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Analysis address	mumtaz.dbuni@analysis.urkund.com

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Assam Don Bosco University Introductory Macro Economics
SYLLABI-BOOK MAPPING TABLE Macro Economics UNIT-I: Concept of Macro Economics, Interrelation between Micro and Macro Economics, Macro variable – Stock and Flow, Circular flow of income, Concept of National Income, Gross National Product (G.N.P.) and Gross Domestic Product (G.D.P.) National Income Accounting, National Income and Economic Welfare. UNIT-II: Classical theory of Employment, Keynesian theory of Employment Aggregate Demand Function and Aggregate Supply Function, Effective Demand, Propensity to consume, save and invest, Principles of Multiplier and Accelerator. UNIT-III: Investment Function and Marginal Efficiency of Capital (M.E.C.) Factors affecting investment Function, Keynesian theory of Liquidity Preference and Liquidity Trap, Discounting Rate. UNIT-IV: Money, Meaning and Functions, Stock of Money and its measures- M 1 , M 2 , M 3 , M 4 , Quantity Theory of Money - Cash Transaction and Cash Balance Approach, Inflation, Deflation and Recession - Definition, Causes and Effects of various segments of economy. UNIT-V: Bank - Meaning and types, Central Bank and its functions with special reference to Reserve Bank of India, Credit Control - Quantitative and Quantitative Methods, Objectives and limitations of Monetary Policy, Functions of Commercial Banks, Process of credit creation MUDRA and Jan Dhan Yojana. Unit-1: Introduction to Macroeconomics (Pages 3-46) Unit-2: Theory of Employment (Pages 47-89) Unit-3: Investment and Liquidity (Pages 91-111) Unit-4: Money (Pages 113-165) Unit-5: Banking and Credit Control (Pages 167-218)

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economics. Macroeconomics is the study of the economy as a whole. It

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Macroeconomics is the study of the economy as a whole.

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Macroeconomics is the study of the economy as a whole.

studies the nature, relationship and behaviour of aggregates and averages of economic variables. Macroeconomic issues assume a great significance in business decisions regarding future investment planning, productions planning, adoption of a new production technology, and merger and acquisition. It is, therefore, essential for business managers to have an understanding of the structure of the economy; how economy works;

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how the level of national income and employment is determined;

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how the level of national income and employment is determined;

how changes in saving and invest affect the economy; and how changes in government policies affect the economy and business environment of the country; what causes inflation or deflation; how inflation and deflation affect the business activities; and how exports and imports affect the domestic economy. The macroeconomics aspects of the economy that are often taken into account in business decisions having long- run implications constitute the subject matter of Macroeconomics . This book is written in a self-instructional format and is divided into five units. Each unit begins with an Introduction to the topic followed by an outline of the Unit objectives. The content is then presented in a simple and easy-to-understand manner, and is interspersed with Check Your Progress questions to test the reader's understanding of the topic. A list of Questions and Exercises is also provided at the end of each unit and includes short-answer as well as long-answer questions. The Summary and Key Terms section are useful tools for students and are meant for effective recapitulation of the text.
Introduction to Macroeconomics NOTES Self - Learning Material 3 UNIT 1 INTRODUCTION TO MACROECONOMICS Structure 1.0 Introduction 1.1 Objectives 1.2 Concept of Macroeconomics 1.2.1 Interrelation between Micro and Macroeconomics 1.2.2 Macrovariable: Stock and Flow 1.3 Circular Flow of Income 1.4 Concept of National Income, Gross National Product and Gross Domestic Product 1.5 National Income Accounting 1.6 National Income and Economic Welfare 1.7 Answers to 'Check Your Progress' 1.8 Summary 1.9 Key Terms 1.10 Self-Assessment Questions and Exercises 1.11 Further Reading 1.0 INTRODUCTION We begin our study of macroeconomics by having a look at how an economy works. An economy is a system of interrelated economic activities and economic transactions. Basic economic activities include production, exchange and consumption This unit presents a brief description of how goods and factor flows are generated and how an economy works in a systematic manner. To begin with, we will first give a description of circular flows in a simple economy consisting of only two sectors: (i) households and (ii) firms. The households have two characteristics: (a) they are owners of all factors of production and (b) they are consumers of all final goods and services. Firms, on the other hand, have two characteristics too: (

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a) they hire factors of production from the households and (b) they produce and sell their final products to the households.

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a) they hire factors of production from the households and (b) they produce and sell their final products to the households.

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a) they hire factors of production from the households and (b) they produce and sell their final products to the households.

