors, experts from NITI Aayog & economists etc.

3) Proposed Budget ______ is prepared

4) Union FM ——→ Minister } Budget ☐

5) ______ Ceremony → Marking & printing of budget documents.

- Budget Documents

a) (AFS) → Govt. Receipts & Expenditure ← Consolidated fund of India, Contingency fund of India, Public Account.

b)

c)

d) Statements mandated under FRBM Act.

i) Macro Economic ______ Statement

ii)

e) Other documents → Explanatory statements.

- Budget shows info of Rec. & Exp. of 2 years.

FY 2026-27 ka Budget hai
- Year Preceding CY → FY 2024-25
- Current Year → FY 2025-26
- Ensuing Year → FY 2026-27

FY 2026-27 ka Budget hai →
- Actual Receipts & Exp → Year Preceding the current F.Y.
- Budgeted Estimates → • Current FY • Ensuing FY
- Revised Estimates → • Current FY

FY 20 | FY 20 | FY 20

Year Preceding Current FY | Current FY | Ensuing FY

6) Budget speech → FM → Lok Sabha.

Part A

- Economic situation
- Estimates for Ensuing FY.
- of Govt.
- raised by Taxes & Borrowing.
- Proposed of Expenditure to diff. sectors [Appropriation Bill]
- schemes for Diff. sectors.

Part B

- of Govt on various developmental measures
- Direction of policies
- proposals & variations in current taxation system [Finance Bill]

Budget Present hone ke baad
↓
7) Budget is discussed in 2 stages in Lok Sabha

a) Discussion → b)

[DG]
of ministries / departments

Budget Circular } Ministries share their estimated exp of ensuing FY as per format in circular.

Ministry of Education } Estimate → ₹10,000 cr
Budget → ₹6,000 cr
Mei allocation

Demand for Grant } Request ₹4,000 cr. } Voting in ___ Sabha.

On the ___ day of days alloted for voting on DG } ___ will put ___ outstanding DGs to voting

___ } Bringing debate on financial proposals to an ___ within specified time.

After Lok Sabha
↓
Now budget is laid in ___ Sabha

___ voting on Demand for Grants → only General Discussion

8) After general discussion & Voting on DG, now Govt. introduces -

→ Bill → Give authority to Govt. → ________ from Consolidated fund of India

After Appr. Bill is passed

→ Bill is taken up for consideration → Motion for leave to introduce FB ________ be opposed.

→ Parliament has to pass F.B. within ___ days

9) After Finance Bill Passed by Lok Sabha sent to Rajya Sabha → Has to return it with ___ days with/without recommendations

Recommendations of RS

________ accepted or rejected by LS.

Lastly, FB will be sent to ____________

After assent, FB → Finance Act.

10) from FY ____________,
Date of presentation of Budget ____________

11) Earlier Railway Budget was presented seperately by Mininster of Railways.
But
from FY ____________,
Railway Budget is merged with General Budget

Central Government

Revenue Receipts
- **Tax Revenue**: Corp Tax, Income Tax, GST, Custom Duty etc.
  - Cn Net Tax Revenue = Total Tax Recd by Cn (-) SG Share (-) NCCD
- **Non-Tax Revenue**: Interest Recd, Dividend Recd, Surplus from RBI etc.

Revenue Expenditure
- Eg - Interest on Loan, Grant to SG, Salary, Rent, Electricity etc.

Capital Receipts
- **in Liabilities** → **Debt Capital Receipt**: Market Loans, Treasury Bills, Security against small savings, external debt, State Provident Fund
- **in Assets** → **Non-Debt Capital Receipt**: Recovery of Loans & Adv., Dis-investment, Sale of Govt. Assets.

Repayment of Debt Capital Receipts is Capital Expenditure

Capital Expenditure
- **of Assets**
  - Physical Assets: CG acquired Land, M/C, Bld. etc
  - Financial Assets: Invt in Shares, Cn giving loan & adv.
- **in Liabilities**
  - Repayment of Loans & Adv. (Principal Amt)
  - Payment of PF etc.

III) Sources of Revenue

- The **Department of** ______________ of Ministry of Finance **controls the revenue matters** relating to **direct & indirect union taxes** through two statutory boards, namely,
  1. ____ (CBDT)
  2. ____ (CBIC).
- It is also entrusted with **administration** & **enforcement** of **regulatory measures** of all taxes.
- Levy & collection of **direct taxes**→ looked after by ___________, whereas
- Levy & collection of **GST, Customs & central excise duties & other IDTs**→ looked by __________
- Centre's **net tax revenue** = **Total tax revenue (-) States' share (-) National Calamity Contingent duty (NCCD)**
- Various ______________ **services** provided by govt. also yield revenue for govt., like-
  - ✓ medical services, public health, broadcasting, education, sports, housing and economic services such as communication, energy, transport, railways etc.

IV) Public Expenditure Management

- In view of ______________ **resources**→ govt to ensure that **level of public expenditure** is **consistent** with a **sustainable** ____.
- **Developing economies** require ______________ amount of public spending to accelerate **economic** _____________ & **promote** __________________ **opportunities**.
- ____________ **in fiscal deficit** requires **mix** of **revenue and expenditure policies**.
- Government expenditure **affects allocation of resources** → care should be taken to **channelize resources to** _______________________________________ **areas**.

- <u>**Public expenditure management**</u>→ process to make governments **fiscally** _________________.

- **Economic costs** of **unproductive public expenditures** can be **extensive** & may lead to:
  - ✓ ____________ deficits
  - ✓ higher levels of ____________,
  - ✓ ____________ economic growth,
  - ✓ ____________ resources available for use elsewhere, and
  - ✓ greater ___________ burden in the future.

- ❑ The **<u>Department of</u>** __________________ of Ministry of Finance → nodal department for **overseeing** the **public financial management system** of government.

It is responsible for-

- **implementation** of **recommendations of Finance Commission** & **Central Pay Commission**,
- ________________________ of **audit comments**/observations, and
- ___________________ of central government **accounts**.
- **assisting central ministries**/departments in-
  - ✓ _____________ **costs** & **prices** of public services,
  - ✓ **reviewing systems** & **procedures** to optimize outputs & outcomes of public exp.

- The **requirements of funds** for all types of expenditure & **receipts** of departments are **discussed** during the **pre-budget meetings** chaired by _________________ **(Expenditure)**.

- **Expenditure estimates** are **provisionally finalized** & **communicated** to ministries/departments after the approval of Finance Minister.

- One of the **explanatory documents** of the budget document is the '______________________' (earlier known as expenditure budget)→ consists **data of all ministries**/departments to outline a **profile** of the **general** _________________________________ of government of India.

- It gives an __________________ of various types of expenditure and certain other items across demands.

- In Expenditure budget, **Central govt expenditure** is classified into **six broad categories**:

A. Centre's Expenditure:

- ✓ ______________________________ **Expenditure** of Centre;
- ✓ ______________________________ **schemes**, and
- ✓ **Other** central expenditures including those on CPSEs and Autonomous Bodies

B. Centrally Sponsored Schemes and other Transfers:

- ✓ ______________________________ **schemes**
- ✓ ______________________________ **transfers,** &
- ✓ **Other** transfers to states

IV) Public Debt Management

- In developing economies, **government** is generally the _______________ **borrower**.
- Government debt from **internal** & **external** sources contracted in the ___________________ ______________________________ is defined as ________________.
- **Public debt** – means **debt incurred by government** in **mobilizing** ______________ of people in the form of **loans**, which are to be **repaid at a future date** with **interest**.
- Public debt is _______ **a one-time exercise** of borrowing and repaying.
- **Debt** _____________ is a _____________ **exercise** as a portion of debt falls due each month, government does not cut expenditure or raise taxes → rather, it _______________ **debt**, i.e. it **sells** _____ **bonds** and uses the proceeds to **pay off holders of maturity bonds**.
- Productive use of public debt → contributes to economic **growth** & **welfare**.

- **Sustainability of sovereign debt** is an **indicator** of **overall** ______________________________
- Debt sustainability is a **function** of-
  - ________ **of debt,** &
  - govt's ______________________________ the outstanding debt.

- **Public debt management** refers to task of determining-
  - ✓ the **size** and **composition** of debt,
  - ✓ **interest rates**,
  - ✓ the **maturity pattern**,
  - ✓ **redemption of debt** etc.

- The **overall objective** of central govt's **debt management policy** is to-
  - ✓ meet central govt's ____________ **needs** at **lowest possible costs** &
  - ✓ to **keep total debt within** ____________________________________
  - ✓ It also aims at **supporting development** of _________________________________

- **Debt management strategy** is based on **three broad pillars** namely,

  1)

  2)

  3)

IV) Public Debt Management

Institutions responsible for public debt management are	
Domestic marketable debt i.e., dated securities, treasury bills and cash management bills.	
External Debt ✓ ________________ loans- (loan from one country/govt) ✓ ________________ loans (_______ part of external debt)– loans from from multilateral agencies (International Bank for Reconstruction and Development, Asian Development Bank, etc.)	
Other liabilities such as small savings, deposits, reserve funds etc.	

- _________ acts as **debt manager** for **marketable internal debt**.
- _____________________ are issued to meet **short-term** cash req. of govt.
- ___________________ are issued to mobilise **longer term** resources to finance fiscal deficit.
- There is ____ sovereign borrowing from **international capital markets**.
- **Risk of external debt** is _______________ **in value of** ____________ **currency** compared to currency of external loans leading to ______________ in government's debt servicing cost.

❑ From ________ onwards, RBI also provides **short-term** credit **up to** _______ **months** to **state governments** banking with it in the form of ______________________________________**(WMA)** to bridge temporary mismatches in cash flows.

Fiscal Responsibility and Budget Management (FRBM)

- It was passed in _________ to provide a legislative framework for ____________________________ & thereby debt of central government to a sustainable level.
- The **objectives** of the act are:

1) _______________________________________ in fiscal management,
2) long run _______________________________________,
3) better __________________ between **fiscal** and **monetary** policy, and
4) ___________________ **in fiscal operation** of the government.

- ____ **(PDMC)** was created in 2016 under the Department of Economic Affairs.
- ____ **Strategy** or MTDS 2021-24 is a framework to determine appropriate **composition of debt portfolio**.

- As part of continuing efforts to increase retail participation in G-sec, '____________________' facility was announced on February 5, 2021:
  - ✓ for improving **ease of __________ by retail investors** through **online access** to primary & secondary government securities market
  - ✓ to provide the facility to __________ **their government securities** __________ ('Retail Direct') with the Reserve Bank.

Budget concepts

Type of budgets

- **Balanced budget**
  - Revenue = Expenditure
- **Unbalanced budget**
  - **Surplus budget**
    - Revenue > Expenditure
  - **Deficit budget**
    - Revenue < Expenditure
      - A deficit budget __________ liability of government or ______________ its reserves.
      - In modern economies, _____ of countries follow deficit budgeting

Budgeted Deficit

Total Expenditure (-) Total Receipts

It shows-
- ✓ **shortfall** of govt's ________ **receipts** ________ over expenditure.
- ✓ govt **revenue is insufficient** to meet **exp.** in connection with ________ ________ of govt,
- ✓ govt is ________ **resources** from ________ **sectors** to **finance its current exp**

Revenue Deficit

Revenue Expenditure (-) Revenue Receipts

- It is presented as a ________________
- It is to be **financed by** ________________.
- It shows ________ ________ **requirements** of govt from **all sources**
- In case **revenue deficit occupies a** __________ **share** of fiscal deficit, it is an indication that a **large part of borrowing** is used for ________ **purposes** rather than for investment.

Fiscal Deficit

Total Expenditure (-) Total Receipts **(excl. borrowings)**

Primary Deficit

Fiscal deficit (–) Net Interest liabilities

- ✓ **Fiscal deficit** → borrowing requirement ______________ of interest payment,
- ✓ **Primary deficit**→ borrowing requirement ______________ of interest payment.
- Primary deficit → how much of govt's borrowings is used for **meeting expenses** ______________ **payments**.
- The **goal** of measuring primary deficit is to **focus on present fiscal imbalances**.

Topic	Meaning
Outcome budget	➢ They establishes a **direct link** between **budgetary** _______________ **of schemes** & its **annual** _____________________ measured by **output** & **outcome indicators**. ➢ It is a ____________________ on what various ministries & departments have done with outlays in previous annual budget. ➢ It measures the ____________________________ of all government programs and **whether** the **money has been spent for the** _______ it was sanctioned including the outcome of the fund _____________.
Guillotine	➢ Parliament has **very** ____________ **time** for **examining the expenditure demands** of all the ministries. ➢ Once **prescribed period** for discussion on demands for grants is **over**, the _________ **of Lok Sabha** puts ____ **outstanding demands** for grants, whether discussed or not, to **vote** of house. ➢ This process is known as '**Guillotine**'.
Cut Motions	➢ **Motions for** _____________ to various demands for grants are made in form of cut motions seeking to ___________ **the sums** sought by govt. on grounds of- ✓ _______________ or ✓ ________________ **of opinion** on matters of policy or ✓ just **in order to** ________________________.
Public Account	➢ Under provisions of **Article** _________ of the Constitution of India, public account is used in relation to all the **fund flows where government is acting as a** ______________. ➢ Eg- ____________________ & ____________________. ➢ This money **does** _____ **belong to govt** but is to be **returned to depositors**. ➢ Expenditure from this fund **need** ______ **be approved by the parliament**.
Consolidated Fund of India	➢ All ______________ received, ____________ raised and **all** ________ **received** by government in repayment of loans are **credited** to the Consolidated Fund of India and **all** _______________ of the government are **incurred from this fund**. ➢ Money can be spent through this fund **only if appropriated by the** ________________________. ➢ The consolidated Fund has further been divided into '____________' & '_________________' divisions.
Contingency Fund of India	➢ A fund (Rs 30,000 cr.) placed at the **disposal of the** ___________ to enable him/her to make advances to the executive/Government to meet _____________________ **expense**. ➢ It **does** ________ **require prior legislative approval**, unlike with the Consolidated Fund. ➢ For meeting such exigencies, advances are made to the executive from the contingency fund which is **subsequently reported to the Parliament** for ___________________ **from the Consolidated Fund of India**.

Chapter 7 - Public Finance
Unit 4 - FISCAL POLICY

I) Basics | II) Types of fiscal policy | III) Instruments of Fiscal Policy | IV) Fiscal policy for long-run economic growth | V) Fiscal policy for reduction in inequalities of income and wealth | VI) Limitations of fiscal policy

I) Basics

- Fiscal policy involves use of government
  - ✓ ________________, ________________ & ________________

  to influence both-
  - ✓ **pattern of** ______________________________ and
  - ✓ level of growth of ____________________ , __________________ **& employment**

Objectives

- The most common objectives of fiscal policy are:
  - ✓ Achievement and maintenance of ________________________________
  - ✓ Maintenance of ________________,
  - ✓ **Acceleration** of rate of ______________________
  - ✓ ______________________________ of income and wealth

- The **importance** as well as order of **priority** of these objectives may _____ **from country to country** and from time to time. For instance-
  - ✓ ______________ **&** ______________ may be the priorities of **developed** nations,
  - ✓ **economic** ________, ____________ **&** ________ → more priority in **developing** country

II) Types of Fiscal Policy

Expansionary fiscal policy	Contractionary fiscal policy
To **stimulate economy during** _______________________ **phase**.	To **stimulate economy during** _______________________ **phase**.
➢ _______________ **aggregate exp**, and	➢ _______________ **aggregate exp**, and
➢ _______________ **in taxes**	➢ _______________ **in taxes**
Thus ___________ **aggregate demand in future**	Thus ___________ **aggregate demand in future**
	It leads to _______ **government budget deficit** or larger budget surplus.
It leads to _______ **government budget deficit** or smaller budget surplus.	CFP is resorted to **close the** ______________**gap**
	If **growth rate is very** _______ causing **inflation** & **asset bubbles**→ CFP will be used to control it.

