पुथना International School
Shree Swaminarayan Gurukul, Zundal

Grade – XII

ECONOMICS

Specimen copy

Year 2021-2022

1. BASIC CONCEPTS OF MACROECONOMICS

Goods : In economics a goods is defined as any physical object, manmade, that could command a price in the market and these are the materials that satisfy human wants and provide utility

Consumption Goods : Those final goods which satisfy human wants directly. ex- ice-cream and milk used by the households.

Capital Goods : Those final goods which help in production. These goods are used for generating income. These goods are fixed assets of the producers.ex- plant and machinery.

Final Goods are those goods which are used either for final consumption or for investment.

Intermediate Goods refers to those goods and services which are used as a raw material for further production or for resale in the same year.

These goods do not fulfill needs of mankind directly.

Investment : Addition made to the physical stock of capital during a period of time is called investment. It is also called capital formation.

capital formation:- Change in the stock of capital is also called capital formation.

Depreciation :means fall in value of fixed capital goods due to normal wear and tear and expected obsolescence. It is also called consumption of fixed capital.

Gross Investment : Total addition made to physical stock of capital during a period of time. It includes depreciation. OR Net Investment + Depreciation

Net Investment : Net addition made to the real stock of capital during a period of time. It excludes depreciation.

Net Investment = Gross investment – Depreciation.

Stocks : Variables whose magnitude is measured at a particular point of time are called stock variables. Eg. National Wealth, Inventory etc.

Flows : Variables whose magnitude is measured over a period of time are called flow variable. Eg. National income, change in stock etc.

Circular flow of income : It refers to continuous flow of goods and services and money income among different sectors in the economy. It is circular in nature. It has neither any end and nor any beginning point. It helps to know the functioning of the economy.

Leakage : It is the amount of money which is withdrawn from circular flow of income. For eg. Taxes, Savings and Import. It reduces aggregate demand and the level of income.

Injection : It is the amount of money which is added to the circular flow of income. For e.g. Govt. Exp., investment and exports. It increases the aggregate demand and the level of income.

Economic Territory : Economic (or domestic) Territory is the geographical territory administrated by a Government within which persons, goods, and capital circulate freely.

Scope of Economic Territory :

(a) Political frontiers including territorial waters and airspace.

(b) Embassies, consulates, military bases etc. located abroad.

(c) Ships and aircraft operated by the residents between two or more countries.

(d) Fishing vessels, oil and natural gas rigs operated by residents in the international waters.

Normal Resident of a country: is a person or an institution who normally resides in a country and whose Centre of economic interest lies in that country.

Exceptions:- (a) Diplomats and officials of foreign embassy.

(b) Commercial travellers, tourists students etc.

(c) People working in international organizations like WHO, IMF, UNESCO etc. are treated as normal residents of the country to which they belong.

1.1. NATIONAL INCOME AND RELATED AGGREGATES

The related aggregates of national income are:-
(i) Gross Domestic Product at Market price (GDP_{MP})
(ii) Gross Domestic Product at Factor Cost (GDP_{FC})
(iii) Net Domestic Product at Market Price (NDP_{MP})
(iv) Net Domestic Product at FC or (NDP_{FC})
(v) Net National Product at FC or National Income (NNP_{FC})
(vi) Gross National Product at FC (GNP_{FC})
(vii) Net National. Product at MP (NNP_{MP})
(viii) Gross National Product at MP (GNP_{MP})

(i) Gross Domestic Product at Market Price : It is the money value of all the final goods and services produced within the domestic territory of a country during an accounting year.
GDP_{MP} = Net domestic product at FC (NDP_{FC}) + Depreciation + Net Indirect tax.

(ii) Gross Domestic Product at FC : It is the value of all final goods and services produced within domestic territory of a country which does not include net indirect tax.
GDP_{FC} = GDP_{MP} – Indirect tax + Subsidy
or GDP_{FC} = GDP_{MP} – NIT

(iii) Net Domestic Product at Market Price : It is the money value of all final goods and services produced within domestic territory of a country during an accounting year and does not include depreciation.
NDP_{MP} = GDP_{MP} – Depreciation

(iv) Net Domestic Product at FC : It is the value of all final goods and services which does not include depreciation charges and net indirect tax. Thus it is equal to the sum of all factor incomes (compensation of employees, rent, interest, profit and mixed income of self employed) generated in the domestic territory of the country.
NDP_{FC} = GDP_{MP} – Depreciation – Indirect tax + Subsidy

(v) Net National Product at FC (National Income) : It is the sum total of factor incomes (compensation of employees + rent + interest + profit) earned by normal residents of a country in an accounting year
or
NNP_{FC} = NDP_{FC} + Factor income earned by normal residents from abroad - factor payments made to abroad.

(vi) Gross National Product at FC: It is the sum total of factor incomes earned by normal residents of a country along with depreciation, during an accounting year.

GNP_{FC} = NNP_{FC} + Depreciation OR

GNP_{FC} = GDP_{FC} + NFIA

(vii) Net National Product at MP : It is the sum total of factor incomes earned by the normal residents of a country during an accounting year including net indirect taxes.