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a) they hire factors of production from the households and (b) they produce and sell their final products to the households.

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a) they hire factors of production from the households and (b) they produce and sell their final products to the households.

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a) they hire factors of production from the households and (b) they produce and sell their final products to the households.

This model is then extended to include the government sector making it a 3-sector model. Finally, the model is extended further to include also the foreign sector (comprising only exports and imports, goods and services) to make it a complete circular flow model consisting of households, firms, government and foreign sector. 1.1

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OBJECTIVES After going through this unit, you will be able to: ?Explain the practical and

theoretical reasons for learning macroeconomics ?Discuss the limitations of macroeconomics
Introduction to Macroeconomics NOTES Self - Learning 4 Material ?Elaborate on the relationship between Micro and Macroeconomics ? Discuss the concepts of National income, gross national product, gross domestic product ?Explain circular flow of income ?Discuss the process of national income accounting ?Elaborate on the national income and economic welfare 1.2 CONCEPT OF MACROECONOMICS As in case of 'Economics as a science', there is no universally accepted definition of macroeconomics. What is important is not to define the subject of study precisely but to understand the nature and subject matter of the subject. This is what is attempted here. Macroeconomics is generally defined as 'the study of economy as a whole'. However, this definition does not bring out the nature of macroeconomics, nor does it indicate the subject matter of the study. Therefore, some economists have attempted to define macroeconomics according to their own perception of its subject matter. A look at some relatively comprehensive definitions of macroeconomics would give a broad view of what macroeconomics is about. Look at the following definitions. Gardner Ackley: Macroeconomics "concerns the over-all dimensions of economic life... More specifically,

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macroeconomics concerns itself with such variables as aggregate volume of an economy, with the extent to which its resources are employed, with size of

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macroeconomics concerns itself with such variables as aggregate volume of an economy, with the extent to which its resources are employed, with size of the national income, with the 'general price level'." Kenneth E Boulding: "Macroeconomics is the study of

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such variables as aggregate volume of an economy, with the extent to which its resources are employed, with size of the national income, with the 'general price level'."

the nature, relationships and behaviour of aggregates of economic quantities....

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Macroeconomics ... deals not with individual quantities as such, but aggregates of these quantities ... not with individual incomes, but the national income, not with individual prices, but with the price levels, not with individual output, but with the national output".

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aggregates of these quantities ... not with individual incomes, but the national income, not with individual prices, but with the price levels, not with individual output, but with the national output". J. M. Culburtson: "Macroeconomic theory is the theory of

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not with individual incomes, but the national income, not with individual prices, but with the price levels, not with individual output, but with the national output".

income, employment, prices and money". P. A. Samuelson: "

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Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

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Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

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Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

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Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

overall level of a nation's output, employment, prices, and foreign trade." Although these definitions are fairly comprehensive, they do not reveal the exact nature and scope of modern macroeconomics, nor do they fully capture its subject matter. Since "macroeconomics is [still] a young and imperect science", it is difficult to define it precisely. However, the definitions quoted above do give an idea of the central theme of theoretical macroeconomics, and this is what matters in economics. The central theme that emerges from the above definitions may be stated as follows. Macroeconomics is essentially the study of the behaviour and performance of the economy as a whole. More importantly, it studies

Introduction to Macroeconomics NOTES Self - Learning Material 5 the relationship and interaction between the 'factors or forces' that determine the level and growth of national output and employment, general price level, and the balance of payments positions of an economy . This definition too should be treated only as a working definition of macroeconomics. To comprehend better the subject matter of macroeconomics, look at the kinds of questions that macroeconomics seeks to answer. ?What determines the levels of economic activities, total output and employment in a country? ?How is the equilibrium level of national income determined? ?What causes fluctuations in the national output and employment? What determines the general level of prices in a country? ?What determines the level of foreign trade and trade balance? ?What causes disequilibrium in the balance of payments of a country? ?How do the monetary and fiscal policies of the government affect the economy and what economic policies can steer the economy on the path of growth? These are some major theoretical questions that macroeconomics seeks to answer. Why Study Macroeconomics With growing macroeconomic complexities and macroeconomic challenges, macroeconomics has emerged as the most challenging and fascinating branch of economic science. As Samuelson puts it, "... no area of economics is today more vital and controversial than macroeconomics." The importance of and interest in macroeconomics has increased tremendously over the past three decades for both practical and theoretical reasons. On the practical side , both developed and developing countries are constantly confronted with some or other kind of macroeconomic problems, e.g., recession and depression, unemployment, persistent inflation or stagflation, balance-of-payment deficits, outflow of capital, mounting debt burden or a country falling into debt trap, and so on. These problems have to be solved if eventual economic collapse like the Great Depression of 1930s or a near collapse of the Indian economy in 1990-91 has to be averted. Although economic catastrophe of this magnitude has not taken place over the past six decades, macroeconomic problems like intermittent recession, unemployment, inflation and increasing external debt burden continue to plague the economies. A reasonable solution to such problems has to be found because they have serious socio-political implications for the country in general and the government in particular. To look at the macroeconomic issues more closely, let us look at some major macroeconomic questions that may be asked in the context of the Indian economy. ?Why could Indian economy grow at only 3.4% p.a. in real terms during the period from 1950 to 1975 in spite of the government's planned development efforts to achieve an annual growth rate of 5-6 percent; what increased the