III) Instruments of Fiscal Policy

III)a) Government (Public) expenditure

➢ Public expenditures are income-generating and include-

✓ **Current expenditures** to meet the ____________ **running** of government

✓ **Capital expenditures** - **investments** made by Govt in ____________ **& infrastructure**,

✓ **Transfer payments** - government **spending** which **does** ______ **contribute to GDP** because income is only transferred, ____________ any direct contribution from the receivers

➢ **During Recession**

✓ It may **initiate** ____________ **of public works**, such as construction of roads, irrigation facilities, ports, electrification of new areas etc.

➢ **During Inflation**

✓ To reduce severity of ____________ & to bring ________ prices

✓ Govt **reduces expenditure** → Reduced incomes→ ____________ excess aggregate demand.

➢ **From where will govt find resources to increase its expenditure, during recession?**

✓ If govt **increases taxes**→ ____________ as increased taxes will reduce incomes & AD

✓ The govt should in such cases go for a **deficit budget** which may be **financed** either

- through ____________ (but it may have risk of crowding out private spending) or
- through ____________ (creation of additional money to finance expenditure).
- Programme of public investment

➢ Primary employment in public works will ________ employment, & economy will be put on an expansion track.

III)b) Taxes

➢ Taxation policies are used for establishing ________ in an economy.

❑ During **recession & depression**,

✓ Taxes are ________ → to encourage private consumption & investment.

❑ During **inflation**,

✓ ______ **taxes** can be levied & rates of existing taxes are raised → to **reduce disposable incomes** & to **wipe off surplus** purchasing power.

✓ However, excessive taxation ____________________ & thus govt has to be cautious about it

➢ The ________ of tax reduction &/or increase in government spending required depends on the _____ **of recessionary gap** and ____________ **of the multiplier**.

III)c) Public Debt

- Public debt may be;

1) **Internal Debt**
   - When government **borrows from its _____ people** in country.

2) **External Debt**
   - When government **borrows from _____________ sources**.

3) **Market Loans**
   - Government issues **treasury bills** and **government securities** of varying denominations and duration which are ___________________________________.
   - For financing **capital projects** -> _____________________________________ are issued
   - For meeting **short-term** government expenditure -> ___________________ are issued.

4) **Small Savings**
   - Borrowings which are ____ **negotiable** & are **not _______________________ in market**.
   - Eg- National Savings Certificates, National Development Certificates, etc.

- **Borrowing from public** through _____ **of bonds** & securities ____________ **aggregate demand** .

- **Repayments of debt** __________ **the availability of money** & ____________ **aggregate demand**.

III)d) Government Budget

- The budget is simply a **statement** of **revenues earned** from taxes and other sources and **expenditures made** by a nation's government in a year.
- The **net effect** of a budget on aggregate demand **depends on** the government's budget **balance**.

- **Balanced budget: (Revenue = Exp)**
  - ✓ ___ **net effect** on aggregate demand since leakages (taxes) = injections (exp)
- **Budget surplus: (Revenues > Exp)**
  - ✓ It has ____________ **net effect** on aggregate demand since leakages > injections
  - ✓ It ____________ **national debt**
- **Budget deficit: (Revenues < Exp)**
  - ✓ It has ______________ **net effect** on aggregate demand since injections > leakages
  - ✓ It __________ **to the national debt**

IV) Fiscal policy for long-run economic growth

- Demand-side policies ________________ by policies to stimulate aggregate _______ cannot produce long-run economic growth.
- For eg-
- ✓ Fiscal policies involving **infrastructure spending** have ______________ **supply-side effects**.

- ✓ Government provision of **public goods** such as education, healthcare, etc. facilitate long-run economic growth through ____________________________. Increase in human capital **makes** _____________ **capital more productive**.

- ✓ **Taxes** can have either __________ or __________ impact on economic growth depending on whether it encourages or discourages saving and investment.
- A **well designed tax policy** that **rewards** ______________ & entrepreneurship, without discouraging incentives will **promote private businesses** who wish to invest & thus help **economy grow**. For eg, an increase in corporate taxes to raise extra revenue may have adverse consequences on incentives and output.
- **Increase in environment taxes** increase the cost of firms and __________ **their output**
- **Subsidies** on inputs and **support prices** to producers (e.g. farmers) generate ______ **output**.

V) Fiscal policy for reduction in inequalities of income and wealth

- Distribution of income is influenced by fiscal policy-
  - ✓ **Directly**- _____________________ **incomes** of are dependent on direct taxes,
  - ✓ **Indirectly**- **Potential for** _________ **earnings** is indirectly influenced

- Few measures as to how **govt** can achieve **desired redistribution of income**-
  - ✓ ____________________ **direct tax** system
  - ✓ **Indirect taxes** can be ________________ (More tax on Luxury goods, Less tax on Necessities)

- A **carefully planned policy of public exp.** helps in **redistributing income** from rich to poor. **Spending programmes** targeted on welfare measures for disadvantaged-
  - ✓ **Poverty alleviation** programmes
  - ✓ Free or subsidized ___________________, __________________
  - ✓ __________________ provision on a **selective basis**
  - ✓ **Subsidized production** of products of ________ consumption
  - ✓ Public production or grant of **subsidies** → for sufficient supply of essential goods,
  - ✓ **Strengthening** ___________________________ for enhancing employability etc

VI) Limitations of fiscal policy

1) ________________– An expansionary policy initiated when economy is already on recovery.

2) **Difficulties in ______________________________ governments' spending** & taxation policies

3) Practically **difficult to reduce government spending** on → ___________ & ________________ as well as on huge **capital projects** which are **already ______________**.

4) **Public works ____________ be adjusted easily** → as huge projects have **long gestation period**.

5) Certain fiscal measures cause ____________________. For eg, increase in profits tax may adversely affect incentives of firms to _______________ & an increase in social security benefits may adversely affect incentives to ____________________________.

6) **Deficit financing** increases the ____________________________ of people. The **production** of G/S, in under-developed countries **may not catch up simultaneously,** resulting in **prices ________________ beyond control**.

7) **Increase is government borrowing** creates ______________________ on **future generations.**

8) **Crowding Out**

- During **recession**, **government** uses expansionary fiscal policy by ________________**govt exp**.
- However, if **taxes** (revenue of govt) are **not sufficient** for the increased spending, then **government increases its spending** by __________________ **from** market → thus __________________ **demand for loans** & **pushes the interest rates ____**.
- Similarly, when govt **increases budget deficit** by **selling bonds or treasury bills**, the **amount of money with private sector ____________** & thus **interest rates will be pushed ____**.
- As a result, **private investments**→ which are **interest– sensitive**, will be ________________.
- **Fiscal policy becomes __________________** as **decline in private spending partially or completely offsets expansion in demand** resulting **from an increase in govt exp**.
- Thus, an increase in size of govt spending during recessions will '__________________' private spending in an economy &
  - ➢ lead to ____________ in an **economy's ability to ________________** from recession,
  - ➢ possibly **reduce** economy's **prospects of ______________________________________**

9) **Lags**

i. **Recognition Lag**

- **Lag in ____________________________** for a policy change

ii. **Decision Lag**

- _________________________________ on most appropriate policy.

iii. **Implementation Lag**

- Delays in ____________________________ and implementing them

iv. **Impact Lag**

- ________________ of a policy are _____ **visible for some time**

Clear CA Foundation & then study Paper 6 – FM & SM of CA Inter on online mode (live/recorded) from MVSIR on "Ultimate CA" platform.

CA Foundation
(New Syllabus)

Business Economics Revision Notes

Chapter 8
Money Market
By CA Mohnish Vora (MVSIR)

These notes are in "FILL IN THE BLANKS" format
Complete these notes by watching REVISION CLASSES of MVSIR

Chapter 8 - Money Market
Unit 1 – The Concept Of Money Demand: Important Theories

BASICS

- **Money** is something that **holds its value over time**, can be **easily translated into prices,** and is **widely accepted**.
- **Fiat Money-** aka. _________ money has _____ **intrinsic value** (materially ________________) → no value if it were not used as money. It is used as medium of exchange as govt has, by law, made them "________________" which means, **they serve, by law, as means of payment**.

DEFINITION OF MONEY

Money can be defined **for policy purposes** as the set of ______________________________, **variation in the** ___________ of which could **impact** on **aggregate economic activity**.

As a **statistical concept**, money could include certain __________________________ of a particular set **of financial intermediaries** or other issuers'.

CHARACTERISTICS OF MONEY

Money should be:

- generally _____________
- _______________ or long-lasting
- effortlessly _______________
- **difficult to** ___________________ i.e. not easily reproducible by people
- relatively ____________, but has elasticity of supply
- _____________ or easily transported
- possessing _________________; and
- ___________ into smaller parts or fractions ____________ **losing value**

FUNCTIONS OF MONEY

1) Convenient ____________________________________
2) Explicitly defined ________________________or unit of account
3) Serves as a unit or standard of ______________________________
4)

DEMAND FOR MONEY

- If **people** ___________ **to** _________ **money**, we say there is **demand for money**.
- Demand for money is in the nature of _____________ **demand**; it is **demanded for its** ____________________________________

THEORIES OF DEMAND FOR MONEY

I) CLASSICAL APPROACH: QUANTITY THEORY OF MONEY

- Given by ________________ in his book 'The Purchasing Power of Money'
- As per QTM, **money in circulation (M)** & **price level (P)** are __________ **related** to each other. (Linear) That is, changes in prices or changes in the value or purchasing power of money are determined by changes in quantity of money in circulation.
- QTM is aka. '**equation of** ______________' or '_______________**approach**'

MV =

- Later, Fisher **extended the equation** of exchange to **include demand (bank) deposits (M')** **and their velocity (V')**

Expanded Form :

- As per QTM, people would **hold money** in a quantity **proportional to total** ________________ irrespective **of interest rate** [More Transactions -> _______ Demand of Money]

II) CAMBRIDGE APPROACH

- Aka ______________________ **Approach** or ______________________ **Theory**

- **Money increases utility** in the following **two ways-**
  1) ________ **of sale and purchase** to two different points of time (transaction motive)
  2) __________ **against uncertainty**. (________________________________of wealth)

- Since **sale & purchase** do **not take place simultaneously**, people need '**temporary** _________' of purchasing power as hedge against uncertainty.

- **How much money will be demanded as per Cambridge Approach?**

➔ **Higher the** _________ -> **greater the** _____________-> **greater demand for** ____________.

Md =

where, PY = nominal income ,

k = = **proportion of nominal income (PY) that people want to hold as cash**

III) Keynesian Theory of Demand for Money

- Aka. '_________________________________'→ people demand money for three motives: **Transactions motive, Precautionary motive, & Speculative motive**

a) Transactions motive

Money for **current transactions** for

____________ & ____________ exchange (income motive & business motive).

Money is demanded **to** _________ **time** gap between receipt of **income** & planned **exp.**

Transaction demand for money is __________ **related** to level of income

Lr =

k is the ratio of earnings which is kept for transactions purposes

b) Precautionary motive

Portion of income kept to **finance** ________________ **exp** which occur due to ________________ **contingencies.**

Precautionary money balances are **income** __________ and & **interest** __________

c) Speculative motive

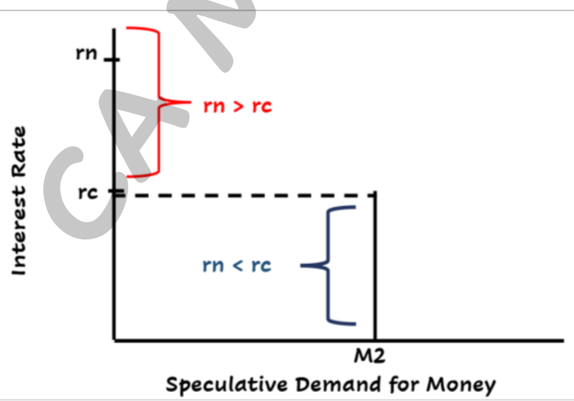
People also demand money to **take advantage of** ______________________________ **,** which is same as future changes in __________________. (to **exploit** any **attractive investment opportunity)**

Assumed that **return on money is** ________, while **returns on bonds** are of **two types**: ____________________ & ____________________

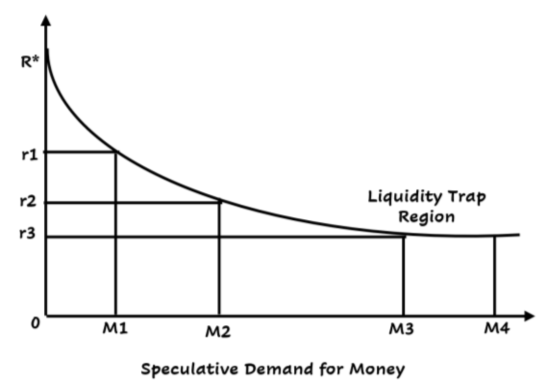
Market Value of Bond inversely related to Market Rate of Interest

Current rate of interest (rn) > Critical rate of interest (rc)	Current rate of interest (rn) > Critical rate of interest (rc)
People **expect a** ______ **in interest rate** (_____ in bond prices) People will **convert their** ______ **balances into** ________ (SDM _______ & Bond _______)	People **expect a** ________ **in interest** rate (________ in bond prices) People would hold their wealth in _______ **cash** rather than ______. (SDM _______ & Bond ________)

Individual's Speculative Demand for Money



Aggregate Speculative Demand for Money



- **Liquidity Trap**
- When **interest rates fall to very ________________**, the **expectation** is that now **____________ go further ________________** & will **move ________________** in future.
- Thus, when **interest rates rise in future**, the **bond prices will ______** leading to taking **risk** of a ____________________ in future

- Thus at such low interest rates-
- desire to **hold bonds** is **very ________** and **approaches ________** , and
- demand to **hold money** in liquid form **approaches ________________ .**

- The **speculative demand of money curve** becomes **parallel to** the **___ axis**, i.e, __________ ____________ with respect to interest rate.
- This situation is called a '**Liquidity trap**'. **(ineffective monetary policy)**

- Empirical evidence of Liquidity Trap is found during "**__________________________ (2008)**"

Post-Keynesian developments in Theory of Demand for Money

IV) Inventory Approach to Transaction Balances

- Aka. **Inventory Theoretic Approach**
- Given by **Baumol and Tobin**, in which money is viewed as an **inventory held for transaction purposes.**

- Inventory models assume that there are **two media for storing value:**
  1) ____________ &
  2) an interest-bearing ____________ financial asset

- There is **_____________ of making transfers** between money & alternative assets e.g. _____________
- As per Baumol, people hold an **optimum ____________** of **bonds and cash balance,** i.e., an amount that **minimizes __________________ cost.**

- The level of inventory holding (holding money in cash)-

is _________________ **RELATED** to
- **Income of person**
- **Cost of making transfer between money and bonds**

&

is _________________ **RELATED** to
- **Carrying cost**
- **Number of times bond transaction are made**

V) Friedman's Restatement of Quantity Theory

Milton **Friedman extended Keynes' speculative money demand** within the framework of ______ ______________________.