NNP_{MP} = NNP_{FC} + Indirect tax – Subsidy

(viii) Gross National Product at MP : It is the sum total of factor incomes earned by normal residents of a country during an accounting year including depreciation and net indirect taxes.

GNP_{MP} = NNP_{FC} + Dep + NIT

Domestic Aggregates

Gross domestic Product at Market Price **(GDP_{MP})** is the market value of all the final goods and services produced by all producing units located in the domestic territory of a country during an accounting year. It includes the value of depreciation or consumption of fixed capital.

Net Domestic Product at Market Price **(NDP_{MP}) : $NDP_{MP} = GDP_{MP} -$** Depreciation (consumption of Fixed capital). It is the market value of final goods and services produced within the domestic territory of the country during a year exclusive of depreciation.

Domestic Income : (NDP_{FC}) : It is the factor income accruing to owners of factors of production for suppling factor services with in domestic territory during an accounting year.

NATIONAL AGGREGATES

Gross National Product at Market Price **(GNP_{MP})** is the market value of all the final goods and services produced by normal residents (in the domestic territory and abroad) of a country during an accounting year.

$GDP_{MP} + NFIA = GNP_{MP}\ (NNP_{FC})$

National Income NNP_{FC} **:**It is the sum total of all factors incomes which are earned by normal residents of a country in the form of wages. rent, interest and profit during an accounting year.

$NNP_{FC} = NDP_{FC} + NFIA = \text{National Income.}$

1.2. Methods of Calculating National Income

Methods of Estimation of National Income:

1. Income thod

Step 1: Net Domestic Product at Factor Cost (NDP_{FC})
- Compensation of employees
+ Operating surplus.
+ Mixed income for self-employed person

Setp 2: National Income (NNP_{FC})
- NDP_{FC}
+ Net Factor Income Earned from Abroad (NFIA)

2. Value Added/Product Method

Step 1: Gross Domestic Product Market Price (GDP_{MP})
- Value Added by Primary Sector
+ Value Added by Secondary sector
+ Value Added by Teritory sector

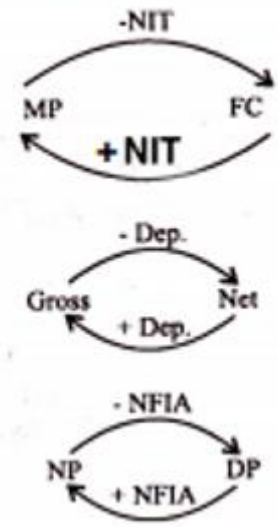
Step 2: Net National Product at Factor Cost (NNP_{FC}) = National Income
- GDP_{MP}
- Depreciation
- Net indirect Taxes (Indirect Taxes – Subsidies)
+ NFIA

3. Expenditure Method

Setp 1: Gross Domestic Product at Market Price (GDP_{MP})
- Private Final Consumptice Expenditure (C)
+ Govt. Final Consumption Expenditure (G)
+ Gross Domestic Capital Formation (2)
+ Net Export (X–M)

Step 2: Net National Product at Factor Cost (NNP_{FC}) National Income
= GDP_{MP}
– Depreciation
– NIT (Net indirect taxes)
+ NFIA

Conversion Hints



Where: NIT : Net indirect tax (Indirect Taxes – subsidies)
MP = Market Price
FC = Factor Cost

Dep = Depreciation = Consumption of fixed capital
NP = National Product
DP = Domestic Product

NFIA = Net Factor Income Earned from Abroad

National Income at Current Prices : It is also called nominal National income. When goods and services produced by normal residents within and outside of a country in a year valued at current years prices i.e. current prices is called national income at current prices.

$Y = Q \times P$

Y = National income at current prices

Q = Quantity of goods and services produced during an accounting year

P = Prices of goods and services prevailing during the current accounting year

National Income at Constant Prices : It is also called as real national income. When goods and services produced by normal residents within and outside of a country in a year valued at constant price i.e. base year's price is called National Income at Constant Prices.

Y' = Q x P'

Y' = National income at constant prices

Q = Quantity of goods and services produced during an accounting year

P' = Prices of goods and services prevailing during the base year

Value of Output : Market value of all goods and services produced by an enterprise during an accounting year.

Value added : It is the difference between value of output of a firm and value of inputs bought from the other firms during a particular period of time.

Problem of Double Counting : Counting the value of a commodity more than once while estimating national income is called double counting. It leads to overestimation of national income. So, it is called problem of double counting.

Ways to solve the problem of **double counting**.

(a) By taking the value of only final goods.

(b) By value added method.