Introduction to Macroeconomics NOTES Self - Learning 6 Material growth rate to around 5% during the 1980s; and what factors are likely to push the growth rate up to 7-8 percent in the the 21st century? ?Why are there many people still unemployed in India despite seven decades of continuous efforts to provide jobs to unemployed labour force? ?Why does nearly 28% of India's population still subsists below the poverty line? ?Why had a high rate of inflation (10.6% p.a.) persisted in India during the first half of 1990s and why had inflation rate declined to 5-6 percent thereafter? ?Why did the Indian economy having achieved an annual average rate of 5.6% during the 1980s, suddenly sunk deep into an unprecedented economic crisis in 1990-91? ?Why has India's BOP been always in deficits until 1980 and what has improved its BOP position during the 1990s despite continued current account deficits? ?Why have

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fiscal and monetary policies of India failed to achieve their goals?

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fiscal and monetary policies of India failed to achieve their goals?

A reasonable answer to these and such other questions and a feasible and effective solution to such macroeconomic problems cannot be obtained through microeconomics because the behaviour of and the nature of relationship between economic aggregates or macro variables "cannot be obtained simply by generalising from the character and behaviour of individual components." It is therefore essential to understand the working of the economy and the mechanism of interaction between the 'factors and forces' that determine the level of aggregate production, employment, saving and investment, growth rate, demand for and supply of money, and international flows of goods, services and finances. As noted above, macroeconomics provides a theoretical framework for the analysis of these aspects of the economy. Theoretical models of macroeconomics provide guidance for ascertaining and collecting the relevant data and for analyzing data to find answer to the kind of macroeconomic issues listed above. Other Reasons for Studying Macroeconomics Study Apart from the reasons given above, there are other reasons which have increased the importance of macroeconomics and have given impetus to the growing interest of the economists in finding solution to macroeconomic issues. 1.Importance of Macroeconomic Issues: Macroeconomics is important because macroeconomic issues are important. Macroeconomic issues of a country need to be resolved effectively as they pertain to the economic fate of a country and its people in the world of today. As Samuelson has put it, "The political, social, and military fate of the nations depends greatly upon their economic success." The internal security, law and order situation, social harmony also depend to a great extent on the economic condition of the common man of a country. The macroeconomic issues have received increasing attention of the economists, politicians, governments, and Introduction to Macroeconomics NOTES Self - Learning Material 7 international bodies (IMF and WB) alike. This is perhaps the most important reason why macroeconomics has gained so much importance in recent years. 2.Growing Complexity of Economic System: The modern economic system has grown extremely complex due to (i) expanding horizons of insatiable human desire to consume more and better goods and services, (ii) increasing economic interaction between the nations and globalisation of economic activities, (iii) increasing international flows of capital, manpower and technology, (iv) growing interdependence of the economies, and (iv) growth of international economic unions and their effect on other nations. To cope with the problems arising out of the changing world economic order, a clear understanding of the economic system is an indispensable condition. The study of macroeconomics helps