Friedman's __________ **determinants** of the demand for money

1. ______________ = Permanent Income / discount rate

Where, discount rate is average return on five asset

2. Positively related to the ______________, **P**
3. Rises if _______________ of money holdings (i.e. returns on bonds and stock) decline
4. _______________- Positive inflation rate reduces the real value of money balances, thereby increasing the opportunity costs of money holdings

IV) Inventory Approach to Transaction Balances

Given by Tobin in his article, **'Liquidity Preference as Behaviour towards Risk'**

This theory is based on the principles of **"________________________________"**

An individual would hold **optimally structured ____________** which is **comprised of ________**

> ____________- (provides return for the risk borne) and

> ____________- (No return, but also no risk)

Just as Keynes' theory, Tobin's theory also implies that **demand for money ________________ on interest rate.**

Chapter 8 - Money Market
Unit 2 – CONCEPT OF MONEY SUPPLY

BASICS

- The term money supply denotes **the total quantity of money available with ________**
- Two things about any measure of money supply:

Supply of money is a ________ **variable** **Change in stock of money is ________ variable**	It refers to stock of money **available to '________'.** This is **always ________ than** the **total stock of money that really exists** in economy.

- **'Public' all economic units except the ________ of money** (i.e. the government and the banking system).
- **Government** = CG, all SGs, and local bodies.
- **Banking system** means **RBI** and all **banks that accept demand deposits**
- Thus, **'supply of money' ________**
  - **interbank deposits** and
  - money held by **government** and
  - money held by **banking system**

Rationale of measuring money supply

Empirical analysis of money supply is important because-

1) Facilitates **analysis of ________** → to understand causes of money growth.
2) Provides a **framework** to evaluate whether money supply is consistent with- **standards for ________** and to **understand nature of deviations.** It helps in **making ________**

Sources of money supply

Central Banks	Banking system
It is **issued by ________**, & is **source** of all other forms of money. The currency issued by ________ is '________ **money**' & is **backed by supporting reserves** → its **value is guaranteed by ________.**	Banks create money supply in the process of ________ **&** ________ **transactions** with the public.

High powered money + Credit Money = Total money stock of a country

- The concept of money has experienced evolution from **Commodity** to **Metallic** to **Paper** to **Digital Currency.**

- Reserve Bank has introduced a concept of ______________________(CBDCs)- **as legal tender issued by a central bank in a digital form.** It is like **sovereign paper currency** but takes a **different form, exchangeable at par with existing currency** and shall be accepted as a medium of payment, legal tender and a safe store of value. CBDCs would appear as liability on a central bank's balance sheet.

- Also, **Crypto currencies** are _____ **legally recognized** in India as currency & are not **money.**

Measurement of money supply

- **Reserve money (M0)** is aka.- **central bank money** or **base money** or **high-powered money**

  Reserve money determines -

  - ✓ level of liquidity and
  - ✓ price level in economy and,

  thus, its management is of crucial importance to stabilize the economy.

	Currency in circulation
+	
+	
	Reserve Money (M0)

	Currency with Public
+	
+	
	M1 (Narrow Money)

	M1
+	
	M2

	Notes in Circulation
+	
+	
-	
	Currency with Public

	M1
+	
	M3 (Broad Money)

	M3
+	
	M4

Difference M0 & M1	M0	M1
Bank Reserves		
Bank Deposits		

- **The above are given in ______________ order of liquidity –**
  M1 (________ Liquid) & M4 (________ Liquid)

- **'Other deposits' with the RBI** __________ those **held by govt** (Central & State Govt.)

Money Multiplier (m)

The money multiplier process explains **how an increase in monetary base** causes **money supply to increase by a multiplied amount**

1st Formula

Money Multiplier (m) = ________________

where, Monetary Base = Currency in circulation + Bank reserves

2nd Formula

Money Multiplier (m) = ________

where,
- **c = currency ratio** = currency / dep.
- **r = required reserve ratio** = required reserves / deposits
- **e = excess reserve ratio** = excess reserves / deposits

3rd Formula

If we **assume-**
1) **Banks never hold** ____________________ (e =)
2) Individuals and non-bank corporations **never hold** ________________ (c =)

Then, money multiplier is ________________ **of the required reserve ratio.**

Money Multiplier (m) = 1 / Required Reserve Ratio = 1 / R

m = 1 / R

Above formula can also be referred as
__________ **Multiplier** or
__________ **Multiplier** or
________________ **Multiplier**

It describes **amount of additional money created by commercial bank** through process of **lending the available money** it has in excess of central bank's reserve requirements.

Determinants of Money Supply

- Money multiplier approach to money supply given by Milton Friedman and Anna Schwartz, (1963) considers **three determinants-**
  1. **Stock of high-powered money (H)** → Depends upon Behaviour of ________________
  2. **Reserve-ratio (r) = R / D** →Depends upon Behaviour of ________________
  3. **Currency Deposit Ratio (c) = C / D** → Depends upon Behaviour of ________________

1. Stock of high-powered money (H)

- Money supply **varies** ______________ with supply of high-powered money.

2. Reserve-ratio (r) = R / D

- If required reserve ratio **increases -**
  - ✓ banks will ____________ lending,
  - ✓ causing a ____________ in deposits

  and hence money supply will ____________...............& vice versa

- **Smaller** the 'r' → ____________ the 'm'

- **Excess Reserves (ER)** are funds that a bank keeps as reserve beyond what is required by regulation as a ____________ **against** __________________________________ **requiring cash.**

Excess reserves (ER) =

- Excess Reserves **do** _______ **lead to any additional loans.**
- **Smaller** the Excess Reserve Ratio 'e' → ____________ the 'm'
- When **opportunity cost to bank of holding ER** _______ **, level of ER** ______ **→ m** will be ______
- If expected deposit outflows increase, banks will will **increase ER ratio. Thus, m will** ______
- Eg- During festival season, people decide to use ATMs very often

3. Currency Deposit Ratio (c) = C / D

- If public keeps more **money in cash,** leads to an **increase in 'c'** & **banks can create less credit money,** thus **m** ___________.

  Eg- Fearing shortage of money in ATMs, people decide to hoard money

- Currency-deposit ratio (c) also represents **degree of** _________ **of banking habits** by people, affected by **degree of financial** __________________, ease & access to financial services etc.

  Eg- 1) Banks open **large number ATMs** all over the country, or

  2) **E-banking becomes very common** and nearly all people use them

✓ Above factors will __________ **'c';** thus _____________________ **'m'** & **money supply**

- The **time deposit-demand deposit ratio** (TD/DD ratio) i.e. how much money is kept as ________ deposits compared to ____________ deposits.
- An **increase in TD/DD ratio →** ____________ **the 'm'**

Monetary Policy and Money Supply

If the central bank of a country wants to _______________ **economic activity** it does so by _______________ **liquidity into the system.**

Eg - Open Market Operations (OMO) by central banks.

___________ **of govt. securities** ________ **high powered money** (monetary base) into system.

$$\Delta \text{ Money Supply} = \frac{1}{R} \times \Delta \text{ Reserves}$$

Effect of government expenditure on money supply

When **RBI lends to governments** under _____________________________ **(WMA)/overdraft (OD)** → leads to **generation of** __________ **money supply in economy** through money multiplier process.

Chapter 8 - Money Market
UNIT 3 – MONETARY POLICY

Introduction

- RBI uses monetary policy to **manage economic** __________ & achieve **price** __________, which means that **inflation is** ________ and __________.
- RBI conducts monetary policy by adjusting supply of money, usually **through buying or selling** securities in open market.
- **Open market operations** affect short-term interest rates, which in turn influence longer-term rates & economic activity.
- ✓ When RBI **lower interest rates**, monetary policy is __________________.
- ✓ When it **raises** interest rates, monetary policy is __________________

The Monetary Policy Framework

It has three basic components-

(i) ______________ of monetary policy,

(ii) ______________ of monetary policy which focus on transmission mechanisms, &

(iii) ____________________________ which focuses on operating targets & instruments

Objectives of monetary policy

The primary objective of monetary policy is maintenance of **judicious balance** between __________________________ & __________________________.

Objectives of Monetary Policy in case of developing countries

1) maintenance of __________________________
2) ensuring ______________________ **of credit to** __________________________
3) sustaining a **moderate structure of** __________________________,
4) creation of an **efficient market for** __________________________

Transmission of Monetary Policy

It describes **how changes** made by RBI to its monetary policy settings ______________ **to** ____________________________ and inflation.

The transmission has ______ stages.

1. Changes to monetary policy **affect** ________________ in economy.
2. Changes to interest rates **affect** ______________________ & ________________

Channels of Monetary Policy Transmission

1) Saving and Investment Channel
2) Cash-flow Channel
3) Asset Prices and Wealth Channel
4) Exchange Rate Channel

Operating Procedures and Instruments

Quantitative tools Credit control tools that impact money supply of entire economy		
1.	Reserve Ratio	Reserve ratio is of **two types-**
1a.	Cash Reserve Ratio (CRR)	Banks are required to set aside a portion of NDTL in **cash with** ______ . RBI ______ required to pay interest on CRR amount.
1b.	Statutory Liquidity Ratio (SLR)	Banks are also required to set aside a portion of NDTL **with** ______, in form of ______ **assets- cash, gold** or **RBI approved securities**. Banks are ______ **to earn interest** on these securities.
2.	Open Market Operations (OMO)	RBI buys and sells government securities in the market. When RBI ______ government securities, **liquidity is** ______ from market→ it is done to ______ inflation. The **objective** is to keep a check on **temporary liquidity mismatches** in market owing to foreign capital flow.

Qualitative tools These are selective credit control tools that have affect money supply of specific sector & not whole economy.		
1.	Margin requirements	When margin requirements are ______→ customers borrow ______
2.	Moral suasion	By way of ______, the RBI convinces banks to keep money in government securities, rather than certain sectors.
3.	Selective credit control	Controlling credit by ______ lending to selective industries.

Market Stabilisation Scheme (MSS)	Under MSS, the ______ **borrows from** ______ (additional to its normal borrowing) and issues treasury-bills, for ______ ______ **liquidity** from market arising from large capital inflows.

Policy Rates		
1.	Bank Rate	The interest rate at which RBI **lends** ______ **term funds** to banks. Aka. Discount rate. Bank rate is used to prescribe ______ **to bank** if it does **not maintain** prescribed **SLR or CRR**
2.	Liquidity Adjustment Facility (LAF)	RBI uses LAF as an instrument to adjust liquidity and money supply. The following types of LAF are-
2a.	Repo Rate	Repo rate is the rate at which ______ **borrow from** ______ on a ______**-term** basis against a **repurchase agreement**.
2b.	Reverse Repo Rate	It is the reverse of repo rate, i.e., this is the **rate** ______ **pays to** ______ in order to **keep additional funds in RBI**. It is ______ **to repo rate**→ **Reverse Repo Rate = Repo Rate -**
3.	Marginal Standing Facility (MSF) Rate	MSF Rate is the ______ **rate** at which ______ **lends money to banks**, ______ the rate available under the **repo policy**. Banks availing MSF Rate can use a **maximum of** ______ **of SLR securities**. **MSF Rate = Repo Rate +**

Organisational Structure For Monetary Policy Decisions

- It is an **agreement** reached between **Government of India & RBI** on ______________________________ **inflation rate** that RBI should target to **achieve price stability**.
- Announcement of an official target range for inflation is known as **inflation** _____________. (‘**Flexible inflation targeting framework**’)
- The **inflation target** is to be **set by the Government of India**, in **consultation with RBI**, _______ **in every** _______ **years**.
-
- Accordingly, Central Government has notified-
- **4 per cent Consumer Price Index (CPI)** inflation as the **target** for period from **Aug 5, 2016 to Mar 31, 2021**

  with the-
  - ✓ **upper tolerance limit of** _______ and
  - ✓ **lower tolerance limit of** _______

- **Monetary Policy Report** is to be published every _____ **months**, explaining **sources of inflation** & **forecasts** of inflation for the coming ________ **months**
- The following are factors lead to a **failure to achieve inflation target**
- **Average inflation** **upper tolerance** level, for any ______________________________ **quarters**; or
- **Average inflation** **lower tolerance** level, for any ______________________________ **quarters**.

Monetary Policy Committee (MPC)

It is a ___ **member committee** consisting of-

- **RBI** ____________ (Chairperson),
- **RBI** _________________________ in charge of monetary policy,
- **One official** nominated by the _____________ and
- **Remaining three** ___________________________ **nominees** representing Govt of India

MPC is required to **meet at least** ___ **times** _________ & **decisions** adopted by MPC are **published** after conclusion of every meeting.

MPC shall determine _________________________ required to achieve inflation target.

CA Foundation
(New Syllabus)

Business Economics Revision Notes

Chapter 9
International Trade

By CA Mohnish Vora (MVSIR)

These notes are in "FILL IN THE BLANKS" format
Complete these notes by watching REVISION CLASSES of MVSIR

Chapter 9 – International Trade
Unit 1 – Theories of International Trade

Basics

- International trade is **exchange of G/S** as well as resources **between countries**.

➢ It involves **transactions-**
- ✓ **between residents of** ____________________.
- ✓ **involves transactions in** ____________________.
- ✓ **greater** ____________ as it involves ____________ **of customers** & **currencies**, **differences in legal systems**, **business practices**, more **elaborate documentation** etc

Benefits of International Trade

1) **Stimulus** to **economic** ________ & **contributes to economic** ________ & **rising incomes**.
2) Efficient deployment of productive resources → leading to productivity gains. It also ________ **likelihood of domestic monopolies**.
3) Trade provides ______ **to new markets** & materials internationally at competitive prices. This reflects in ________ **products at** ________ **prices** & wider choice for consumers. It also **enables nations** to **acquire** ____________ **reserves** necessary for imports.
4) It necessitates **increased use of** __________, **supports technological change**, **stimulates innovations**, & facilitates **greater investment in R&D** & **productivity improvement**.
5) **Stimulus to innovative** ________ in banking, insurance, logistics, consultancy services etc
6) For emerging economies, **improvement in the** ______ **of output** of G/S, superior products, finer labour etc. enhance value of products & lead to move up the **global** ________.
7) Opening up of **new markets** results in **broadening the productive base** & **facilitates** ______ **diversification** so that new production possibilities are opened up.
8) Trade can also **contribute** to ____________________, by facilitating **research & exchange of** __________ & best practices between trade partners.
9) Strengthens bonds between nations→ **promotes** ________ & ________ **in nations**.

Major arguments put forth against trade openness

1) **Not** ________________ **to all nations**. Potential **unequal market** ________ & disregard for principles of ______________.
2) **Economic** ________ → **growing political power** of **corporations operating globally**. Domestic entities can be ____________ by financially stronger transnational cos.
3) **Substantial environmental** ________ & __________ **of natural resources**.
4) Trade cycles & **associated economic crises** in a country get ________ to other country
4) **Risky** ________ of **underdeveloped countries on foreign nations**, impairs economic ______ & endangers their **political** ______ → **exploitation** & ____**of cultural identity**.
5) Too much export orientation may ______ **actual investments** ______.
6) **Lack of** ________ & ________ of trade policies of trading partners **Changes** in **govts' policies**→ **imposition of import** ___, ____ **import tariffs or** ________.