Components of $GDP_{MP} = \sum Values$ Added by all 3 sectors

1. Value Added by Primary Sector(=VO-IC)

2. Value Added by Secondary Sector(=VO-IC)

3. Value Added by Tertiary Sectors(=VO-IC)

Hints

VO=Value of output

IC=Intermediate Consumption

VO=Price X quantity OR

Sales + Change in stock

(Change in stock = Closing Stock - Opening Stock)

Components of Final Expenditure:

1. Final Consumption Expenditure

a. Private Final Consumption Expenditure(C)

b. Government Final Consumption Expenditure(G)

2. Gross Domestic Capital Formation

a. Gross Domestic Fixed Capital Formation

i. Gross business Fixed Investment

ii. Gross Residential Construction Investment

iii. Gross public Investment

b. Change in Stock or Inventory Investment

3. Net Export(X-M)

a. Export(X)

b. Import(M)

Components of Domestic Income :

1. Compensation of Employees

a. Wages and salaries(Cash/or kinds)

b. Employers Contribution of Social security Schemes

2. Operating surplus

a. Rent

b. Interest

c. Profit

i. Corporate Tax

ii. Dividend

iii. Undistributed corporate profit

3. Mixed Income for self-Employed person

Net Factor Income from Abroad NFIA = It is difference between factor income received/earned by normal residents of a country and factor income paid to non-residents of the country.

Components of NFIA :

1. Net Compensation of Employees

2. Net Income from Property and entrepreneurship

3. Net Retained earning of resident companies abroad

Hints :NFIA : Net Factor Income Earned from Abroad.

NFIA = Factor Income Received from Abroad.

–Factor Income Paid to Abroad.

OR

NFIA = Net compensation of Employees

+ Net income from property and entrepreneurship.

+ Net retained earning of resident companies abroad.

Net National Disposable Income (NNDI): It is defined as net national product at Market price (NNP_{MP}) plus net current transfer from rest of the world.

NNDI = NNP_{MP}

+ Net current transfers from rest of the world.

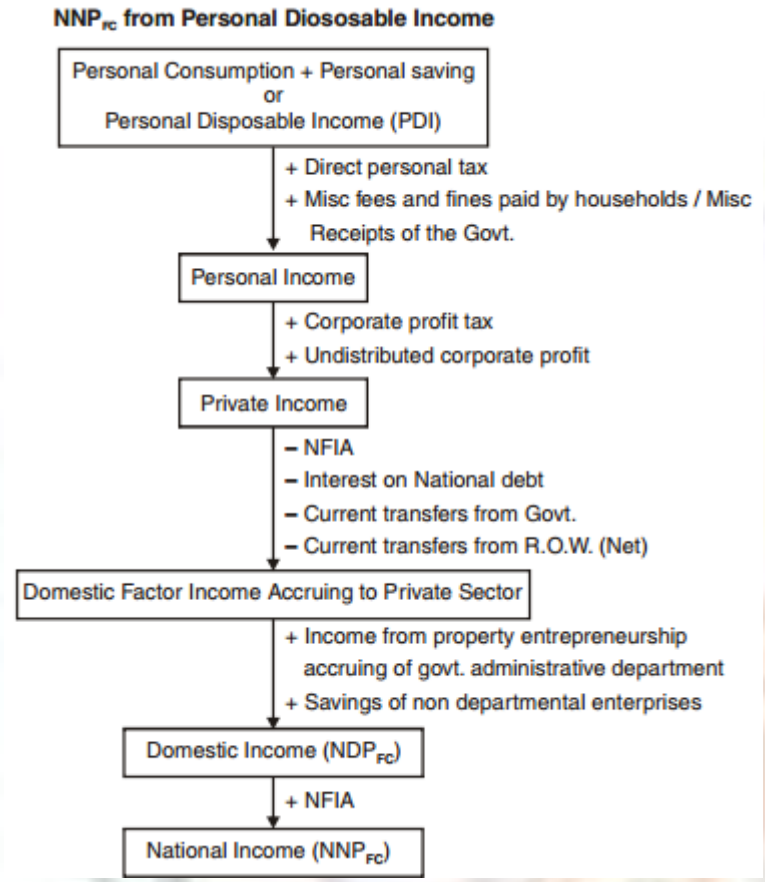
=National income + net indirect tax + net current transfers from the rest of the world.

Gross National Disposable Income (Gross NDI $= GNP_{MP}$ + Net current Transfers from rest of the world.

Net National Disposable Income (Net NDI) $= NNP_{MP}$ + Net current Transfers from rest of the world.

OR

= Gross NDI – Depreciation.



