INTER CA – NOVEMBER 2018

Sub: ECONOMICS (FULL PORTION)
Test Code – N17
Branch: Multiple Date:

(50 Marks)

Answer 1

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

a) Transactions motive
b) Precautionary motive
c) Speculative motive

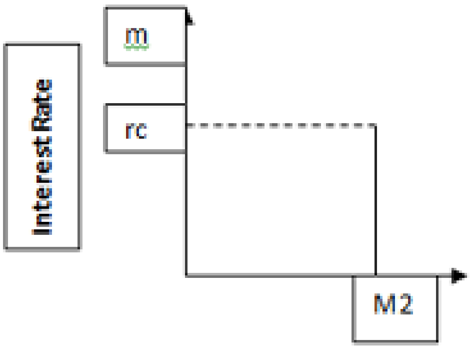
The sum of the transaction, precautionary, and the speculative demand, is the total demand for money. An increase in income increases the transaction and precautionary demand for money and a decrease in the rate of interest increases the speculative demand of money. **(2 marks)**

a) The transaction motive: The transactions motive for holding cash relates to the need for cash for current transactions for personal and business exchange. The transaction demand for money is directly related to the level of income. It can be calculated as follows: **Lr = kY**
Lr = Transaction demand for money
k = ratio of earning which is kept for transaction purposes
Y = earning**. (2 marks)**

b) The precautionary motive: Individuals as well as businesses keep a portion of their income to finance unanticipated expenditures. It depends on the size of income, prevailing economic as well as political conditions and personal characteristics of the individual etc. **(2 marks)**

c) The speculative motive: The speculative motive reflects people's desire to hold cash in order to be equipped to exploit any attractive investment opportunity requiring cash. Investment gives two two type of income viz. interest and capital gain. If current rate of interest is higher than the critical rate of interest, bond price is expected to increase. Person will invest in bond to earn high interest and capital gain, so demand of money decrease. If the current rate of interest is lower than the critical rate of interest, bond price is expected to decrease. Person will hold cash to avoid capital loss and low interest, so demand of money increase. The inference from the above is that the speculative demand for money and interest are inversely related. **(3 marks)**

Individual`s Speculative Demand for Money(1 mark)



Answer 2

1. Establishment of rules and regulations: Government can establish rules and regulation to prohibit actions which are likely to restrain competition. These legislations differ from country to country. Such legislations generally aim at prohibiting contracts, combinations and collusions among producers or traders which are in restraint of trade and other anticompetitive actions. **(2 ½ marks)**

2. Price regulation: Price regulation in the form of setting maximum prices that firms can charge. Price regulation is most often used for natural monopolies that can produce the entire output of the market at a cost that is lower than what it would be if there were several firms. In some cases, the government's regulatory agency determines an acceptable price, so as to ensure a competitive or fair rate of return. This practice is called rate -of –return regulation. **(2 ½ marks)**

Answer 3

General difficulties(5 marks)

(a) Due to income inequality, per capita income is inadequate measure of welfare.
(b) Quality improvements in systems and processes due to technological as well as managerial innovations which reflect true growth in output from year to year.
(c) Productions hidden from government authorities
(d) Non-market production and Non-economic contributors to well-being
(e) The dis-utility of loss of leisure time.
(f) Bad economic which make us worse off.
(g) The volunteer work and services rendered without remuneration in the economy
(h) Many things that contribute to our economic welfare such as, leisure time, fairness, gender equality, security of community feeling etc.,
(i) Non-productive services included in GDP for example police services.

Conceptual difficulties (5 marks)

(a) lack of an agreed definition of national income,
(b) accurate distinction between final goods and intermediate goods,
(c) issue of transfer payments,
(d) services of durable goods,
(e) difficulty of incorporating distribution of income
(f) valuation of a new good at constant prices, and
(g) valuation of government services
(h) Inadequacy of data and lack of reliability of available data,
(i) presence of non-monetised sector,
(j) production for self-consumption,
(k) absence of recording of incomes due to illiteracy and ignorance,
(l) lack of proper occupational classification, and
(m) accurate estimation of consumption of fixed capital

Answer 4(5 marks)

The stabilization function is concerned with the performance of the aggregate economy in terms of:

(1) Labour employment and capital utilization
(2) Overall output and income
(3) General price level
(4) Balance of international payments
(5) The rate of economic growth

Answer 5(5 marks)

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.

Types of budget and its effect: Balance, Deficit, and Surplus

Balanced budget: When expenditures in a year equal its revenues for that year. No effect on demand.

Surplus budget: When the government collects more than what it spends. It reduce demand and control inflation. It decreases nation's debt. But it reduce indus

Deficit budget: When the government expenditure in a year is greater than the tax revenue it collects. It increase demand, output, employment and industrial growth. But it increase nation's debt

Answer 6
Fiscal policy involves the use of government spending, taxation and borrowing to influence both the pattern of economic activity and level of growth of aggregate demand, output and employment. In other words, fiscal policy is designed to influence the pattern and level of economic activity in a country. Fiscal policy is in the nature of a demand-side policy. Governments of all countries pursue innumerable policies to accomplish their economic goals such as rapid economic growth, equitable distribution of wealth and income, reduction of poverty, price stability, exchange rate stability, full-employment, balanced regional development etc. **(2 marks)**

Objectives of fiscal Policy : (3 marks)
(1) Achievement and maintenance of full employment,
(2) Maintenance of price stability,
(3) Acceleration of the rate of economic development, and
(4) Equitable distribution of income and wealth,
Priorities of these objectives may vary from country to country. Stability and equality may be the priorities of developed countries while economic growth and equity may get higher priorities in developing countries.

Answer 7
Meaning : Distribution function is concerned with the distribution of income and wealth so as to ensure distributive justice, equity and wealth. When there is high inequality in distribution of income and wealth, government intervene for distributive justice and wealth. **(1 marks)**

Objectives(2 marks)
(1) Achieve an equitable distribution of social output among household
(2) Advancing the well being of those member of the society who suffer from deprivations of different type
(3) Providing equality in income, wealth and opportunities
(4) Provide security for people who had hardship
(5) Ensuring that everyone enjoy a minimal standard living

Instruments(2 marks)
(1) Taxation policies
(2) Financing public services for the benefits of low income households
(3) Employment reservation and preferences to protect certain segments of the population
(4) Regulation of the manufacture and sale of certain products to ensure the health and well being of consumers
(5) Special schemes for backwards regions etc.

There should be optimal budgetary policy towards any distributional change so there should be proper trade off between efficiency and equity. This function should be accomplished with minimal costs by carefully balancing between equity and efficiency objectives.

Answer 8(2 marks)
It is standard rate at which the RBI is prepared to buy or re-discount bills of exchange or other commercial paper eligible for purchase under the Act. The bank rate once used to be the policy rate in India. Discounting/rediscounting of bills of exchange by the Reserve Bank has been discontinued on introduction of Liquidity Adjustment Facility (LAF). Now, bank rate is used only for calculating penalty on default in the maintenance of Cash Reserve Ratio (CRR) and the Statutory Liquidity Ratio (SLR).Current bank rate is 6.25%.

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