the macro variables and the relationship between them requires identifying and measuring the forces that are both the cause and effect of the economic activities. Macroeconomics provides powerful tools to understand the working of the complex economic system. 3.Need for Government Intervention with the Market System: The need for government intervention with the market system and management of the economy by the government has arisen out of the failures of the market mechanism to ensure efficient allocation of resources, to achieve socially optimum production and distribution patterns of goods and services, and to bring stability in growth, employment, price levels and exchange rates. Economic history reveals that capitalist economies have often suffered from business cycles. These issues received a greater attention, as a matter of necessity, during the post-World War II period. The economists of the Keynesian tradition recommended government intervention in the market system to control, regulate and direct the economy with a view to achieving a sustainable high growth rate with a high rate of employment. While the government intervention with the market system has proved helpful in preventing business cycles and controlling inflation, it has created new kinds of problem like inefficiency, corruption, reducing growth rate, creating parallel economy, etc. These may be consequences of the misconceived and inappropriate economic policies of the government. Formulation of appropriate policies and their effective implementation requires a clear understanding of the economic system at the macro level. A very important purpose that macroeconomics serves is that it provides the logical framework for devising appropriate tools of intervention and for formulating suitable macroeconomic policies to direct and regulate the economy towards the desirable goals. Limitations of Macroeconomics In spite of its great merits and usefulness, macroeconomics has certain limitations. Some of its major limitations are described below. First , an important limitation of macroeconomics is that it ignores the structural changes in the

the behaviour of the aggregate variables
Introduction to Macroeconomics NOTES Self - Learning 8 Material may be misleading. For example, economic growth over time may lead to the conclusion that the economy is performing well and any intervention with the economy might prove counterproductive. But, this growth might be accompanied by such structural changes as excessive substitution of capital for labour resulting in labour unemployment and transfer of income from low-income to high-income sections, widening income disparities. Economic growth accompanied by growing income disparities would not be considered a healthy economic trend in the long run as it may ultimately limit the growth prospects. Besides, such a trend is socially undesirable. Similarly, a study of the general price level may show stable price situation in the country. Despite this price stability, however, there may be major sectoral changes in the price structure. Prices of agricultural products may be decreasing while prices of industrial products are increasing. The rise in the industrial prices is so compensatory, that the overall price level remains unchanged. But, such changes in price structure may be undesirable requiring government intervention and corrective measures. Second , macroeconomics deals with national aggregates and " aggregates are not a reality but a picture or approximation of reality ." The individual components of the aggregates are, in fact, the reality. The individual quantities are heterogeneous and have heterogeneous measures. The aggregation of heterogeneous quantities is beset with problems. A major problem in estimating the aggregates, e.g., national income, arises in respect of non-marketed goods and services. Often a large number of products and services does not have market value and are evaluated on the basis of a presumed values, i.e., their imputed value. This leads often to under- or over-estimation of the key aggregate values. The conclusion based on such data may be misleading. Third , some economists consider microeconomics only as an "intellectual attraction" without much practical use. In Hicks' opinion, "most of the 'macro' magnitudes which figure so largely in economic discussions (Gross National Products, Fixed—Capital Investment, Balance of Payments, Employment—and so on) are subject to errors and (what is worse) to ambiguities." These critical views, however, should not lead to the conclusion that macro- economics is of little use in real life economic situations. It adds a great deal to the understanding of the working of the economy and in formulation of macroeconomic policies. 1.2.1 Interrelation between Micro and Macroeconomics Before, we proceed, let us have a glance at how economists distinguish between microeconomics and macroeconomics as it help in comprehending the subject matter of the two branches of modern economics. The first distinction between the two branches of economics is made on the basis of the unit of study . As mentioned above, microeconomics studies economic behaviour of individual decision-making units (individuals, households and firms) and how price of an individual product is determined in the market. It analyses how an individual household decides on what to consume, how much of it to consume and how to allocate its total consumption expenditure on various goods
Introduction to Macroeconomics NOTES Self - Learning Material 9 and services so that its total utility is maximized; it analyses how individual firms decide on what to produce and how to price its product so that its total profit is maximized, given its resources. Also, microeconomics analyses the working of markets for individual goods or services and explains how individual prices are determined in the market. In addition, it explains how inter-firm and inter-industry shift of resources—labour and/or capital—affects the firm's and the industry's output. In simple words, microeconomics takes a microscopic view of economic system and studies how the system works at the micro level. According to Lerner, "Microeconomics consists of looking at the economy through a microscope, as it were, to see how the millions of cells in the body economic—the individuals or households as consumers, and the individuals or firms as producers—play their part in the working of the whole economic organism". In contrast, the unit of study in macroeconomics is the economy as a whole. Macroeconomics is concerned with the nature, relationship and the bebaviour of such economic aggregates as national income, total consumption expenditure, savings and investment, total employment, and the general price level. As Boulding has put it, "