Concept of Value Added of One Sector or One Firm

1. Value output = Sales + Change in Stock. or value of output = price × qty. sold + ΔS.

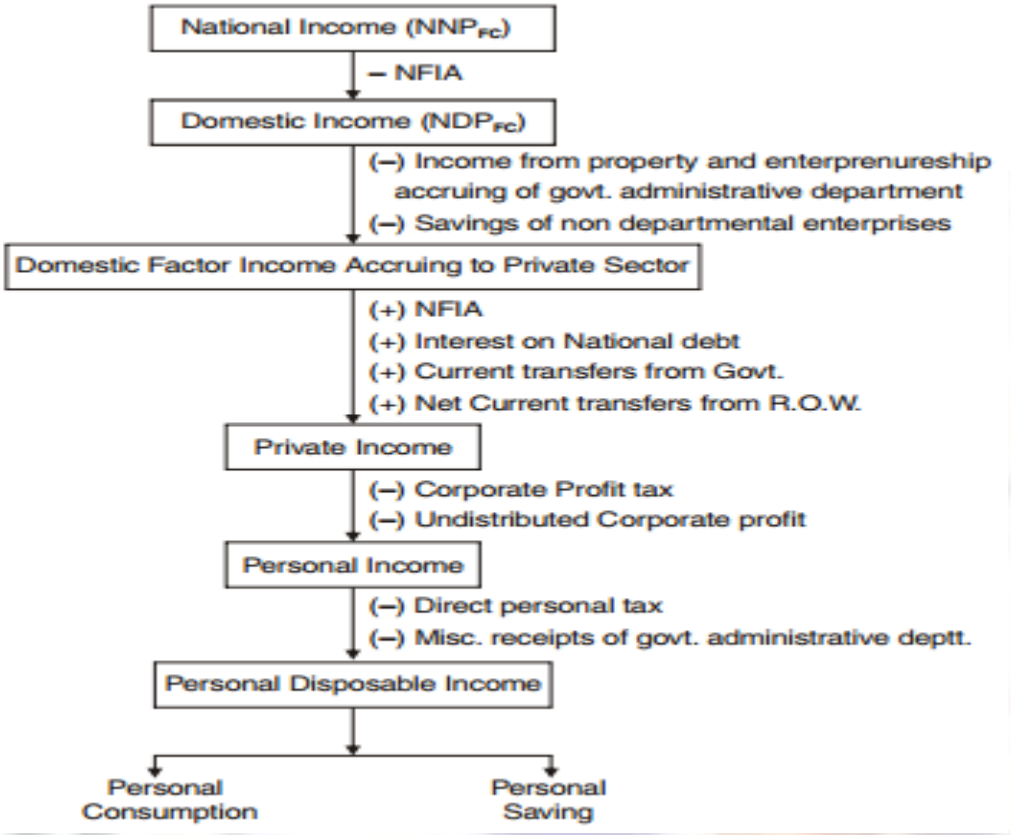
2. Gross value added at market price (GVA_{MP}) = Value of output – Intermediate consumption.

3. Net value added at market price (NVA_{MP}) = GVA_{MP} – Depreciation.

4. Net value added at factor cost (NVA_{FC}) = NVA_{MP} – Net indirect tax.

Note: By adding up NVA_{FC} of all the sectors, we get NDP_{FC} or Domestic Income.

Personal Disposable Income from National Income (NNP_{FC})



Private Income : Private income is estimated income of factor and transfer incomes from all sources to private sector within and outside the country.

Personal Income : It refers to income received by house hold from all sources. It includes factor income and transfer income.

Personal Disposable Income : It is that part of Personal income which is available to the households for disposal as they like.

GDP and Welfare :

In general GDP and Welfare are directly related with each other. A higher GDP implies that more production of goods and services. It means more availability of goods and services. But more goods and services may not necessarily indicate that the people were better off during the year. In other words, a higher GDP may not necessarily mean higher welfare of the people. There are two types of GDP:

Real GDP : When the goods and services are produced by all producing units in the domestic territory of a country during an a/c. year and valued these at base year's prices or constant price, it is called real GDP or GDP at constant prices. It changes only by change in physical output not by change price level. It is called a true indicator of economic development.

Nominal GDP : When the goods and services are produced by all producing units in the domestic territory of a country during an a/c. year and valued these at current year's prices or current prices, it is called Nominal GDP or GDP at current prices. It is influenced by change in both physical output and price level. It does not consider a true indicator of economic development.

Conversion of Nominal GDP into Real GDP

$$\text{Real GDP} = \frac{\text{Nominal GDP}}{\text{Price index}} \times 100$$

Price index plays the role of deflator deflating current price estimates into constant price estimates. In this way it may be called GDP deflator.

Welfare mean material well being of the people. It depends on many economic factors like national income, consumption level quality of goods etc and non-economic factor like environmental pollution, law and order etc. the welfare which depends on economic factors is called economic welfare and the welfare which depends on non-economic factor is called non-economic welfare. The sum total of economic and non-economic welfare is called social welfare. Conclusion thus GDP and welfare directly related with each other but this relation is incomplete because of the following reasons.

Limitation of percapita real GDP/GDP as a indicator of Economic welfare :

Non-monetary exchange
Externalities not taken into GDP but it affects welfare.
Distribution of GDP.
All product may not contribute equally to economic welfare.
Contribution of some products may be negative.
Inflation may give falls impression of growth of GDP.

2. Money

Money: Money may be defined as anything which is generally acceptable as a medium of exchange and at the same time acts as a measure, store of value and standard of deferred payment.

Functions of Money:

1. Primary Functions

a. Medium of exchange

b. Common measure of value or unit of value

2. Secondary Functions

a. Standard of deferred payment

b. Store of value

c. Transfer of value

3.Contingent Functions

a. Basis of credit

b. Liquidity

c. Basis of price mechanism

d. Maximum profit to the producers

e. Maximum satisfaction to the consumers

f. Basis of distribution of income

Barter Exchange: It implies the direct exchange of goods for goods without the use of money.