Theories of international trade

1) The Mercantilists' View of International Trade
2) The Theory of Absolute Advantage
3) The Theory of Comparative Advantage
4) The Heckscher-Ohlin Theory of Trade
5) New Trade Theory – An Introduction

The Mercantilists' View of International Trade

- **Mercantilism** → derived from word '**mercantile**'→ "________ & ______________ **affairs**".
- Mercantilism → was **economic policy in** ______________ from 16th to 18th centuries.
- Mercantilism advocated ________________ exports → to bring in more "________" (money in form of ______________) & _________________ **imports** through **imposing very high tariffs**.
- This view argues that trade is a '__________ **game**'→ winners win only at ________________ → **one country's gain** is ________ to **another country's** __________, → so that **net** ___________________________or benefits **among the participants is** ______.

The Theory of Absolute Advantage

- According to ________________________, a country will **specialize in production and export** of commodity in which it has an ___________________________________.
- The principle of absolute advantage refers to the **ability of a country to produce a** _____________ **quantity of a G/S than competitors, using the** ________________________________
- Principle of absolute advantage → uses ____________ **as the only input.**
- **Exchange of goods** between two countries will take place **only if** ______ **of two countries** can **produce** ____ **commodity** at an **absolutely** ______ **production cost than** _______ country.

Commodity	Productivity of Labour _______________________of Labour	
	Country A	Country B
Wheat (units/hour)	6	1
Cloth (units/hour)	4	5

- ___ has **absolute advantage in production of wheat**, so country ____ will export & specialize in production of wheat
- ____ has **absolute advantage in production of cloth**, so country ____ will export & specialize in production of cloth

✓ The above theory explained that ____ **is possible.**

The Theory of Comparative Advantage

- This law, given by by __________ states that even **if one nation is ________ efficient than** (has an absolute ______________ with respect to) **other nation in production of ______ commodities**, there is ____________ **scope for** _____________________________________

Commodity	Productivity of Labour (Output per Hour of Labour)	
	Country A	Country B
Wheat (units/hour)	6	1
Cloth (units/hour)	4	2

- In above eg, _____ **has absolute advantage in production of both** wheat & cloth
  - Wheat [ ]
  - Cloth [ ]
- However, A has ___________________________ **(comparative advantage) in case of ________**. Hence A should specialize in **production & export of ________________**
- Further, B has ______________________________**(comparative advantage) in case of _____**. Hence B should specialize in **production & export of __________**

✓ ____________________ **(2009)** calls comparative advantage **"________________" for economic development**. "Even if a developing country lacks an absolute advantage in any field, it will **always have ________________ advantage** in the production of ________ goods," and will **trade __________________ with advanced economies.**

The Heckscher-Ohlin Theory of Trade

- Aka. ____________________________ Theory or __________ Theory or Heckscher-Ohlin Samuelson theorem
- This theory states that **comparative advantage in cost** of production is explained exclusively by ______________________________________ of the **nations**.
- '**Factor endowment**' refers to **overall** _____________ of usable resources- **labour & capital**.
- It states that a country tends to-
  - ✓ specialize in the **export** of a commodity whose **production** requires ______________ **use of its** ________________ **resources** and
  - ✓ ______________ a commodity whose **production** requires intensive **use of its** ____________ **resources**.
- **Capital abundant country**- **Produce and export** ______________**-intensive goods**
- **Labour-abundant country**- **Produce and export** ______________**-intensive goods**

Theory of Comparative Adv.	Modern Theory
Trade occurs due to difference between countries' ______________	Explains causes of differences in comparative costs as differences in ______________
Based on __________ theory of value	Based on ________ cost - more __________.
Considered labour as _____ factor of production one factor (labour) model	Widened scope - labour and capital as factors of production. It is ___-factor model
Treats international trade as quite _________ from domestic trade	International trade is only a ________ case of ______________ trade.
Studies only ______________ of the goods concerned	Considers ______________ of factors which influence comparative costs
Diff. in cost due to differences in ______________ of __________	Diff in cost due to differences in ______________.
Does ____ take into account the factor price differences	__________ factor price differences as the main cause price differences

New Trade Theory

- NTT (given by ______________) helps in understanding **why developed & big countries** are trade partners when they **are trading** __________ G/S. Eg- electronics, IT, cars
- Those **countries with** ______________ will dominate the market, & the market takes the form of ______________ **competition.**
- **Two key concepts** give advantages to countries that import goods to compete with products from the home country
  1) **Economies of Scale-** If firm serves __________ as well as __________ market, then it can reap **benefit of large scale of production & increase profits.**
  2) **Network Effects-** The value of G/S is enhanced as ______________ using it __________. This is called '__________ **effect'. Consumers like** ______________, but they also **want G/S with** ______________, & **network effect** __________ **utility.** Eg- **WhatsApp, Instagram, Windows** etc

Chapter 9 - International Trade
Unit 2 – The Instruments of Trade Policy

Basic Definitions

➢ **Free Trade-** Buyers and sellers from separate economies voluntarily **trade with** ________________ **of** ____.

➢ **Protectionism:** It is a state policy aimed to **protect** ____________ **producers** against **foreign competition** through the **use of** ________ , ________ & **non-tariff trade policy instruments**.

➢ **Trade liberalization:** It refers to ________________ **of domestic markets** to G/S from rest of world by ________________ **trade barriers**.

➢ **Trade policy:** It consists of **all instruments** that govts may use to __________ **or** ___________ **imports & exports**. Instruments of trade policy are-

- ✓ **price- related measures** such as ____________ and
- ✓ **Non-price measures** or _____________________________________(NTMs).

Tariffs

➢ Tariffs, (aka) **customs duties**→ ________ **or duties on G/S** which are __________ or __________

➢ It is a ________________ in form of a **tax, imposed at the** ___________ on goods going from one country to another.

➢ They are the **most** _________ and ___________________________ **trade measures** that determine market access. Countries generally have a **tariff** ___________

➢ Tariffs are aimed at _________________ **the relative prices** of G/S imported, so as to ______________ **domestic demand** & thus ___________________________ **of their** ____________.

➢ Tariffs also ______________________________ **of government.**

Types of Tariffs

1) **Specific Tariff-** It is **fixed amount of money** per _____________________ or according to ____________ or ___________________ of commodity.

Eg- Specific tariff of Rs. 1000/- on each imported bicycle _________________of its value.

Disadvantage- Its **protective value varies** ___________________ with **price** of the import

2) **Ad Valorem Tariff-** When duty is **levied as _______________ of _______ of trade commodity.**
Eg- A 20% ad valorem tariff on any bicycle.
This tariff ___________________ protective value of tariff on home producer, but it gives incentives to ___________________________ **good's price on invoices** to reduce tax burden.

3) **Mixed Tariffs-** Expressed __________ **on basis of** _________ of imported goods (an ad valorem rate) ____ on **basis of a** _______________ of the imported goods (a specific duty) **whichever is** ___________.

4) **Compound Tariff-** Calculated by ____________ **up** __________ **duty to an** __________ **duty.**

CT = ***ts.q + ta.p.q***

5) **Technical/Other Tariff-** Calculated on basis of **specific** _____________ **of imported goods** i.e. duties are payable by its ______________ or related items.

6) **Tarrif Rate Quota-** TRQs **combine two policy instruments:** ________ & ___________.
Imports **under specified quota portion →** __________ or _________ tariff rate.
Imports _________ quantitative threshold of quota → _________ **tariff**

7) **Most-Favoured Nation Tariffs-** Import tariffs which **countries promise to impose on imports from other** __________________________. In practice, MFN rates are the ____________ that **WTO members charge each other.**

8) **Variable Tariff-** A duty typically fixed to **bring the price of an imported commodity up to level of** ____ for the commodity.

9) **Preferential Tariff-** Countries promise to give another country's products ___________ **tariffs than their MFN rate.**
These agreements are _______________ → (Eg- preferential duties in EU region)
Countries, may also have **'**______________________ **preferential treatment'** → Eg- GSP

10) **Bound Tariff-** A WTO member **binds itself with** _________ **commitment** _______ **to raise tariff rate** _________________________________ (_______________ level of import duty).
A member is **free to impose a tariff that is** _________ than bound level.
Once bound, a tariff rate becomes _______________ & a member can only _____________ it **after** ________________ **with trading partners** & **compensating them for possible losses.**

11) **Applied Tariffs- Duty that is** _________________________ **on imports** on a MFN basis.
Applied tariff should ________ be higher than the bound level.

12) **Escalated Tariff-** Tariff **rates on imports of ____________________ goods** are ______________ than tariff **rates on __________________________ & _______________________**. This type of tariff is ___________________ as it **protects** manufacturing industries in ____________ countries & **adversely affects** industries of ______________________countries.

13) **Prohibitive tariff-** It is **set _____________ that no imports can enter.**

14) **Import subsidies-** It is simply a ____________ **per** ______ **or as a** _______________________ **for importation of a good** (i.e., a __________________ import tariff)

15) **Tariffs as Response to Trade Distortions- Countries affected by '___________' foreign-trade practices, respond** quickly by measures in form of tariff responses to offset distortion. (aka "_____________________" mechanisms)

16) **Anti-dumping duty-** It is a **protectionist tariff** that a domestic govt imposes on imports that it believes are **priced ____.**

- **Dumping** occurs when manufacturers sell goods in a foreign country-
  - below the ____________________ in their ____________________________or
  - below their full _________________________ of the product.
- Dumping may also be used as ______________________________ practice to **drive out ___________________ producers** from market and to establish ___________________.
- Charging ADD is **justified _____________** domestic industry is _________________________ by import competition, & protection is in **_____________________________**

17) **Countervailing duties-** CVD is charged in an importing country to **________ advantage that ________________ get from ______________** (from their govt.) to ensure fair pricing of imported G/S & thus **protecting ____________________** firms.

Effects of Tariffs

1) Create **obstacles to trade**, **decrease** imp & exp. **Mkt access of _________country is worsened**.
2) Tariffs **discourage domestic consumers from buying __________________________ goods**. _________________ consumers suffer a **loss in _______________________.**
3) Tariffs **encourage consumption & production of domestically produced _____________________________________** & thus protect domestic industries.
4) **Producers in _________ country** experience an **increase in well being (_____ producer surplus)**
5) Price increase **induces an increase in output of existing firms** & possibly **addition of new _______ to industry** to take advantage of high profits & hence **increase in _______________**
6) Tariffs **increase government ________________** of importing country.
7) It discourage _________________ production in ________________________ & encourage inefficient prod. in ________ country, by **_____________________ comparative advantage of foreign countries.**

Non – tariff measures (NTMs)

They comprise all types of measures which _______ **conditions** of **international trade**, including _______________________________ that restrict trade & those that facilitate it.

Technical Measures

Technical measures refer to ___________ _________________ **properties** such as **characteristics** of product, **technical specifications and production processes**

These measures are intended for **ensuring product** __________, _____________, **environmental** ___________, national security and protection of animal and plant ______________.

Sanitary & Phytosanitary (SPS) Measures

These are applied to **protect** ___________, __________ **or** __________ **life** from **risks arising from additives, pests,** etc. or disease-causing organisms and to **protect** ________________.

Ban of import of certain goods due to **quality** and **hygienic requirements**.

For Eg- prohibition of import of **poultry** from countries affected by **avian flu** etc

Technical Barriers to Trades (TBT)

Covers both ______ **&** _____________ **products** - refer to mandatory '_____________ **& Technical Regulations**' - define specific ______________ that product should have, like size, design, packaging, etc. excluding measures covered by SPS.

_______________________ **procedures** e.g. testing, & certification). Eg: **food law, quality standard**

Non-Technical Measures

They **relate to** ______________________; for eg- **shipping requirements, custom formalities, trade rules, etc**

These are further distinguished as:

1) **Hard measures** (e.g. Price and quantity control measures),
2) **Threat measures** (e.g. Anti-dumping and safeguards) and
3) **Other measures** such as trade-related finance & investment measures.

Furthermore, the categorization also distinguishes between:

a) **Import-related measures**
b) **Export-related measures**
c) **Procedural obstacles (PO)** - **practical problems** in **administration**, transportation, delays in testing, certification etc → **difficult for org. to comply**.

Non – tariff Barriers (NTBs)

NTBs are ____________________ NTMs, which are used as means to ______________ free-trade rules and _____________ **domestic industries at expense of foreign competition**.

NTBs are thus a ___________ **of NTMs** that have a 'protectionist or discriminatory intent'.

Types of Non-technical measures

1. **Import Quotas**- restriction → only certain **physical amount of good will be allowed into country** during a given time period, usually one year.

a) **Binding Quota-** Set __________ **free trade level of imports** & **enforced by issuing** _____________.

b) **Non-binding quota-** Set _______________ **free trade level** of imports→ little effect on trade.

c) **Tariff rate quotas (TRQs)** combine _____ policy instruments → ___________ **&** ___________.

d) **Absolute quotas or quotas of a permanent nature-** They limit quantity of imports to a specified level during a specified period of time & imports can be done any time of year-

- ✓ Either no condition of country of ___________ of product. or
- ✓ ___________________________________ can be specified.

e) **Seasonal quotas and**

f) **Temporary quotas**

➢ With a quota, **government receives** ____ **revenue.** The **profits received by holders of such import licenses are** known as '________________________'.

➢ If **quota is set** ____________ **free trade level,** amount of imports will _____________. It will **lower** __________ **of good in domestic market &** __________ **domestic price.** _________ **of consumer surplus &** ___________________ **in producer surplus.**

2. **Price Control Measures**- These are steps taken to **control prices of imported goods** in order **to support** ________________________ **of products** when **import prices are** _________.

✓ Aka. '__________________' **measures** & include measures→ that **increase cost of imports** by a **fixed percentage** or by a **fixed amount**.

✓ Eg: A minimum import price established for sulphur.

3. **Non-automatic Licensing and Prohibitions**- These are aimed at **limiting** ___________ **of goods** that can be **imported**, ______________ of whether they originate from **different** ____________ **or from one particular** _____________.

✓ These measures include non-automatic licensing, or **complete prohibitions**.

✓ Eg- **India prohibits import/exp of arms** and related **from/to Iraq**.

4. **Financial Measures**- The objective is to ____________ import costs by regulating ___________ to & _________ of foreign exchange for imports & to **define terms of payment**. It includes measures like __________________________________ **requirements** & foreign exchange controls ___________________________ **of foreign exchange** for certain types of imports

5) **Measures Affecting Competition**- These measures are aimed at **granting** ____________ **or special preferences** to economic operators. It may include **government imposed** _____________ ________________________________ **or enterprises**, and compulsory use of national services.

✓ Eg, a **statutory marketing board** may be **granted exclusive rights to import wheat**: or a canalizing agency (like State Trading Corp.) may be given monopoly right to distribute palm oil.

6) **Government Procurement Policies**- It involve **mandates** that whole of ______________ **of government** __________ should be from __________ **firms** rather than foreign firms In **accepting public tenders**, a government may **give preference to** ___________ rather than foreign tenders

7) **Trade-Related Investment Measures**- These measures include rules on local content requirements that **mandate a specified fraction of a final good should be produced domestically**.

a) requirement to **use certain minimum levels of locally made components**,

b) **restricting** the **level of imported components**, and

c) **limiting the purchase or use of imported products** to an amount related to the **quantity or value of local products that it exports**.

8) **Distribution Restrictions**- **Limitations imposed on distribution** of goods in importing country involving **additional** __________ **or** __________ **requirement**. These may relate to ______________ **restrictions** or **restrictions as to** ______________ **who may resell**.

Eg: a restriction that imported fruits → sold only through outlets having refrigeration facilities.