Macroeconomics seeks to answer such questions as (a) how the level of aggregate production (GDP or GNP) is determined; (b) what determines the growth rate of an economy; (c) how the level of employment is determined; (d) how the general level of price is determined in an economy; (e) why some times price level rises at a high rate of 10-12 percent and at another at 5-6 percent; and (f) how government's monetary, fiscal and income policies affect the aggregate level of output, employment and prices. Difference in Basic Assumptions Another factor that distinguishes the two branches of economics is the basic assumption on which microeconomic and macroeconomic studies are based. Microeconomics assumes all the macro variables to be given. That is, it assumes the level of total production (national income), consumption, saving and investment, employment, and the general price level, etc. to remain constant. In contrast, macroeconomic treats them as variables. Instead, it assumes economic decisions of households and firms, prices of individual products to be given. Briefly speaking, what microeconomics treats as constants, macroeconomic treats them as variables and what macroeconomics treats as constants, microeconomics treats them as variables. Micro-Macro Paradoxes 1. The paradox is related to individual and aggregate savings and investments. If an individual saves and invests more, his/her income increases. But this is not true for the economy as a whole. The reason is if all the individuals with given incomes decide to save more and more, the
Introduction to Macroeconomics NOTES Self - Learning 10 Material consumption expenditure will decrease by the same amount. Decrease in consumption expenditure reduces the aggregate demand. This reduces the prospect for investment. The aggregate investment may even decrease which will reduce the level of aggregate income. 2. Another important paradox pertains to cash holding. If individual decides to hold a larger amount of cash, the sum of cash holding increases. But the stock of money remains the same for the economy as a whole. 3. The third paradox pertains to profit and wages. At micro level, one tends to accept the proposition that the distribution of national income between wage incomes and profits depends on the relative bargaining power of the labour and the employers. According to Boulding, however, it depends on "a combination of other factors, the most important of which are decisions of management to invest, i.e., to accumulate real assets, and the complex of the decision of the whole society about liquidity preference". Boulding concludes, "It is these paradoxes, more than any other factor, which justify the separate study of the system as a whole, not merely as an inventory or list of particular items". 1.2.2 Macrovariable: Stock and Flow Before we proceed to discuss macroeconomic theories, it will be useful to get acquainted with some of the basic concepts and approaches widely used in macroeconomic studies. (i) Stock and Flow Variables

Macroeconomics uses certain economic aggregates, called macroeconomic variables , to assess the performance and to analyze the behaviour of an economy. Macroeconomic variables that figure in macroeconomic studies are generally grouped under (i) stock variables , and (

ii) flow variables . Another kind of variables used in macroeconomic analysis are called rates . A brief description of stock and flow variables is given below. The stock variables refer to the quantity of a variable given at a point in time, e.g., on 31st March, 2005 or 31st December, 2006. In other words, the variables that are measured with reference to a point in time are stock variables. For example, the water stored in a tank at a point in time is a stock variable and number of books in a library on a particular date is a stock variable. In economics, the stock of capital in a country, the number of persons employed, the total money supply, all at a point in time, are some examples of stock variables. The flow variables , on the other hand, are the variables that are expressed per unit of time, e.g., per hour, per week, per month, or per year, e.g., GDP, consumption, saving, investment, exports, imports, etc. To understand the distinction between stock and flow variables, see the following examples. The water accumulated in a lake is a stock variable but the quantity of water flowing in or flowing out it per unit of time (per day or per week) is a flow variable. Monthly provision of sugar in a household, i.e., the quantity of sugar stocked for monthly consumption, is a stock variable and quantity of sugar Introduction to Macroeconomics NOTES Self - Learning Material 11 consumed per day is a flow variable. A fixed deposit with a bank is a stock variable and interest earned on the deposit, e.g., monthly interest income, is a flow variable. Accumulated investment in plant, building, machinery, stocks, etc. is a stock variable and the annual return from such investments is a flow variable. The stock and flow variables often used in macroeconomic studies are listed in Table 1.1. Table 1.1 Stock and Flow Variables Stock Variables Flow Variables Stock of Capital (K) Supply of Money (M) Business Inventories (BI) Accumulated savings Labour force Total employment Gross National Product (NP) Consumption Expenditure (C) Savings (S) and Investments (I) Exports (X) and Imports (M) Change in inventories Government revenue (R) Government expenditure (G) Some flow variables are functionally related to their stock counterpart and vice versa. For example, 'investment' is stock and flow variables the flow counterpart of 'stock of capital' and 'change in inventories" is the flow counterpart of 'inventories'. It is important to note that the classification of stock and flow variables, as given above, is a matter of convenience and practice. Conceptually, it is difficult to make an all-purpose classification of macroeconomic variables between stock and flow. For, given the purpose of analysis, a flow variable can be interpreted as a stock variable and vice versa . For example, national income is a flow variable, but it can be treated as stock for the year of reference. Similarly, exmployment is a stock variable, from head-count point of view, but from the view point of work effort in terms of man-hours, it can be treated as a flow variable. Furthermore, macroeconomic variables are open to different interpretations. Therefore, it is difficult to make a clear distinction between the two kinds of variables. This causes a 'dangerous' confusion with regard to stock and flow variables. According to Gardner, "... almost no other single source of confusion is more dangerous in economic theory—not only to beginners, but sometimes to advanced students in the field." He cites some examples of certain variables which are open to such confusion. 'Money is stock variable' but when exchanged for goods, it become 'flow'; 'income is flow, wealth [accumulated income] is stock'; 'saving is a flow' but 'accumulated saving' is a stock; and 'investment is a flow' but accumulated investment 'is a stock'. He has suggested, "Upon encountering any variable, the student should spend a moment determining for himself whether it is a stock, a flow, or a ratio concept. ... Much confusion will be saved by this exercise." Check Your Progress 1. Mention working definition Macroeconomics. 2. What is stock and flow variables?
Introduction to Macroeconomics NOTES Self - Learning 12 Material 1.3 CIRCULAR FLOW OF INCOME National income, output, and expenditure are generated by the activities of the two most vital parts of an economy, its households and firms, as they engage in mutually beneficial exchange. Income (Y) in an economy flows from one part to another whenever a transaction takes place. New spending (C) generates new income (Y), which generates further new spending (C), and further new income (Y), and so on. Spending and income continue to circulate around the macro economy in what is referred to as the circular flow of income. The circular flow of income forms the basis for all models of the macro-economy, and understanding the circular flow process is key to explaining how national income, output and expenditure are created over time. Circular Flow in a Two-Sector Economy We begin with the description of circular flows in a simple economy consisting of