Difficulties involved in the Barter Exchange:

1. Lack of a common measure of value.

2. Lack of double coincidence of wants

3. Lacks of standard of deferred payments.

4. Lack of store of value.

5. Lack of divisibility.

6. Difficulty in exchange of services

Supply of Money: Total stock of money (currency notes, coins and demand deposit of banks) in circulation are held by the public at a given point of time.

Supply of money does not include cash balance held by central and state govt. and stock of money held by banking system of country as they are not in actual circulation of the country.

Measures of Money Supply = Currency held by Public + Net Demand Deposits held by commercial banks

M_1 = C + DD + OD

C = Currency and coins with the public

DD = Demand deposits of the public with the banks

OD = Other deposits

M_2 = M_1+ Post office savings deposits

M_3 = M_1+ Time deposits of commercial banks

M_4= M_3+ Total deposits with the post office saving organisation excluding the deposits on NSC

2.1 Banking

Banks:

Commercial Banks: Commercial Banks are financial institution who accepts deposits from the public and provide loans facilities for investment with the aim of earning profit.

Functions of Commercial Banks

1. Primary functions:-

(a) Accepting deposits

(b) Advancing loans

(c) Discounting bill of exchange.

2. Secondary functions:-

1. Agency function

(a) Transfer of fund

(b) Collection of funds

(c) Purchase and sale of shares and securities on behalf of the customers

(d) Collection of dividend and interest

(e) Payment of bills and insurance premium on behalf of customers

(f) Acting as executor and trustee of will

(g) Acting as correspondent and representative of customer and provide letter of credit to the customer.

2. General utility function

(a) Purchase and sell of foreign exchange.

(b) Issuance of travelers cheque.

(c) Safe custody of valuable goods in lockers.

(d) Underwriting of securities.

Central Banks: The central Bank is the apex institution of monetary and financial system of a country. It makes monetary policy of the country in public interest. It manages, supervises and facilitates the banking system of the country.

Functions of Central Banks

1. Bank of Issue
2. Banker to the Government
3. Banker's Bank and Supervisor.
4. Controller of credit.
5. Lender of last resort
6. Custodian of foreign exchange reserves

MONEY CREATION OR CREDIT CREATION BY COMMERCIAL BANKS

CREDIT is defined as finance made available by one party to another party on a certain rate of exchange.

The capacity of banks to create money or credit depends on (i) Amount of primary deposits and (ii) Legal reserve ratio(LRR).

Legal Reserve Ratio(LRR):- is fixed by the central bank of a country and it is the minimum ratio of deposit legally required to be kept as cash by banks.

Cash Reserve Ratio(CRR):- It is a part of LRR which is to be kept with the central bank.

Statutory Liquidity Ratio(SLR):- It is a part of LRR which is to be kept with the bank themselves.

Commercial bank's demand deposits are a part of money supply. Commercial banks lend money to the borrowers by opening demand deposit account in their names. The borrowers are free to use this money by writing cheques. According to definition demand deposits are a part of money supply. Therefore, by creating additional demand deposits bank create money. Money creation depends upon two factor: Primary deposits and Legal Reserve Ratio (LRR). Deposit Multiplier = 1/LRR Total Deposit creation = Initial deposit X 1/LRR.

Repo rate : Repo rate is the rate at which the central bank of a country (Reserve Bank of India in case of India) lends money to commercial banks in the event of any shortfall of funds. Repo rate is used by monetary authorities to control inflation.

Description: In the event of inflation, central banks increase repo rate as this acts as a disincentive for banks to borrow from the central bank. This ultimately reduces the money supply in the economy and thus helps in arresting inflation.

Reverse repo rate : Reverse repo rate is the rate at which the central bank of a country (Reserve Bank of India in case of India) borrows money from commercial banks within the country. It is a monetary policy instrument which can be used to control the money supply in the country.

Description: An increase in the reverse repo rate will decrease the money supply and vice-versa, other things

remaining constant. An increase in reverse repo rate means that commercial banks will get more incentives to park their funds with the RBI, thereby decreasing the supply of money in the market.

3. AGGREGATE DEMAND , AGGREGATE SUPPLY AND RELATED CONCEPTS

Aggregate Demand refers to total value of all final goods and services that are planned to buy by all the sectors of the economy at a given level of income during a period of time. **AD** represents the total expenditure on goods and services in an economy during a period of time.

Components of Aggregate demand are:

(i) Household consumption expenditure (C).

(ii) Investment expenditure (I).

(iii) Govt. consumption expenditure (G).

(iv) Net export (X – M).

Thus, **AD = C + I + G + (X – M)**

In two sector economy AD = C + I

Aggregate Supply is the money value of all final goods and services available for purchase by an economy during a given period. It is the flow of goods and services in the economy. Since, money value of final goods and services is equal to net value added, **AS is nothing but the national income.**

AS = C + S

Aggregate supply represents the national income of the country.