9) **Restriction on Post-sales Services**- Producers may be **restricted from providing** __________ __________ **for exported goods** in the importing country. Such services may be **reserved to** ____________________ of importing country.

10) **Administrative Procedures**- ______ **&** ______________ administrative procedures which are **mandatory for import of foreign goods**. These will **increase** ________________ & __________ **imports**.

Eg-specifying procedures & formalities, requiring licenses, **administrative delay**, corruption in customs clearing, procedural obstacles linked to prove compliance etc.

11) **Rules of origin**- **Country of origin** means **country in which a good was** __________, or ______ country of service provider. Rules of origin are criteria needed by governments of importing countries to **determine** ______________ **of a product**. **Duties & restrictions** in some cases **depend upon** __________ **of imports**.

12) **Safeguard Measures**- Restrict imports of a product ____________ if its ______ **industry is** ________ with serious injury **caused by a** ______ **in imports**. These measures are for __________ **time** & ________________

13) **Embargos**- __________ imposed by government **on import/export of some commodities** to **particular** ________ for a **specified period**. This may be done **due to** ______________ or for reasons such as **health**, ______ **sentiments**→ ____________ **form** of trade barrier.

Export-related measures

These refer to all measures applied by government of ________________ country including both technical and non-technical measures.

Ban on exports

Eg- during periods of shortages, export of ______________ products such as onion, wheat etc. may be prohibited to make them available for domestic consumption.

Export Subsidies and Incentives

Tariffs on imports hurt exports & thus countries have developed ____________ measures of different types for exporters like export ___________, duty ___________, ______________ access to imported intermediates etc.

Government usually provide financial contribution to domestic producers in form of grants, loans, equity infusions etc. or give some form of income or price support.

Export Taxes

An export tax is a tax collected on __________ goods & may be either __________ or ________________.

The effect of an export tax is to _______ price of good & to __________ exports.

It _________ domestic supply, it also reduces domestic ________ & leads to __________ domestic consumption.

Voluntary Export Restraints

They refer to a type of informal quota administered by an exporting country ______________ ______________ the quantity of goods that can be exported out of that country during a specified period of time.

Such restraints originate from _______________ considerations.

The inducement for exporter to agree to a VER is mostly to __________ importing country & _______ effects of possible ____________ trade restraints that may be imposed by the importer.

VERs may arise when import competing industries seek ________ from _________ of imports from particular exporting countries.

VERs cause domestic prices to _____ and cause ____ of domestic consumer surplus

Chapter 9 - International Trade
Unit 3 – Trade Negotiations

Regional Trade Agreements (RTAs)

RTAs are defined as **groupings of countries** → with the **objective of ____________________ to trade** between member countries.

Types of RTAs

S. No.	Type of RTA	Meaning	Example
1.	**Unilateral trade agreements**	Importing country offers trade ____________ in order to encourage exporting country, to engage in international economic activities that will **__________ __________ country's economy**. (__________)	
2.	**Bilateral Agreements**	Agreements which set rules of trade **between two countries**, two blocs or a bloc and a country. (_____________)	
3.	**Regional Preferential Trade Agreements**	Among a group of countries **reduce trade barriers on __________ & _____________ ________** for **only __________** of the group	
4.	**Trading Bloc**	**Group of countries** that have a **________ agreement** between themselves & may **apply a __________________________ to other countries**.	
5.	**Free-trade area**	**Group of countries** that **__________ all tariff & quota barriers.** Members **retain _____________ in determining their tariffs with _____________**	
6.	**Customs union**	Group of countries that eliminate all tariffs on trade among __________ but **maintain a ________________ on trade with countries outside union** (thus, technically violating MFN)	
7.	**Common Market**	It deepens a customs union by providing for the **free flow of _______ & ____________** by reducing or **eliminating internal tariffs** on goods and by **creating a __________ set of external tariffs**. There are also **common barriers against non-members**	
8.	**Economic and Monetary Union**	Here members share a ________________. This requires strong ______________ in macroeconomic policies.	

GATT

- General Agreement on Tariffs and Trade (GATT) was a **multilateral trade agreement** which **provided rules of international trade** from ________ **to** _________ (47 years)
- GATT governed international trade working along with World Bank & IMF.
- The __________ **round of GATT (**__________ **Round)** of 1986- 94, was _______ → lead to the **birth of** ___________.

GATT lost its relevance by 1980s

1) _____________ to **fast-evolving world trade** scenario
2) _________________________ **investments** had expanded substantially
3) ____ and trade in ________________ were **not covered**
4) World ______________ **trade increased** & was beyond its scope.
5) ______________________ in the **multilateral system** could be heavily exploited
6) Efforts at **liberalizing** ________________________ **trade** were **not successful**
7) There were **inadequacies in institutional** ____________ & ______________________________system
8) it was ________ **a treaty** & thus terms of GATT were binding only insofar as they are ________ incoherent with a nation's domestic rules.

Functions of WTO

1) Acts as a **forum for** __________________________________ among member govt,
2) Administering **trade** ____________________________,
3) **Reviewing** ____,
4) **Assisting** ______________________ **countries** in trade policy issues, through ___________________ ________________________ & _____________________________________
5) **Cooperating** with other _______________________ **organizations**

Objectives of WTO

- The **principal objective** of the WTO is to **facilitate flow of international trade** smoothly, freely, fairly and predictably.

- The WTO has **six key objectives-**

1) to set and enforce __________ for international trade
2) to provide a ____________ for _______________ **&** ____________________
3) **further trade** ________________________
4) to ______________ **trade** ______________
5) to **increase** __________________________ of **decision-making processes**
6) to **cooperate with other major international economic institutions** involved in global economic management, and
7) to **help** _______________________ **countries** benefit fully from ____________________________.

- The **objectives** of the WTO Agreements is also given in **preamble of Agreement creating WTO**,
  - ✓ raising ________________________,
  - ✓ ensuring full ____________ & growth of ___________ & effective _________,
  - ✓ expanding the _______________ of and ___________ in G/S.

Structure of the WTO

- The WTO activities are supported by a _________________ located in ____________, headed by a _______________________________.
- It has a _________-tier system of decision making

1st level (Top-Level)

- It **takes decisions on all matters** under any of the ___________________ trade agreements.
- It **meets at least __________ every ______ years.**

2nd Level

- It **meets ________ times a year** at Geneva HQ.
- It also meets as the **trade policy Review Body and the dispute settlement Body**

3rd Level

- These councils **report to** _____________________ & are **responsible for overseeing _________________ of WTO agreements** in their respective areas of specialisation

The Guiding Principles of World Trade Organization (WTO)

1) Most-favoured-nation (MFN) – [Trade without discrimination]

- Treating other countries equally → Countries **cannot _________________ between their trading partners.**
- Grant **someone a special favour** (such as a lower duty rate) then you have to **do ________ for all other WTO members**.

- Some **exceptions** are allowed. For eg-,

✓ Countries can set up a ____________________________ that applies **only to goods traded ________________ the group** – **discriminating against goods from outside**. Or

✓ They can give __________________ **countries special access** to their **markets**. Or

✓ A country can __________ **barriers against products** that are **traded unfairly.**

2) National treatment

- Treating foreigners & locals ___________ → ______________ & ________________________ **goods** should be treated **equally** – at least _____ **foreign goods have ____________ market**. (giving others the same treatment as one's own nationals)

- Charging **customs duty on import is _______ a violation of national treatment** even if locally-produced goods are not charged an equivalent tax. (since it has _____ entered yet)

3) Freer trade: gradually, through negotiation

- From time to time issues such as __________ & ____________________ **policies** have also been discussed.
- WTO agreements allow countries to introduce changes gradually, through "____________ **liberalization**". Developing countries are usually given longer time to fulfil this obligation.

4) Promoting fair competition

- WTO is described as a "**free trade**" institution, but it is _______ **entirely accurate**. The system does allow tariffs and, in limited circumstances, other forms of protection. More accurately, it is a system of rules dedicated to **open, fair, and undistorted competition**.

- Eg- Agreement on government procurement (a "plurilateral" agreement because it is signed by only a ________ WTO members) **extends competition rules to purchases by thousands of government entities in many countries**. And so on.

5) Predictability: through binding and transparency

- Sometimes, **promising not to raise a trade barrier** can be as important as **lowering one**, because the promise gives businesses a ____________ **of their** ___________ **opportunities**.
- With **stability & predictability**, ____________ **is encouraged**, jobs are created and consumers can fully enjoy the benefits of **competition — choice and lower prices**.
- One achievement of **Uruguay Round of multilateral trade** talks was to **increase amount of trade** under ______________ **commitments**.
- In ______________ , **100% of products** now have **bound tariffs**→ results in high degree of market security for traders & investors.

- Predictability & stability can be improve in **other ways** as well-

1) Dscourage use of ___________— Administering quotas lead to **red-tape & unfair play**.

2) Make countries' **trade rules as** ______ **&** _________ (transparent) as **possible**.

6) Encouraging development and economic reform

- WTO agreements themselves allow for _____________________ & _____________________________ for ____________________ countries.

- **Over** ___________________ **of WTO members** are **developing countries** & countries in transition to market economies.

- A decision adopted at end of Uruguay round says _____________ **countries** should ______________ **implementing** _____________________ **commitments** on goods **exported by** ________**-developed countries**, & it seeks **increased technical assistance** for them.
- Recently developed countries have started to **allow** _______**- free** & _______**-free imports** for almost _____ products from ____________-developed countries.

WTO Agreements (aka. WTO's trade rules → WTO is described as "rules-based")

1. **Agreement on Agriculture** → binding commitments made by WTO Members in **three areas** of ____________________, ____________________ & ____________________.
2. **Agreement on the Application of Sanitary and Phytosanitary (SPS) Measures**
3. **Agreement on Textiles and Clothing (ATC) later replaced Multi-Fibre Arrangement (MFA)**
4. **Agreement on Technical Barriers to Trade (TBT)**
5. **Agreement on Trade-Related Investment Measures (TRIMs)**
6. **Anti-Dumping Agreement**
7. **Customs Valuation Agreement**
8. **Agreement on Pre-shipment Inspection (PSI)**
9. **Agreement on Rules of Origin**
9. **Agreement on Import Licensing Procedures**
10. **Agreement on Subsidies and Countervailing Measures**
11. **Agreement on Safeguards**
12. **General Agreement on Trade in Services (GATS):**
13. **Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS):** This agreement stipulates ____________________ treatment & ____________________ for **intellectual properties**, such as copyright, trademarks, patents, etc. It also requires member countries to **maintain high levels of intellectual property protection**.
14. **Trade Policy Review Mechanism (TPRM)** provides the **procedures** for the trade policy review mechanism to **conduct periodical reviews** of **members' trade policies** and practices conducted by ____ **(TPRB)**.
15. **Plurilateral Trade Agreements:**

✓ **Multilateral negotiations** are negotiations involving _________ **WTO contracting parties**.

✓ **Plurilateral trade agreements** involve several countries with a common interest but **do __________ involve _____ WTO countries**.

The Doha Round

- The Doha Round was ______ round since Second World War was officially launched at the WTO's Fourth Ministerial Conference in Doha, Qatar, in Nov 2001.
- The negotiations include _____ areas of trade.
- Most controversial topic of Doha round was ____________________________.

WTO Achievements

- G-20 was founded in __________, as a forum for countries to **discuss global ____________ & ____________ issues**.

- **620 members are**:

✓ Argentina; Australia;	✓ Japan;
✓ Brazil;	✓ Korea;
✓ Canada; China;	✓ Mexico;
✓ European Union;	✓ Russian Federation;
✓ France;	✓ Saudi Arabia; South Africa;
✓ Germany;	✓ Türkiye (Turkey);
✓ India; Indonesia; Italy;	✓ UK & USA

- The **WTO ________________________________** have been prepared by the **WTO Secretariat** since 2009.

Chapter 9 - INTERNATIONAL TRADE
Unit 4 - Exchange Rates and its Economic Effects

Foreign Exchange

It refers to **money denominated in a currency ______________ the domestic currency**.
Similar to any other commodity, **foreign exchange has a __________**.

Exchange rate

Aka. **foreign exchange (FX) rate**, is **price of one currency expressed in terms of units of ______________________**. It represents ____________ number of units of one country's currency required to purchase one unit of other country's currency. (1$ = Rs 85)

2 ways to express nominal exchange rate-

1) Direct Quote (European Currency Quotation)

Number of units of ________ currency exchangeable for one unit of ___________ currency

Foreign currency (USD) = ___________ currency

Domestic currency (INR) = ___________ currency

Eg: USD 1 = INR 75

2) Indirect Quote (American Currency Quotation)

Domestic currency (INR) = _________ currency

foreign currency (USD) = ____________ currency.

Indirect Quote =

Eg: INR 1 = USD 0.013

A **foreign currency transaction** is a **transactions arising when an enterprise either-**

a) ___________________ **goods or serwices** whose price is in foreign currency,

b) ____________________________ **funds** in foreign currency.

c) becomes a party to an **unperformed** __________________________________;

d) acquires or disposes of _______, or incurs or settles _____________, in foreign currency.

The Exchange Rates Regimes

- **Exchange rates are determined by** _____________ & __________. But governments can influence those exchange rates in various ways.

- **There are three broad categories of exchange rate systems/regime-**

a) **fixed** exchange rate regime (aka. ______________ exchange rate),

b) **floating** exchange rate regime (aka. ______________ exchange rate),

c) **managed float** exchange rate regime (aka. ____________________ exchange rate)

- **Exchange rate regime** → system by which a **country ____________ its ___________ with respect to ____________ currencies**. It is a method where value of _____________ curr. in terms of foreign curr. is _________________.

Floating exchange rate regime (aka. Flexible exchange rate)

- Here **equilibrium value** of **exchange rate** is _____________________ i.e. **demand** & **supply**.
- There is ____ **interference** by **government** or **central bank**.
- **Any interference** in would be **only for _____________ the rate of exchange**. [Eg- India, USA etc]- (Managed Float)

Advantages

1) Allows central bank to pursue its **own _____________ monetary policy**.
2) **Allows exchange rate** to be **used as a ________________**
3) **_____________________ to intervene** in currency markets, central bank is _____ **required to maintain a huge foreign exchange reserves**.

Disadvantages

1) **_____________ exchange rates** generates a **lot of ___________________**
2) It **adds a _______________________** to the costs of goods & assets traded across borders.

Fixed exchange rate regime (aka. pegged exchange rate)

Here **central bank** and/or **government ____________ or __________ what its currency will be worth** in terms of either-
- ✓ __________ country's ___________ or
- ✓ a ___________ of currencies or another measure of value, like ______.

In order to **____________** the **exchange rate** at ________________________ level, **central bank ___________** in the foreign exchange market. [Eg- Hong Kong]

Advantages

1) __________ currency ____________ & eliminates exchange rate ______ & transaction costs thus making international trade ________________
2) **______________ speculation**
3) **Imposes** _____________ on a country's monetary authority & generates **__________ inflation**.
4) Govt can **encourage _____________ trade & investment** as ____________ encourages investment.
5) Pegging **enhances _____________** of the country's **monetary-policy** (more stable)

Disadvantages

1) **__________ flexibility**
2) **Central bank** is required to **stand ready to intervene** & maintain ______ **foreign exchange reserves** for this.

Managed Float System

- Govts & central banks seek to **increase or decrease their exchange rates** by **__________ or ____________** their **own currencies**.
- Exchange rates are still **free to float**, but govt. try to **_____________ their values.**
- **Govt or central bank ________________** in floating exchange rate system is called a **managed float**.
- Typically, the purpose of such intervention is to prevent __________________________ in value of nation's currency.