only two sectors, viz., households and firms, and there is no government and no foreign trade.

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only two sectors, viz., households and firms, and there is no government and no foreign trade.

In our simple economy model, households are assumed (i) to own all the factors of production, (ii) to consume all final goods and services and (iii) their income consists of wages, rent, interest and profits. The business firms, on the other hand, are assumed (i) to

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hire factors of production from the households; (ii) they produce and sell goods and services to the households; and (

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hire factors of production from the households; (ii) they produce and sell goods and services to the households; and (

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hire factors of production from the households; (ii) they produce and sell goods and services to the households; and (

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hire factors of production from the households; (ii) they produce and sell goods and services to the households; and (

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hire factors of production from the households; (ii) they produce and sell goods and services to the households; and (

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hire factors of production from the households; (ii) they produce and sell goods and services to the households; and (

iii) they do not save, i.e., there is no corporate saving. The working of and circular flows of incomes and expenditure in the two- sector model are illustrated in Figure 1.1. As the figure shows, factors of production flow from the households to the factor market and from the factor market to the firms. As shown in the figure, goods and services produced by the firms flow from the firms to the households. The arrows showing factor and product flows make the product flows or real flows. Note that real flows take a circular path. Fig. 1.1 The Circular Flows of Goods and Money in a Simple Economy Product flow generates money flow. As the figure shows, money flows from the

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firms to the households in the form of factor payments as wages, interest, rent and

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firms to the households in the form of factor payments as wages, interest, rent and

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firms to the households in the form of factor payments as wages, interest, rent and

dividends. Factor payments take the form of household incomes.

Introduction to Macroeconomics NOTES Self - Learning Material 13 Households spend their incomes on goods and services they consume. As a result, money incomes flow

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from the households to the firms in the form of payments for goods and services.

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from the households to the firms in the form of payments for goods and services.