AS = Y (National Income)

Consumption function shows functional relationship between consumption and Income.

C = f(Y)

where C = Consumption

Y = Income

f= Functional relationship.

Equation of Consumption Function

$C = \bar{C} + MPC * Y$

C = Consumption

$\bar{C}$ = Autonomous consumption.

MPC(b)= Marginal Propensity to consume

$\bar{C}$ does not changed/affected by change in income. It is minimum level of consumption , even when income is zero. Consumption expenditure at zero level of income is called autonomous consumption. It is income inelastic.

Induced consumption is the expenditure which is affected by change in income. It is indicated by MPC × Y. **Induced consumption** is the portion of **consumption** that varies with disposable income.

Propensity to consume:- It is a schedule that shows consumption expenditure at different levels of income in an economy.

Consumption function (propensity to consume) is of two types:

(a) Average propensity to consume (APC)

(b) Marginal propensity to consume (MPC)

Average propensity to Consume (APC): It refers to the ratio between total consumption(C) and total income(Y) at given level of income in the economy.

$$APC = \frac{\text{Consumption}(C)}{\text{Income}(Y)} = \frac{C}{Y}$$

Important Points about APC

(i) APC is more than 1: as long as consumption is more than national income before the break-even point, APC > 1.

(ii) APC = 1, at the break-even point, consumption is equal to national income.

(iii) APC is less than 1: beyond the break-even point. Consumption is less than national income.

(iv) APC falls with increase in income.

(v) APC can never be zero: because even at zero level of national income, there is autonomous consumption.

Marginal Propensity to Consume (MPC): Marginal propensity to consume refers to the ratio of change in consumption expenditure to change in income.

$$MPC = \frac{\text{Change in Consumption}}{\text{Change in Income}} = \frac{\Delta C}{\Delta Y}$$

Important Points about MPC

(1) Value of MPC varies between O and 1: If the entire additional income is consumed, then $\Delta C = \Delta Y$, making MPC = 1. However, if entire additional income is saved, than $\Delta C = 0$, making MPC = 0

(2) MPC is the slope of consumption curve and remain constant throughout in the short run.

(3) Value of APC > MPC

Saving function refers to the functional relationship between saving and national income.

S = f (y)

Equation of Saving function

$S = -\bar{C} + MPS.Y$

where S = saving

Y = National Income

f = Functional relationship.

Saving function (Propensity to Save) is of two types.

(i) Average Propensity to Save (APS)

(ii) Marginal propensity to Save (MPS)

Average Propensity to Save (APS): Average propensity to save refers to the ratio of savings to the corresponding level of income

$$APS = \frac{\text{Savings}}{\text{Income}} = \frac{S}{Y}$$

Important Point about APS

(1) APS can never be 1 or more than 1 : As saving can never be equal to or more than income.

(2) APS can be zero: At break even point C = Y, hence S = 0

(3) APS can be negative: At income levels which are lower than the break-even point, APS can be negative when consumption exceeds income.

(4) APS rises with increase in income.

Marginal Propensity to Save (MPS): Marginal propensity to save refers to the ratio of change in savings to change in total income.

$$MPS = \frac{\text{Change in Savings}}{\text{Change in Income}} = \frac{\Delta S}{\Delta Y}$$

MPS varies between 0 and 1

(i) MPS = 1 if the entire additional income is saved. In such a case, $\Delta S = \Delta Y$, then MPS = 1

(ii) MPS = 0 If the entire additional income is consumed. In such a case, $\Delta S = 0$, then MPS = 0

(iii) Mps is the slope of saving curve.

(iv) MPS remains constant throughout in short run.

Relationship between APC and APS

The sum of APC and APS is equal to one. It can be proved as under we know:

APC + APS = 1

Y = C + S

Dividing both sides by Y, we get

$$\frac{Y}{Y} = \frac{C}{Y} + \frac{S}{Y}$$

$$1 = APC + APS \left[\begin{array}{l} APC = \frac{C}{Y} \\ APS = \frac{S}{Y} \end{array}\right]$$

APC + APS = 1

because income is either used for consumption or for saving.

Relationship between MPC and MPS

The sum of MPC and MPS is equal to one. It can be proved as under:

MPC + MPS = 1

We know

$\Delta Y = \Delta C + \Delta S$

Dividing both sides by ΔY, we get

$$\frac{\Delta Y}{\Delta Y} = \frac{\Delta C}{\Delta Y} + \frac{\Delta S}{\Delta Y}$$

$$1 = MPC + MPS$$

$$\left[\because \frac{\Delta C}{\Delta Y} = MPC, \frac{\Delta S}{\Delta Y} = MPS\right]$$

MPC + MPS = 1 because total increment in income is either used for consumption or for saving.

Investment refers to the expenditure incurred on creation of new capital assets.

The investment expenditure is classified under two heads:

(i) Induced investment

(ii) Autonomous investment.

Induced Investment: Induced investment refers to the investment which depends on the profit expectations and is directly influenced by income level (only for reference).

Autonomous Investment: Autonomous investment refers to the investment which is not affected by changes in the Level of income and is not induced solely by profit motive. It is income inelastic.