Central bank can implement **soft peg** and **hard peg** policies.

Soft peg

It refers to an exchange rate policy under which the **exchange rate** is generally **determined by** ____________, in case the exchange rate tends to be **move speedily in** _______________ then **central bank will** _________________ in market.

Hard peg

Here, the **central bank** _______ _______ **&** ________________ **value** for exchange rate.

Both soft peg and hard peg policy **require** that the **central bank** __________ in foreign exchange market.

Normal Vs. Real Exchange Rate

Nominal exchange rate

It refers to **rate** at which a person can **trade the** ______________ of one country for _____________ **of another country.**

For any country, there are __________ nominal exchange rates because its currency can be used to purchase many foreign currencies.

Real exchange rate

It is the rate at which a person can **trade** ___________________ of one country for ____________________ **of another**.

It describes **'**________________' of a good or service **in one country** can be **traded for 'one'** of that good or service **in a** ______________ **country.**

$$\text{Real Exchange Rate} = \text{Nominal Exchange Rate} \times \frac{\text{Foreign Price}}{\text{Domestic Price}}$$

[Please follow above formula in exam. Formula given in ICAI Material is wrong]

Real Effective Exchange Rate (REER)

- It is the ________________ effective exchange rate (a measure of the **value of a domestic currency** against a ____________________________ **of various foreign currencies**) divided by a ____________________.
- An **increase in REER** implies that **exports become more** _________________ & **imports become** ______________; thus, an **increase in REER** indicates a ____________ **in trade competitiveness**.

Foreign Exchange Market
Two types of transactions

Current Transactions
They are **carried out in** __________ **market** and the exchange **involves** __________________ **delivery**

Future Transactions
Here **contracts are agreed upon to buy or sell** currencies for __________ **delivery** which are **carried out in** ___________ **and/or** ____________ markets

Other Terms

1) **Spot Exchange Rates-** Exchange **prevailing for** _______ **trading** (settlement takes max ________ days).

2) **Forward Exchange Rates-** The **exchange rates quoted** in foreign exchange transactions that **specify a** __________ **date**

3) **Currency forward contracts-** They are quoted just like spot rate; however, the _______________________ **of currencies** takes place **in** __________

4) **Forward Premium**= **Forward exch rate ___spot exch rates**

5) **Forward Discount**= **Forward exch rate ___spot exch rates**

6) **Vehicle Currency-** Most international transactions are done in ____________ even when it is _______ **national currency** of **either** the ____________ or ______________.
On account of its critical role in the forex markets, the ____________ is often called a 'vehicle currency'.

Changes in exchange rates

Appreciation

Currency appreciates when its **value increases** with respect to **value of another currency**

Example
Old Rate → $ 1 = Rs 73
New Rate → $ 1 =
Here, **Indian Rupee is** & **US Dollar is**

Depreciation

Currency depreciates when its **value falls** with respect to the **value of another currency**

Example
Old Rate → $ 1 = Rs 70
New Rate → $ 1 =
Here, **Indian Rupee is** & **US Dollar is**

Home Currency Appreciates

Exporter of Domestic Country	
Importer of Domestic Country	

Home Currency Depreciates

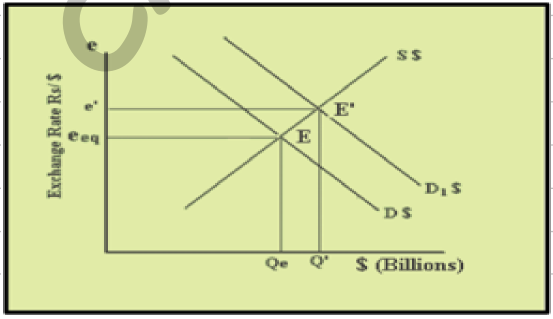
Exporter of Domestic Country	
Importer of Domestic Country	

	Devaluation	Depreciation
1.	Devaluation is a __________ **downward adjustment** in value of a country's currency due to ____________________	Depreciation is a **decrease in a currency's value** with respect to other currencies due to ____________________ **of** ____________________
2.	Occurs in ______ **exchange rate system**	Occurs in ________ **exchange rate system**
3.	______________, **opposite of devaluation**, refers to a **deliberate increase in value of a nation's currency**.	______________, **opposite of depreciation**, is an **increase in a currency's value** due to market forces

Changes in exchange rate under floating rate system

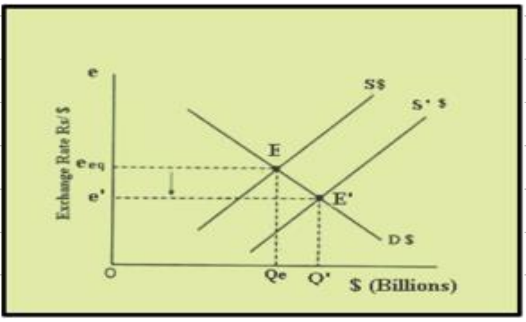
Demand of Foreign currency increases, Supply remains unchanged

The exchange value of foreign currency ________ & **domestic currency** ______________ **in value**



Supply of Foreign currency increases, Demand remains unchanged

The exchange value of foreign currency ________ & **domestic currency** ______________ **in value**



Impacts of currency depreciation

1) __________________ (unexpected/sudden increase in income) for __________-oriented sectors
2) Remittances to homeland → fetches ___________ in terms of domestic currency
3) _____________ government revenues from _____________ related taxes
4) Results in _________ amount of local currency for a given amt of foreign currency borrowings of government.
5) ____________ impact on country's trade deficit → as imports __________ & exports cheaper
6) Depreciation also can have a _______________ impact on controlling _______________ (increasing) gold ____________ & ________________ trade balance.

Impacts of currency appreciation

1) ____________ price of exports → quantity of exports would ________. Imports become ___________→ ____________ in the quantity of imports.. Thus domestic aggregate demand _______ & economic growth is _____________ impacted.

2) Appreciation in recessionary phase→ _____ in agg. demand & __________ unemployment
3) Appreciation in boom phase→ _____________ in inflation; _________ growth rate of economy

4) It leads to ________ inflation because imports are ____________. Lower price of imported inputs lead to ____________ in cost of production , thus decrease prices of output & __________________ std of living

5) With increasing export prices, the competitiveness is _______________ affected & thus, firms have incentives to introduce _____________________________ & capital-intensive production to ______ costs to remain competitive

6) Increasing imports and declining exports are liable to cause ___________ deficits & _______________ the current account

Cross Rate

The rate between Y and Z which is derived from the given rates of ____________ set of two pairs of currency (say, X and Y, and, X and Z) is called cross rate

There may be two pairs of currencies with _______ currency being ___________ between the two pairs.

Eg- **USD 1 = INR 75 ; 1 GBP = USD 1.30**

$$\text{Cross Rate} = \frac{INR}{USD} \times \frac{USD}{GBP}$$

$$= 75 \times 1.30 = 97.50$$

Other Imp Points

- The wide-reaching collection of markets and institutions that handle the exchange of foreign currencies is known as __________________________.
- It is not physical place; rather, an ____________________________ network bringing buyers and sellers together.
- On account of ___________________, regardless of physical location, at any given moment, all markets tend to have the same exchange rate for a given currency.

Chapter 9 - INTERNATIONAL TRADE
Unit 5 - International Capital Movements

- '**Foreign Capital**' includes any _________ **of capital into home country from** __________.

Foreign capital may **flow into an economy in different ways**

Components of foreign capital flows

- Bilateral or direct **inter government grants**.
- **Multilateral aid from many governments** who pool funds **with** international organizations like the **World Bank**.
- **Tied aid** with strict mandates regarding the use of money or untied aid where there are no such stipulations
- **Foreign grants** which are **voluntary transfer of resources by governments**, institutions, agencies or organizations

- Direct **inter government loans**
- **Loans** from **international institutions** (e.g. world bank, IMF, ADB)
- **Soft loans** for e.g. from affiliates of World Bank such as IDA
- **External commercial borrowing**, [ECBs are loans in India made by non-resident lenders in foreign currency to Indian borrowers] and
- **Trade credit** facilities

- **Foreign portfolio investment (FPI)** in bonds, stocks and securities, and
- **Foreign direct investment (FDI)** in industrial, commercial and similar other enterprises

Foreign Direct Investment

- According to **IMF manual on 'Balance of payments'**
- ✓ FDI is "all investments involving _____________ **relationship** & **reflecting** _____________ **interest** & **control of resident entity** in a economy in an enterprise resident in economy ____________________ that of direct investor".

- According to **IMF and OECD definitions**,
- ✓ FDI occurs through **acquisition of** ______________________ **of the shares of the target asset.**

3 Components of FDI

1) ______________________
2) ______________________
3) Other direct capital in the form of _________________

Foreign direct investors

1) **individuals**,
2) Incorporated or unincorporated private or public **enterprises**,
3) **associated groups of individuals** or enterprises,
4) **governments or government agencies**, estates, trusts, or other organizations
5) or any **combination** of above

The main forms of direct investments / Modes Of FDI

1) the opening of _______________ **companies**, (**Equity injection** into an overseas co.)
2) including the establishment of **subsidiaries** or __________________,
3) creation of _______________________ on a contract basis or **M&A**
4) _________________________________ of **natural resources** &
5) ___________________ **of companies** in country receiving foreign capital
6) __________ **field** investment (_____________ **starting** production)
7) __________ investments (**using** ______________ **infrastructure** by merging)

FDI may be categorized as

- **[ ]** When the investor establishes the ____ **of business operation** in a foreign country as it operates in its home country.
  For example, a **cell phone** service provider based in the United States moving to India to **provide the same service.**
- **[ ]** When the investor establishes or acquires a business activity in a foreign country which is **different from the investor's main business** activity yet **in its major activity.**
  For example; an **automobile manufacturing** company may acquire an interest in a **foreign company that supplies parts or raw materials required** for the company
- **[ ]** When an investor makes a foreign investment in a business that is **to its existing business** in its home country.
  This is often in form of a joint venture with a foreign firm already operating in the industry, as **investor has no prèvious experience.**
- **[ ]** These are **investments** between countries.
  These investments occur when **some industries are more advanced in one nation** (for example, computer industry in USA), while **other industries are more efficient in other nations** (such as automobile industry in Japan).

Foreign Portfolio Investment

- FPI flow of '____________ **capital**' & does **not involve ownership or control.**
- Eg of FPI are deposit of funds in India by an Italian company etc
- FPI→ investment in **financial stocks, bonds and other financial instrument**
- FPI has **immediate effects** on ______________________________ or _______________________.
- It is ______ **concerned** with either **manufacture of goods** or with **provision of services.**
- Sole **intention** of FPI is to **earn a** _______________________ through investment in foreign securities
- Portfolio investments are characterised by lower stake in companies with their total stake in a firm _____________________________________.

Foreign direct investment (FDI)	Foreign portfolio investment (FPI)
Investment involves **creation of ____________ assets**	Investment is only in ____________ **assets**
Has a ________ **term interest** & thus remain **invested for long**	Only ________ **term interest** and generally remain invested for **short periods**
Relatively ___________ **to withdraw**	Relatively _________ **to withdraw**
_________ inclined to be speculative	___________________ in nature
Often accompanied by **technology transfer**	_____accompanied by technology transfer
Direct impact on employment of labour and wages	**No** direct impact on employment of labour and wages
Enduring **interest in management and control**	**No** abiding interest in management and Control
Securities are **held with significant degree of influence** by the investor on the management of the Enterprise	Securities are held **purely as a financial investment** and **no significant degree of influence** on the management of the Enterprise

Reasons of FDI

Investments move across borders on account of- (Reasons for FDI)

1) **increasing ________________________ of countries** & consequent trade relations
2) **______________________ of production** & **investment** of transnational companies
3) **desire to reap ______________________________operation** arising from technological growth
4) **lack of feasibility of ________________ agreements with foreign producers** in view of the rapid rate of technological innovations
5) **desire to ____________ a promising foreign firm** to avoid future ___________________ & possible loss of export markets
6) **risk _____________________** so that recessions may be experienced with reduced severity
7) **shared common _______________** or **common _______________** & possible **_________ in time & transport costs** because of geographical proximity
8) **promoting ___________________________** of physical, human, financial and other resources
9) **desire to capture large** and **rapidly growing high potential ____________________________**
10) **ease of penetration into markets** of those countries that have established import restrictions → '**getting __________ the tariff wall**'.
11) **__________ environmental standards in host country** & relative **savings in costs**
13) **_________ political environment** & ________________ investment climate in host country
14) **higher degree of openness** to foreign capital exhibited by recipient country
15) **Better tax policies of host country** which support FDI.
16) **High GDP** & **high per capita income** coupled with their **high rate of growth** in host country.
17) Prevalence of **high standards of social amenities** and possibility of **good quality of life** in the host country.

Deterrents to FDI

Factors in the host country discouraging inflow of foreign investments are-

- **_________ macro-economic environment**
  - ✓ Infrastructure ______,
  - ✓ ________ rates of inflation and continuing instability,
  - ✓ balance of payment ____________,
  - ✓ exchange rate ____________,
  - ✓ unfavourable tax regime,
  - ✓ ________ size of market
- **Unfavourable resource and labour market conditions**
  - ✓ ______ natural and human resources,
  - ✓ _____ literacy,
  - ✓ _______ labour skills
- **Unfavourable legal and regulatory framework**
  - ✓ Absence of well-defined property rights,
  - ✓ ________ of security to life & property,
  - ✓ ________________ regulations,
  - ✓ ___________________ legal formalities & delays
- **Lack of host country trade openness**
  - ✓ lack of openness,
  - ✓ prevalence of ___________________ barriers,
  - ✓ lack of spirit of _____________________ towards foreign investors

Benefits of Foreign Direct Investment

1) Entry of foreign enterprises __________ _________________ & generates a **competitive environment in host country**.
2) International capital **allows countries to finance ________ investment than can be supported by ____________ savings**.
3) FDI **accelerates growth & foster economic development**
4) **Competition for FDI among national governments** also has helped to **promote political & structural reforms** important to attract foreign investors.
5) **FDI** generates **direct _________________** in **recipient country**.
6) FDI **promotes __________ wages** for **skilled jobs**. More **indirect employment** will be generated in **lower-end services sector** (**less educated & unskilled persons**).
7) Foreign corporations provide **better access to foreign markets**.
8) **Promotion of ____________ units resulting in job creation** and **skill development** for workers.
9) If foreign capital **produces goods with export potential**, the **host country is in a position** to **secure scarce _________________________** needed for other important imports.
10) FDI also acts as a **source of _______ revenue** which can be used for development projects.
11) It is likely that foreign investments enter into industries in which **economies of scale can be realized** so that **consumer prices may be reduced.**
12) **Increased competition** due to FDI reduces **domestic monopolies**
13) Since FDI has a ___________ impact on the host country's **balance of payment position**,
14) **Better ____________________** & **higher ______________ standards** brought in by foreign firms may contribute to overall human resources development.