Thus, money paid by the firms as factor payments flows back to the firms as payments made by the households for goods and services. This makes the circular flow of money. Note that product and money flows make the circular flows in the economy and that products and money flow in opposite directions. These flows represent the working of the simple economy. An important feature of product and money flows is that the value of real flow equals the money flow. This equality results from the fact that factor payments are equal to household incomes and since households spend their total income on consumer goods and services, household expenditure equals the total receipts of the firms, which equals the value of the output. These equalities can be summarized in the form of identities as follows. In the final analysis, household incomes ? factor payments ? the money value of output. This identity holds so long as households spend their total income, i.e., households do not hoard any part of their income, and firms spend their total receipts on hiring factors of production from the households. The Effect of Withdrawals and Injections The product and money flows shown in Figure 1.1 assume that there are no withdrawals from and injections into the economy. Withdrawals means withholding money incomes as idle cash balance. This withholding is not 'saving' for savings are returned to the circular flows in the form of purchase of capital goods (investment). Withdrawals are also called leakages . Injection, on the other hand, means money expenditure in addition to factor incomes. In reality, however, there are withdrawals from and additions to the circular flows. Let us look at the forms and nature of withdrawals and injections. In our two-sector model, a withdrawal is an amount set aside by the households and/or by the firms, not to be spent on the goods and services over a period of time. For example, if households set aside a part of their current income as a provision for old age or as security against the loss of job, etc., it is called a withdrawal. It is important to note that a withdrawal is not a saving. For, savings are ultimately returned to the circular flows in the form of investment expenditure. Likewise, firms may withhold a part of their sales revenue and not return it to the circular flows if they anticipate depression. Withdrawals reduce the volume of the circular flow. Injections , on the other hand, are the amount that is spent by the households and/or firms in addition to their current incomes generated within the regular economy. Injections may be made by the households in the form of spending past savings or hoardings. Injection by the firms may take the form of spending their accumulated savings. Firms may inject money into the economy by borrowing from households. Injections increase the size of the flow. Circular Flows of Product and Money in a Three-Sector Economy This section presents circular flows in a three-sector model. A three-sector model is created by adding the government sector to the two-sector model. The inclusion

Introduction to Macroeconomics NOTES Self - Learning 14 Material of the government into the model brings in the government's economic role and the effect of its fiscal operations on the circular flows. For simplicity sake, however, we will consider only three kinds of monetary flows between the government and the rest of the economy, viz., (i) direct taxes on both households and firms, (ii) government expenditure, (iii) transfer payments and subsidies. These fiscal operations of the government have different kinds of effects on the circular flows of goods and money flows. The real and money flows in a three-sector model are shown in Figure 1.2. Note that in this modified figure, 'factor market' is placed in the centre to make place for the 'government sector' at the top. In Figure 1.2, real and money flows between the households and firms (or business sector) are the same as shown in Figure 1.1. Let us now look at the real and money flows between the government on one hand and households and firms on the other. Fig. 1.2 Real and Money Flows in a Three-Sector Model As Figure 1.2 shows, a part of the household incomes flows to the government in payment of taxes. The government spends a part of its tax revenue as 'factor payments' to the households, i.e., on purchase of factor services (labour and private property) and a part in the form of transfer payments, as pension and food subsidy, etc. These flows make money flow between the households and the government. As regards the real flows, factors of production move from the households to the government and social services (schools, hospitals, police, roads, etc.) flow from the government sector to the households. These flows make the real flows. Thus, a part of household resources (real) and money incomes keep

Introduction to Macroeconomics NOTES Self - Learning Material 15 circulating between the house-holds and the government. Note that the two flows need not be equal. Similar flows take place between the government and the firms. Firms pay a part of their incomes as taxes to the government. In return, the government pays back a part of its tax revenue in the form of payments for purchases from the firms and a part as subsidies. This makes money flow between households and firms. The flow of goods and services from firms to government makes the real flow. It may be noted at the end that taxes are withdrawals from the circular flows and government expenditure is an injection into the income stream. The transfer payments by government (e.g., old age pension, subsidies, unemployment allowance, etc.) are injections to the circular flows. Circular Flows in a Four-Sector Model: A Model with Foreign Sector In this section, we describe circular flows of goods and money in a four-sector model. Four-sector model is formed by adding foreign sector to the three-sector model. Foreign sector consists of two kinds of international economic transactions: (i) foreign trade, i.e., export and import of goods and services and (ii) inflow and outflow of capital. International transactions and the consequent flows of goods and money make a complex system. For simplicity sake, however, we assume that foreign sector consists only of exports (X) and imports (M) of goods and services and that households export only labour but import goods and non-labour services. The circular flows of goods and money in a four-sector model are illustrated in Figure 1.3. In this figure, the internal flows of goods and money (i) between households and firms, (ii) between households and government and (iii) between firms and government are the same as shown in Figure 1.2. We will, therefore, concentrate on the flows of goods and money (i) between households and the rest of the world, (ii) between domestic firms and the rest of the world and (iii) between the government and the rest of the world. In Figure 1.3, 'foreign sector' is shown at the bottom of the figure. As mentioned above, foreign sector consists of exports from and imports to the domestic economy by (a) households, (b) firms and (c) government. As shown in the figure, households export only manpower (labour). In return, they receive foreign remittances. But they import goods and services for which they make payments. The inflows and outflows pertaining to households need not be equal. Firms, on the other hand, are shown to import and export both goods and services. So is the case with the government. The government sector exports and imports both goods and services. Let us look at the consequences of exports and imports on the volume of circular flows. Exports (X) from any sector make goods and services flow outside the domestic economy and make money (foreign exchange) flow into the domestic economy in the form of 'receipts from export'. Exports make foreign incomes