Ex-Ante Savings: Ex-ante saving refers to amount of savings which all the household intended to save at different levels of income in the economy at the beginning of period. It is also known as planned savings.

Ex-Ante Investment: Ex-ante investments refers to amount of investment which all the firms plan to invest at different level of income in the economy at the beginning of the period. It is also known as planned investment.

Ex-Post Saving: Ex-post savings refer to the actual or realised savings in an economy during a financial year at end of the period.

Ex-Post Investment: Ex-post investment refers to the actual or realised investment in an economy during a financial year at the end of the period.

Equilibrium level of income is determined only at the point where AD = AS or S = I, .i.e. the flow of goods and services in the economy is equal to the demand for goods and services But it cannot always be at full employment level also as it can be at less than full employment.

Full employment is a situation when all those who are able and willing to work at prevailing wage rate, get the opportunity to work.

Voluntary unemployment is a situation where person is able to work but not willing to work at prevailing wage rate.

Involuntary unemployment is a situation where worker is able and willing to work at prevailing wage rate but does not get work.

Under employment is a situation where all those who are able to work at existing wage rates, are not getting jobs. It refers to that situation in the economy where AS = AD or S = I, but without fuller utilisation of labour force.

Investment multiplier (K) is the ratio of change in income (ΔY) due to change in investment ΔI.

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

Value of investment multiplier lies b/w 1 to infinitive.

Excess demand refers to a situation when aggregate demand exceeds aggregate supply corresponding to full employment.

Inflationary gap is the gap by which actual aggregate demand exceeds the level of aggregate demand required to establish full employment.

It measures the extent of excess demand.

Deficient Demand: When AD falls short of AS at full employment it is called deficient demand. In other words, AD < AS at the level of full employment. It is called deficient demand.

Deflationary gap is the gap by which actual aggregate demand is less than the level of aggregate demand required to establish full employment.

It measures the extent of deficient demand.

Methods to control excess demand or deficient demand:

1. Fiscal Measures or Fiscal Policy

a. Change in Tax

b. Change in Public expenditure

c. Change in Public borrowing

d. Deficit financing (Printing new notes)

2. Monetary Measures or Monetary Policy

a. Quantitative measures

i. Bank rate

ii. Cash Reserve Ratio

iii. Statutory Liquidity Ratio

iv. Open Market operation

b. Qualitative/Selective measures

i. Marginal requirement

ii. Rationing of credit

iii. Direct Action

iv. Moral Suasion

4. SHORT RUN EQUILIBRIUM & MULTIPLIER

Equilibrium level of income is determined only at the point where AD = AS or S = I, .i.e. the flow of goods and services in the economy is equal to the demand for goods and services But it cannot always be at full employment level also as it can be at less than full employment.

Full employment is a situation when all those who are able and willing to work at prevailing wage rate, get the opportunity to work.

Voluntary unemployment is a situation where person is able to work but not willing to work at prevailing wage rate.

Involuntary unemployment is a situation where worker is able and willing to work at prevailing wage rate but does not get work.

Under employment is a situation where all those who are able to work at existing wage rates, are not getting jobs. It refers to that situation in the economy where AS = AD or S = I, but without fuller utilisation of labour force.

Investment multiplier (K) is the ratio of change in income (ΔY) due to change in investment ΔI.

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

Value of investment multiplier lies b/w 1 to infinitive.

Excess demand refers to a situation when aggregate demand exceeds aggregate supply corresponding to full employment.

Inflationary gap is the gap by which actual aggregate demand exceeds the level of aggregate demand required to establish full employment.

It measures the extent of excess demand.

Deficient Demand: When AD falls short of AS at full employment it is called deficient demand. In other words, AD < AS at the level of full employment. It is called deficient demand.

Deflationary gap is the gap by which actual aggregate demand is less than the level of aggregate demand required to establish full employment.

5. DEFICIENT DEMAND & EXCESS DEMAND

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Deflationary gap is the gap by which actual aggregate demand is less than the level of aggregate demand required to establish full employment.

It measures the extent of deficient demand.

Methods to control excess demand or deficient demand:

1. Fiscal Measures or Fiscal Policy

a. Change in Tax

b. Change in Public expenditure

c. Change in Public borrowing

d. Deficit financing (Printing new notes)

2. Monetary Measures or Monetary Policy

a. Quantitative measures

i. Bank rate

ii. Cash Reserve Ratio

iii. Statutory Liquidity Ratio

iv. Open Market operation

b. Qualitative/Selective measures

i. Marginal requirement

ii. Rationing of credit

iii. Direct Action

iv. Moral Suasion

6. GOVERNMENT BUDGET AND ECONOMY

Budget is a financial statement showing the expected receipt and expenditure of Govt. for the coming fiscal or financial year.

Main objectives of budget are:

(i) Reallocation of resources.

(ii) Redistribution of income and wealth

(iii) Economic Stability

(iv) Management of public enterprises.