Potential Problems associated with Foreign Direct Investment

1) FDIs **concentrate on capital-intensive methods** → **hire _____ workers**.
2) FDI flows towards regions which are **well endowed** in **natural resources** & **infrastructure**, leading to ______________________________ & increasing income inequalities.
3) **Inflow of foreign capital** → cause **govts to ______ down** its **efforts to generate more domestic savings**→ foreign cos. get incentives like tax holidays → host _______ **tax revenues**.
4) Foreign firms partly finance their investments by borrowing funds in host country. This can ____________ **interest rates** in **host country** & lead to a **decline in domestic investments** through '**crowding-out' effect**. Also, lenders would **prefer foreign firms →** due to lower risks.
5) The expected benefits from **easing of balance of payments (BOP)** might **reduce due to the likely instability** in **BOP & exchange rate** → when **inputs** are **imported** or when **profits are repatriated**→ it **strains host country's BOP** & **home currency depreciates**.
6) Jobs requiring **expertise & entrepreneurial skills** → **retained in ________ country** & thus **host country is left with ___________ management jobs** that demand ______**level of skills & ability**
7) **High profit orientation** → production **concentrated on items of elite & popular consumption** & on non-essential items.
8) Foreign entities are **anti-ethical** → **aggressive advertising** & **anti-competitive practices**.
9) A large foreign firm with **deep pockets** may **______________ a competitive local industry** & may **even drive out domestic firms** resulting in problems of **displacement of labour**.
10) **High growth of wages** in **foreign cos.** can **influence a similar escalation in the domestic cos.** which are not able to cover this increase in cost→ leads to **decreasing competitiveness of domestic cos.**
11) FDI leads to domestic cos. '**off –shoring**' or **shifting jobs** & operations **abroad** in pursuit of **lower operating costs** & **consequent higher profits**.
12) The continuance of _________ **labour or environmental standards** in host countries is highly **appreciated by profit seeking foreign cos**.
13) At times, there is **potential national security considerations**.
14) FDI may have **adverse impact on host country's commodity "terms of trade"** (defined as price of a country's exports divided by the price of its imports). If investments go into production of export-oriented goods & country does huge exports. This can lead to an __________________ **in global market** & thus **export prices decreases relative to import prices**.
15) Ruthless _______________________ **of natural resources & environmental damage**.
16) Possibility of **dual economy**→ **developed ________ sector** & **underdeveloped ___________ sector**
17) A large foreign investment sector can exert **excessive** ___________→ loss of ______________ by host country over _________ **policies** & thus **host country's sovereignty** is put at ________
18) Multinational firms→ criticized of ________________ **issues**, unduly **influencing policy making** and _____________ **of corporate social responsibility**.

- Many **safeguards & performance requirements** are put in place by countries to **improve the ratio of benefits to costs** associated with foreign capital. For eg-
  - ✓ _____________ **content requirements** on inputs,
  - ✓ _______________ of certain **key sectors** to domestic firms,
  - ✓ requirement of a **minimum percent of** _________________________,
  - ✓ _____________ **(upper limit)** on **repatriation** of profits,
  - ✓ __________ **sourcing** of requirements &
  - ✓ stipulations for **full or partial** ____________ **of output** to earn foreign exchange.

Foreign Direct Investment in India

- FDI → is a **key driver of economic growth**& also **non-debt financial resource** for India.
- Foreign corporations invest in India to benefit from → **tax breaks** & **lower salaries**. This helps India develop **technological know- how** and **create jobs**.
- These investments are coming into India due to-
  - ✓ **government's supportive policy framework,**
  - ✓ **vibrant business climate,**
  - ✓ **rising global competitiveness & economic influence.**

- According to the **World Investment Report 2022**, India was ranked _____ among **world's major FDI recipients** in 2020, up from ninth in 2019.
- **Information and technology**, **telecommunication** and **automobile** were the **major receivers of FDI** in FY-22.

The following points are not in syllabus, but ICAI can ask MCQ on them

There are **two routes to for FDI** in India

1) Government Route – Prior approval of govt is required

2) Automatic Route

Where there is **no approval through Automatic Route**, the company can **seek permission from** ____ **(FIFP)**.

Permission for FDI is ______ **uniform for all sectors**.

Sectors where FDI in India is **prohibited** under both Government Route as well as Automatic Route:
- ✓ **Atomic** Energy
- ✓ **Lottery** Business
- ✓ **Gambling** and **Betting**
- ✓ Business of **Chit Fund**
- ✓ **Nidhi** Company
- ✓ **Agricultural** (**excluding** **Floriculture, Horticulture, Development of seeds, Animal Husbandry, Pisciculture and cultivation of vegetables, mushrooms, etc. under controlled conditions and services related to agro and allied sectors**) and **Plantations** activities (**other than Tea Plantations**)
- ✓ **Housing** and **Real Estate** business (**except** **development of townships, construction of residential/ commercial premises, roads or bridges to the extent specified**)
- ✓ Trading in **Transferable Development Rights** (TDRs)
- ✓ Manufacture of **cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes**.

CA Foundation
(New Syllabus)

Business Economics Revision Notes

Chapter 10
Indian Economy

By CA Mohnish Vora (MVSIR)

These notes are in "FILL IN THE BLANKS" format
Complete these notes by watching REVISION CLASSES of MVSIR

STATUS OF INDIAN ECONOMY: PRE INDEPENDENCE PERIOD (1850 -1947)

- Between __ & ___ **century AD**→ India was **largest economy of ancient & medieval world**.
- It was prosperous & self-reliant → controlled between ______ **&** ______ **of world's wealth**.
- ____________ was **dominant occupation**, & main source of livelihood for majority of people.
- It also had a **highly skilled set of ________ & craftsmen** who produced **handicrafts & textiles.**

Ancient Economic Philosophy of India

- The **earliest treatise on ancient Indian economic philosophy** is '____________________' by Kautilya (_________________) (321–296 BCE).
- Arthashastra → important works on statecraft in the genre of ________________________
- It was handbook for **King Chandragupta Maurya**, founder of Mauryan empire→ containing directives as to **how to reign** over kingdom & **encouraging direct action in political concerns**
- **Artha** is not wealth alone; → also includes all aspects of _______________________________.
- **Arthashastra → science of 'artha' or material prosperity**, or "the means of subsistence of humanity," which is, primarily, '______________' and, secondarily, '______________'.
- Major focus → means of **fruitfully maintaining and using land**.
- Kautilya emphasized on **robust agricultural initiatives** which will fill state's treasury.
- **Taxes** → charged **equal** for private & state-owned business, **fair** to all & **easily understood**.
- **True kingship** → **ruler's subordination of his** ___________________ to the **good of his people**;
- King's policies should reflect → **concern for greatest good of greatest number of his subjects**.
- __ **vital elements** →**King, Ministers, Farmlands, Fortresses, Treasury, Military** and **Allies**.

Period of British Rule

- The period of **British rule** can be divided into two sub periods:
  - Rule of **East India Company** from
  - **British government** in India from

- **Industrial revolution in Britain** in latter half of 18th century → required _________________ & ____________ **for finished goods**→ led to change in nature of India's foreign trade from **exporter of** ____________________ to **exporter of** _______________________

- **Indian** ____________ of finished goods were subjected to _________ **tariffs** & **imports** were charged _________ **tariffs** → _____________ **tariffs** followed by the **British**.
- This made the India's **exports of finished goods** ____________ & **imports** ____________. Thus, Indian goods lost their ________________________________.

- The following led to **destruction** of **Indian handicrafts & manufactures**
  - **external** & **domestic demand** for __________________ **products fell sharply**
  - _____________ **imperial policies** to serve British interests & competition from ___________________________ goods
  - Problem aggravated by ________ **in demand** by ________ **consumers favouring** ______ **goods** as Indians wanted to affiliate themselves with western culture & life.

Stagnated Nature of Industrialisation: During the Colonial Era

- Indian **cotton mill industry** had ___ **million spindles** in 1930s→ (**5th position** in **no. of spindles**)

- **Jute mills** expanded rapidly in __________ → global demand for **ropes**. At the **end of the 19th** century, **Indian jute mill industry was __________ in world** in amount of **raw jute consumed.**

- Heavy industries like **iron industry** were **established** in _________ by British capital.
- India's **iron industry was ranked ____ in world** in terms of ____________ **in 1930**.

- **Before Great Depression(1930), India** was **ranked ______ largest industrialised country** measured by the value of __________________.

- The **producer goods industries**→ **did ____ show expansion** → because of pressure exerted by the English producers to ________________ **development of industries in India** which were likely to compete with them.

- The **share in** Net Domestic Product (**NDP**) of **manufacturing sector** → ______ **in 1946**.

Indian Economy: Post-independence (1947- 1991)

- **At time of independence**, India → **literacy rate ____** & ____ **yrs life expectancy in 1951**. India's poverty was in terms of income & human capital.

- **Nehruvian model** which supported social & **economic** ______________ & ______________ directed by the state came to **dominate the post-Independence Indian economic policy**.

- **Planning Commission of India** established in ________ → plan for **economic development** in line with **socialistic strategy** → through **5-year plans** (First FYP- **1951**)

- **Rapid ____________________ of economy** was **cornerstone** of **Nehru's development strategy**.
- The concept of '**planned** _____________________' meant a **systematic planning to support industrialization**. (bureaucrats and technocrats)

Industrial Policy Resolution

- The **Industrial Policy Resolution (______)** → expanded role of _________ sector & licensing to the _________ sector. It granted **state (govt.) monopoly** for strategic areas such as-

  ✓

  Also, rights to new investments in basic Industries were exclusively given to state.

- The **policies** in **1950's** were guided by two **economic philosophies**:

1. __________________________ to **build a socialistic society** with **emphasis on heavy industry**,
2. __________________________ **of small scale and cottage industry** and **village republics**

- The **Industrial Policy Resolution of _______** → framework for industrial development, but was ___________ as it supported **enormous expansion of scope of __________ sector**. (lead to **_______________________ of private sector initiatives**)

- India followed an **open** foreign trade policy **until late 1950s**. A **balance of payments crisis** emerged in **1958** causing concerns **regarding foreign exchange depletion**.
- Consequently, it lead to **gradual tightening of trade** & **reduction in investment-licensing** of new investments requiring imports of capital goods. These import controls were till **1966**.

- In first **3 decades after independence (1950–80)**, India's average annual rate of growth of GDP- '**Hindu growth rate**'- was **______%**.

Agriculture Issues & Green Revolution

- **Strategy for agricultural development** till mid 1960s was reliance on **_________________ model i.e. land reforms**, **farm cooperatives** etc. and no importance given to technocratic areas like R&D , irrigation etc.

- With continuous failures of monsoon, two severe **droughts struck India in _______ & ______**

- The **agricultural sector recorded substantial __________ growth** and India faced a serious food problem. **India had to depend on the United States for food** aid under _____________.

- Restructuring of agricultural policy → '**green revolution**' was initiated soon → which was materialised by-
  - **________________ farm technologies**, **including _____________________seed varieties** &
  - **intensive use of water, _______________ and _______________**

Nationalisation of Banks

- The **government nationalized-**
  - ✓ **____ banks in 1969** and
  - ✓ then followed it up with **nationalizing another ____ in 1980**.

Indian Economy - Worst Performance

- The **economic performance** during "**___________**" **is the worst** in **independent India's history**.
- This happened due to-
  - ✓ **decline in productivity**.
  - ✓ license-raj,
  - ✓ the autarchic policies that dominated the 1960s and 1970s,
  - ✓ external shocks such as **three wars** (in 1962, 1965, and 1971),
  - ✓ major droughts (in 1966 and 1967), and
  - ✓ oil shocks of 1973 and 1979.

Monopolies and Restrictive Trade Practices (MRTP) Act, 1969

- The MRTP Act, 1969 was aimed at **regulation of _________ firms** which had relatively ___________ **market power**. Several **restrictions** were placed on them in terms of **licensing**, **capacity addition**, **mergers** and acquisitions.
- Thus, policies restricting the **possibility of expansion of big business houses kept their entry away** from nearly all but a **few highly capital intensive sectors**.

Reservation for Small Scale Sector

- In _____, many products were **reserved** for exclusive manufacture by the **small scale sector**
- It was thought that this policy will encourage _________**-intensive economic growth & allow** _____________________ **of income**.
- However, this policy **excluded all** ______ **firms from labour intensive industries** and **India** was _____ **able to compete** in the **world market** for these products. _______________ **labour laws** also discouraged labour intensive industries.

The Era of Reforms

- The initiatives, spanning **1981 to 1989**, were referred to as '_________ **liberalization**' which aimed at **changing** prevailing thrust on '**inward-oriented**' **trade and investment practices**.
- This liberalization is often referred to as '**reforms by** _________' to denote its **ad-hoc & not widely publicized nature**.
- The **average annual growth rate of GDP** during-
  - **sixth plan period** (1980–1985) was **5.7 %** and
  - **seventh plan period** (1985–1990) was **5.8 %**
- The **early reforms of 1980's** covered **three areas**- ____________, __________ & ______________.

❑ The prominent **industrial policy initiatives** during this period directed towards **removing constraints on growth** were:

✓ In 1985 delicensing of **25 broad categories** of industries was done.

✓ The facility of '**broad-banding**' was accorded for industry groups to **allow flexibility and rapid changes** in their product mix without going in for **fresh licensing**.

✓ The **asset limit** above which firms were subject to **MRTP regulations** was **raised** from **20 crore** to _______ **crore.**

✓ The **multipoint excise duties** was **converted** into a **modified value-added** (**MODVAT**) tax which reduced taxation on inputs.

✓ **Establishment** of the Securities and Exchange Board of India (**SEBI**) in __________________

✓ The **open general licence (OGL)** list was expanded & the number of capital goods items reached **1,329** in April 1990.

✓ Several **export incentives** were introduced and expanded

- ✓ Exchange rate was set at a level → to __________ exports & reduced pressure on foreign exchange needed for imports
- ✓ Price & distribution controls on cement and aluminum were entirely abolished.
- ✓ Based on the real effective exchange rate (REER), the rupee was depreciated by about 30.0 per cent from 1985-86 to 1989-90.
- ✓ The budget for 1986 introduced policies of-
  - ❖ __________ taxes,
  - ❖ ______________ imports &
  - ❖ __________ tariffs.

- ➢ Thus, liberalization in the 1980s served as necessary ______________ for the more universal and organized reforms of the 1990s.

The Economic Reforms of 1991

- ➢ The economic reforms in 1991 under the ___________________ government.

- ➢ The **causes** attributed to the immediate **need for such a drastic change** are:
  1) Large ________ deficit (financed by huge debt), & adverse balance of payments.
  2) Persistent huge deficits → ___________ public debt → govt revenue used for ______________ payments
  3) _____in oil prices (due to gulf war in 1990) & thus strain on a balance of payments.
  4) The foreign exchange reserves touched _________ point → only $ ____ billion → sufficient for only ______________________ of imports.
  5) Tightening of import restrictions to collect forex for essential imports resulted in reduction in industrial output.
  6) India had to depend on ____________ borrowing from International Monetary Fund which in turn puts stringent conditions.
  7) Fragile political situation along with economic crises → led to 'crisis of confidence'.

- ➢ 1991 reforms→ known as **LPG**- Liberalization, Privatization and Globalisation, had two major objectives:
  1) ______________________ of economy from a centrally directed and highly controlled one to a '__________ friendly' or ____________ oriented economy.
  2) ______________________ stabilization by substantial reduction in fiscal deficit.

- ➢ The policies can be broadly classified as:
  1) stabilization measures → ________ term measures → for problems of inflation & adverse balance of payment, &
  2) structural reform measures → ________ term → aimed at bringing in productivity & competitiveness by removing structural rigidities in different sectors of economy.