(v) Economic Growth

(vi) Generation of employment

There are two components of budget:

(a) Revenue budget

(b) Capital budget

Revenue Budget consists of revenue receipts of govt. and expenditure met from such revenue.

Capital budget consists of capital receipts and capital expenditure.

BUDGET RECEIPTS:

1. Revenue Receipts

A. Tax

a. Direct Tax

i. Income tax

ii. Corporate Tax

iii. Wealth and Property Tax

b. Indirect Tax

i. Value added Tax

ii. Service Tax

iii. Excise Duty

iv. Custom Duty

v. Entertainment Tax

B. Non-Tax

a. Commercial Revenue

b. Interest

c. Dividend, Profits

d. External Grants

e. Administrative Revenues

f. Fees

g. License Fee

h. Fines, Penalties

i. Cash grants-in-aid from foreign countries and international org.

2. Capital Receipts

A. Borrowing and Other liabilities

B. Recovery of Loans

C. Other receipts(Disinvestments)

Direct Tax: A direct tax is one whose burden cannot be shifted to others I.e. the impact and incidence of the tax is on the same person.ex- income tax, wealth tax, gift tax.

Indirect Tax: An indirect tax is one whose burden can be shifted to others or the impact and incidence of an indirect tax falls on different people. ex- excise duty, VAT, service tax.

Revenue Receipts:

(i) Neither creates liabilities for Govt.

(ii) Nor causes any reduction in assets.

Capital Receipts:

(i) It creates liabilities or

(ii) It reduces financial assets.

BUDGET EXPENDITURE:

1. Revenue Expenditure

(i) Neither creates assets

(ii) Nor reduces liabilities.

e.g., Interest Payment, subsidies etc.

Capital Expenditure:

(i) It creates assets

(ii) It reduces liabilities.

e.g., Construction of school building Repayment of loans etc.

Budget Deficit:- It refers to a situation when budget expenditure of a govt. are greater than the govt. receipts.

Budgetary Deficit: Total Expenditure > Total Receipts.

Revenue deficit: It is the excess of govt. revenue expenditure over revenue receipts.

Revenue Deficit: Total revenue expenditure > Total revenue receipts

Implications of Revenue Deficit are:

(i) A high revenue deficit shows fiscal indiscipline.

(ii) It shows wasteful expenditures of Govt. on administration.

(iii) It implies that government is dissaving, i.e. government is using up savings of other sectors of the economy to finance its consumption expenditure.

(iv) It reduces the assets of the govt. due to disinvestment.

(v) A high revenue deficit gives a warning signal to the government to either curtail its expenditure or increase its revenue.

Fiscal Deficit: When total expenditure exceeds total receipts excluding borrowing.

Fiscal Deficit: Total expenditures > Total Receipts excluding borrowing.

Implications of Fiscal Deficits are:

(i) It leads to inflationary pressure.

(ii) A country has to face debt trap.

(iii) It reduces future growth and development.

(iv) It increases liability of the government.

(v) It increases foreign dependence.

Primary Deficit: By deducting Interest payment from fiscal deficit we get primary deficit.

Primary Deficit: Fiscal deficit – Interest payments.

Implications of Primary Deficits are:

It indicates, how much of the government borrowings are going to meet expenses other than the interest payments.

Measures to correct different deficits:-

(i) Monetary expansion or deficit financing.

(ii) Borrowing from public.

(iii) Disinvestment

(iv) Borrowing from international monetary institution and other countries.

(v) Lowering govt. expenditure.

(vi) Increasing govt. revenue.

7. BALANCE OF PAYMENTS

The balance of payment is a comprehensive and systematic records of all economic transaction between normal residents of a country and rest of the world during an accounting year.

Accounts of Balance of Payments:

1. **Current Account:** The current account records export and import of goods and services and unilateral transfers.

2. **Capital Account:** It records of all such transactions between normal residents of a country and rest of the world which relates to sale and purchase of foreign assets and liabilities during an accounting year.

Components of Current Account	**Components of Capital Account**
1. Visible items (import and export of goods).	1. Foreign Direct investment.
2. Invisible items (import and export of services).	2. Loans.
3. Unilateral transfers.	3. Portfolio investment.
4.Income receipts and payments from and to abroad.	4. Banking capital transactions.
5. These are the transactions which do not affect the assets or liabilities position of the country.	5. These are the transactions which affect assets or liabilities position of the country.
6. It is a flow concept.	6.It is a stock concept.

Balance of trade is the net difference of Import and export of all visible items between the normal residents of a country and rest of the world.

Autonomous items are those items of balance of payment which is related to such transaction as are determined by the motive of profit maximisation and not to maintain equilibrium in balance of payments. These items are recorded as a first items before calculating deficit or surplus in balance of payment a/c.

These items are generally called 'Above the Line items' in balance of payment.

Accommodating item refers to transactions that take place because of other activity in Balance of Payment. These transactions are meant to restore the Balance of Payment identity. These items are generally called 'Below the Line items'.

Deficit of Bop Account: When total inflows of foreign exchange on account of autonomous transactions are less than total outflows on account such transaction then there is a deficit in Bop.