Fiscal Reforms

- Bringing in fiscal discipline by reducing the fiscal deficit was vital because-
  - ✓ __________ **domestic demand**,
  - ✓ __________ **in imports** and
  - ✓ **widening of the** ______________________________________ **(CAD)**

  This was attempted by measures to **increase govt revenues** & **curtail govt exp**.

- Measures to this effect included:
  1) Introduction of a **stable and transparent tax structure**,
  2) Ensuring **better tax compliance**,
  3) Thrust on **curbing government expenditure**
  4) **Reduction** in **subsidies and abolition of unnecessary subsidies**
  5) **Disinvestment** of part of **govt's equity holdings** in select PSUs &
  6) **Encouraging private sector participation**.

Monetary & Financial Sector Reforms

- The focus was mostly on-
  - _______________ **the burden of** ________ on government banks,
  - introducing and sustaining ___________________, and
  - ___________________ **interest rates**.

- These included many measures, important among them are:

1) **Interest rate** ____________________ & _______________ **in controls on banks** by **RBI** in respect of interest rates.
2) **Opening of** _______ **private sector banks** & facilitating competition among public, private sector and foreign banks and removal of **administrative constraints.**
3) _______________ **in reserve requirements** namely, SLR & CRR, in line with recommendations of the ______________________ **Committee Report, 1991**.
4) **Liberalisation of bank branch licensing policy** and granting of freedom to banks in respect of **opening, relocating or closure of branches**
5) **Prudential norms of accounting** in respect of classification of assets, disclosure of income and provisions for bad debt, to ensure books of banks reflect truthful financial position.

Reforms in Capital Markets

- SEBI which was set up in __________ was given **statutory recognition in** __________**.**

- It is an **independent regulator of the** _______________ **market** → creates a **transparent environment** which would **facilitate mobilization of adequate resources** and their efficient allocation.

The 'New Industrial Policy'

- The '**New Industrial Policy**' was announced on ________________→ substantially deregulate industry to promote growth of a **more efficient and competitive industrial economy**.

- To facilitate **domestic industry**, a series of **reforms** were introduced-

1. Ended '__________________' by **removing licensing restrictions** industries **except for 18,** later reduced to 5, namely-
   1) arms and ammunition,
   2) atomic substances,
   3) **narcotic drugs** and
   4) **hazardous chemicals**,
   5) distillation and brewing of alcoholic drinks and cigarettes and cigars

   as these have **severe implications on health, safety, and environment**.

2. Public sector was limited to eight sectors based on security and strategic grounds. Subsequently only two items remained – **railway transport and atomic energy**

3. **MRTP Act** was restructured and the provisions relating to merger, amalgamation, and takeover were repealed. This has eliminated the need for pre-entry scrutiny of investment decisions and **prior approval for large companies for capacity expansion or diversification**.

4) Products reserved for **small-scale industries** → **dereserved** enabling entry of large scale ind

5) The policy **ended the public sector monopoly** in many sectors. Now industries reserved for public sector are only a part of **atomic energy generation** and **railway transport**.

6) **Foreign investment** → liberalized → concept of **automatic approval** was introduced. FDI is prohibited only in **four sectors** viz. **retail trade, atomic energy, lottery business & betting and gambling.**

7) **External trade** was further **liberalised** by substituting 'the positive list approach' of listing license-free items on the **OGL** list with the **negative list approach**.

8) In **1990-91**, the **highest tariff rate** was ______**%.** The top tariff rate was brought down to 10% in 2007-08, with some exceptions such as automobile at 100%

9) Rupee was **devalued by** ____**%** against the dollar.

10) ____________________ of government holdings of equity in PSUs. PSUs were provided with **greater autonomy in decision making** and **opportunity for professional management**. The **budgetary support** to public sector was **progressively reduced**.

Notes

____

____

____

____

____

____

____

____

____

____

____

____

____

____

____

____

____

____

____

____

____

NITI AAYOG: A bold step for transforming India

- Planning Commission was abolished in __________→ & on _______________ it was replaced by ____ **(NITI) Aayog**.

- The major objective of such a move was to-
  - ✓ '**spur** ________________ **thinking** by objective 'experts', &
  - ✓ promote '_______________ **federalism**' by enhancing the voice & influence of states'.

- NITI Aayog is expected to serve as a ____________________ of the government & a 'directional and policy dynamo'.

- **The key initiatives of NITI Aayog are:**

1. _________ → envisions **replacing** the prevalent **'use-and-dispose' economy**
2. ____(NDAP) facilitates and **improves access to Indian government data**
3. _________________ **campaign** aims to **improve** _____________________ in India by accelerating the _____________________ **of electric vehicles**
4. _____________ is a _____________ destination for all information on **electric vehicles**

5. **India Policy Insights** (IPI)

6. **'Methanol Economy'** programme → for **reducing India's ___________ bill**, **____________ gas emissions**, & **converting ______ reserves** & ______________ **solid waste into methanol**, and

7. **'Transforming India's ________ Market'** → recommend measures for tapping into the potential of the sector and provide a **stimulus to exports and economic growth**.

❑ **Shortcomings of NITI Aayog**

- NITI has a ____________ **role** → does not produce national plans, control expenditures, or review state plans.
- It is ____________ **from the budgeting process**.
- It **lacks** ___________ **& balance of power** within policy making apparatus of central govt.
- The termination of Planning Commission → strengthened Ministry of Finance, with its 'fixation of macroeconomic stability & natural instinct to limit expenditure'.
- It **lacks the independence** & **power** to perform as a '**counterweight**' to act as a "**voice of development**" **concerned with inequities**.

The Current State of the Indian Economy: A brief overview

I) **The Primary Sector**

- Agriculture, with its allied sectors, is the ____________ **source of livelihood** in India.

- **India** has **emerged as-**
  - ✓ **world's __________ producer** of **milk**, **pulses**, **jute** and **spices**.
  - ✓ **largest** ____________________ under **wheat**, **rice** and **cotton**.
  - ✓ ______ **largest producer** of **fruits**, **vegetables, tea, farmed fish, cotton, sugarcane, wheat, rice, cotton, and sugar.**
  - ✓ **world's _____ largest food and grocery** market is the
  - ✓ **world's largest** __________________(buffaloes).

- ______ **of India's population** is **directly dependent on agriculture** for living. It contributed **18.80%** to the Gross Domestic Product (**GDP**).

- **Food grains production has reached 315.7 million tonnes in 2021-22.**
- **Private investment** in agriculture has increased to **9.3%** in 2020-21.

- Agri sector had a growth of **3.50%** in 2022-23, driven by **buoyant rabi sowing**
- **Export of agricultural** → touched an all-time peak of **Rs 3,74,611 crore** during last one year, & it **rose by 25 percent within 6 months of current financial year 2022-23** (Apr-Sep)

- ____ **(APEDA)** is entrusted with the **responsibility** of **export** _____________ **of agri-products**.

A large number of measures were undertaken by government to improve agri. sector-

1) Allowing ______ **FDI** in marketing of food products and in food product ________________ under the ___________________ route
2) **Income support** to farmers through ____________
3) Fixing of **Minimum Support Price (MSP)** at ______ **times** the **cost of production**
4) **Institutional credit** for agriculture sector at __________________ **rates**
5) Launch of the **National Mission for Edible Oils**
6) ______________________ **Bima Yojana (PMFBY)** – a novel **insurance scheme** for financial support to farmers **suffering crop loss/damage**
7) **Mission for Integrated Development of Horticulture** (MIDH) for the holistic growth of the **horticulture** sector
8) Provision of **Soil Health Cards**
9) ____ (PKVY) supporting and promoting **organic farming**, and **improvement of soil health**.
10) **Agri Infrastructure Fund**, a medium / long term debt financing facility for investment in viable projects for post-harvest management Infrastructure and community farming assets
11) Promotion of **Farmer Producer Organisations** (FPOs) to **ensure better income** for the producers through an organization of their own.
12) ________________________**(PDMC)** scheme to **increase water use efficiency** at the farm level
13) Setting up of **Micro Irrigation Fund**
14) Initiatives towards **agricultural mechanization**
15) Setting up of _________ **-a pan-India** __________ **trading portal** which networks the existing _______ **mandis** to create a **unified national market** for agricultural commodities.
16) Introduction of _______________ for **improvement** in farm produce **logistics**, and
17) Creation of a **Start-up Eco system** in agriculture and allied sectors

II) The Secondary Sector

- Secondary sector contributes ______ of **total gross value added** in the country and employing over **12.1 crores** of people.
- The industrial sector in India broadly **comprises of-** manufacturing, heavy industries, fertilizers, pharmaceuticals, chemicals and petrochemicals, oil and natural gas, food processing, mining, defence products, textiles, retail, micro, small & medium enterprises, cottage industries and tourism.
- The **share of informal sector in the economy is more than 50% of GVA**.
- Manufacturing sector accounts for **78% of total production**.
- In **Jan 31, 2023** the Manufacturing Purchasing Managers' Index (PMI) in India stood at 55.4. **India's rank in the Global Innovation Index** (GII) improved to **40th in 2022 from 81st in 2015.**

- ______________________________(DPIIT) has a role in **formulation and implementation** of **industrial policy** and **strategies for industrial development.**

- **Some of the policies are presented below:**

1) **Introduction** of **GST** on ________ single indirect tax **replacing** many indirect taxes.
2) **Reduction of corporate tax to domestic comp.** giving an option to pay income-tax at **22%**
3) '____________' is a **'Vocal for Local'** initiative launched in 2014 to- facilitate **investment, innovation, infrastructure** in India.
4) '**Ease of Doing Business**' → simplification of procedures, rationalization of legal provisions, digitization of government processes, and decriminalization of minor defaults. India ranks _____ in the **World Bank's** annual **Doing Business Report** (DBR), 2020
5) **The National Single Window System** is a one-stop-shop for **investor related approvals** & provide **continuous facilitation and support to investors**.
6) **PM Gati Shakti National Master Plan** to **facilitate data-based decisions** related to integrated planning of **multi-modal infrastructure**, thereby reducing logistics cost.
7) **National Logistics Policy (NLP)**→ aims to lower cost of logistics
8) To become 'Atmanirbhar', the **Production Linked Incentive (PLI) Scheme** was initiated for **14 key sectors** to enhance India's manufacturing capabilities and export competitiveness.
9) **Industrial Corridor Development Programme:** **Greenfield Industrial regions** with sustainable infrastructure and to make available '**plug and play' infrastructure at the plot level.**
10) _______**-India Scheme** (Faster Adoption and Manufacturing of Hybrid and Electric Vehicles) to **promote** ____________ **of electric and hybrid vehicle technology**
11) '____________' → empowerment of Micro Small and Medium Enterprises (MSMEs).
12) **PM** ______________________________ (PM MITRA): ensure **world-class industrial infrastructure** & **boost FDI** and **local investment in the textiles sector**.
13) **Opening up for global investments**: Make India a more attractive investment destination
14) ______ **FDI under** ________ **route** is permitted for the sale of **coal**, and **coal mining** activities, & insurance intermediaries.
15) **Foreign Investment Promotion Board (FIPB)** was abolished in May 2017, and replaced by ______________________________(**FIFP**). Under FIFP, process for granting FDI approvals has been simplified. FDI has **increased jumped by 39% since FIFP** came.
16) **Remission of Duties and Taxes on Export Products (RoDTEP)** _______ **formed to replace the existing** _____ (Merchandise Exports from India Scheme) to boost exports. It provides for **rebate** of all hidden central, state, and local duties/taxes/levies on goods exported
17) **Start-up India Programme** → facilitator for ideas & innovation in the country. **India's rank** in the **Global Innovation Index** (GII) → _____ **in 2022**.
18) **Public Procurement (Preference to Make in India) Order, 2017** gives preference to **locally manufactured goods/serv.** in **public procurement** thereby giving boost to industrial growth.
19) **Emergency Credit Line Guarantee Scheme (ECLGS)** is a fully guaranteed emergency credit line to **monitor lending institutions**.

- India is gearing up for **4th industrial revolution** or **Industry 4.0** in which focus will be on- **cloud computing, IoT, machine learning, & artificial intelligence (AI).**
- The ______________________________ which aims to **increase the share of manufacturing in GDP to 25% by 2025** is a step in this direction.

III) The Tertiary Sector

- Unlike the usual economic development process of nations where **economic growth has led to a shift from- agriculture to industries**,

  India has unique experience of ________________ **the secondary sector** in the growth trajectory by a **shift from agriculture to ______________ sector.**

The broad classification of services as per the National Industrial Classification, 2008	
1.	Wholesale and retail trade and repair of vehicles
2.	Transportation and storage
3.	Accommodation and food service activities
4.	Information and communication
5.	Financial and insurance activities
6.	Real estate activities
7.	Professional, scientific and technical activities
8.	Administrative and support services
9.	Public administration, defence and compulsory social security
10.	Education
11.	Human health and social work activities
12.	Arts, entertainments and recreation
13.	Other service activities
14.	Activities of households as employers, undifferentiated goods and services producing activities of households for own use
15.	Activities of extra territorial organizations and bodies

- The **service sector** refers to **industry producing ____________ goods** viz. services as output.

- The services sector is the **largest sector of India** & accounts for **______ of total India's GVA**. Gross Value Added (GVA) of services sector is estimated at **₹ 96.54 lakh crore** in 2020-21.

- The service sector is the ______ **growing sector** in India and has the **highest labour productivity**. The exceptionally rapid expansion of **knowledge-based services** such as **professional** and **technical services** has been responsible for the faster growth of the services sector.

- The start-ups which have grown remarkably over the last few years mostly belong to the **services sector**.

- **India** is among **top _______** WTO members in **service exports and imports**.

- India's **services exports** at **US$ 27.0 billion** recorded robust growth in November 2022 due to software, business, and travel services.

- While exports from all other sectors were adversely affected, India's services exports remained **resilient during the Covid-19 pandemic**. The reasons are the **higher demand** for **digital support** and need for **digital infrastructure modernization**.

- Services sector is ____________________ **of FDI inflows**. FDI equity inflows into the services sector accounted for **more than 60 per cent** of the total FDI equity inflows into India.

- The **World Investment Report 2022 of UNCTAD** places **India** as ____ **largest recipient of FDI in the top 20 host countries in 2021**.

- In 2021-22, India received the **highest-ever FDI inflows of US$ 84.8 billion** including **US$ 7.1 billion** FDI equity inflows in the **services sector**.

- To ensure liberalisation, government permitted **100% foreign participation** in **telecommunication services** through Automatic Route.

- The **FDI ceiling in insurance companies** was also raised from 49 to ____**%**.

- Measures undertaken by the Government, such as the launch of the **National Single-Window system** and **enhancement in the FDI ceiling** through the **automatic route**, have played a significant role in facilitating investment.

Conclusion

- The **India Development Update (IDU) of the** ____________________ published in November 2022, observes that India had to face an unusually challenging external environment-
  - Russia-Ukraine war,
  - **increased crude oil** and **commodity prices**,
  - **persistent global supply disruptions**,
  - **tighter financial conditions** and
  - **high domestic inflationary pressures**.

- Despite all these, the **real GDP of India grew by 6.3 percent in July-September** of **2022-23 driven by strong private consumption** and **investment**.

- The report observes that **India's economy** is relatively **more** ______________ **from global spillovers** than other emerging markets

- As such, compared to other emerging economies, **India is much more resilient to withstand adversities in the global arena.**

Connect with MVSIR

Telegram

@camvsir

Instagram

@ca_mohnishvora

YouTube

@ca_mohnishvora

Website

mvsir.in

Scan the above QR codes