Introduction to Macroeconomics NOTES Self - Learning 16 Material flow into the domestic economy. Similarly, imports (M) cause inflow of goods and services and outflow of money converted in foreign exchange. This means outflow of domestic income to foreign countries. Another flow is generated by the 'export of manpower' by the households. The export of manpower brings in ' foreign remittances ' in terms of foreign exchange. Foreign exchange converted in domestic currency makes another inflow of income. These inflows and outflows go on continuously so long as there is foreign trade and export of manpower. Savings Investment Fig. 1.3 Circular Flows in Four-Sector Model So far as the effect of foreign trade on the magnitude of the overall circular flows is concerned, it depends on the trade balance, defined as X – M. If X < M, it means inflow of foreign income is greater than its outflow or there is net gain from foreign trade. This increases the magnitude of circular flows of income and expenditure. By the same logic, if X > M, it decreases the magnitude of circular flows. And, if X = M, inflow and outflows of incomes are equal. This leaves the volume of circular flows unaffected.

Introduction to Macroeconomics NOTES Self - Learning Material 17 1.4 CONCEPT OF NATIONAL INCOME, GROSS NATIONAL PRODUCT AND GROSS DOMESTIC PRODUCT The concept of national income is very important in macroeconomic accounting and theory. While for an individual, his income during any given period of time largely consists of the earnings which he receives from his participation in the productive activities carried on in the economy, national income is the aggregate of all those individuals' earned incomes who are residents of the country. The nationals of a country earn their incomes by offering either their labour services or the use of their land, capital and enterprise in the productive processes. The definition of national income links income with production or economic activity in the economy. Thus, from the national point of view what is important is the income earned by the nationals of a country by undertaking the productive services. In other words, corresponding to the factor incomes there is the counterpart production of goods and services which represents the manifold economic activities undertaken on the part of input owners or factors of production. Thus, while for an individual his entire money receipts during any given period of time are his money income, from the macroeconomic point of view, such money receipts will be included in the national income only if these have been earned by the individual during that time period, i.e., if the individual has engaged himself in the productive activity to earn that income. For example, a man may have received income in the form of gifts or transfer receipts from other individuals, business firms and government. Although such money receipts are rightly regarded as his income by an individual, these will not form a part of the national income because there has been no corresponding economic activity reflected in the production of goods and services against such money receipts in the economy. Here, what one man has gained by way of transfer receipts, another man has lost by way of transfer payments. Unless the transfer of money also involves the exchange of the productive services, it will not be counted as income from the macroeconomic point of view. In fact, income may be earned without involving any transfer of money. For example, in the case of subsistence farming, income is earned without involving any money payment. Similarly, where farm labour is paid in kind for its services rendered on the farm, income is earned without involving any money transfer. In the primitive backward communities, productive activities are carried on without involving the use of money. In ancient times, goods were produced and consumed through the clumsy barter system. Households possess different kinds of property the services of which accrue to their owners. Such services should, therefore, be included in the national income although their inclusion in the national income presents many formidable problems. In deciding whether or not individual or personal income should be included in the national income or product, the appropriate question to be answered is: Is the income received by an individual the payment for some work done by him? If the answer is 'yes', it should be included in the national income, otherwise not. In other words, in order to be included in the national

Introduction to Macroeconomics NOTES Self - Learning 18 Material income, a money receipt or payment should involve a quid pro quo in the form of rendering the productive services on the part of the person receiving the money payment. National income is, therefore, the aggregate of individuals' incomes excluding transfer receipts or payments. The logic behind not including the transfer payments in the national income and product accounts is that these receipts do not have their counterpart in the form of current economic activities embodying the production of goods and services in the economy although these are part of the income of the personal or household sector and have to be added in deriving the personal income. Also excluded from the national income are the capital gains made (or losses suffered) by the individual or institutional asset-holders because such capital gains (or losses) do not represent any productive activity in the economy. Apart from excluding the transfer receipts and capital gains from national income, any reasonable definition of national income must provide for the depreciation or capital consumption allowance considered necessary to maintain the economy's total capital stock intact. If a part of an individual's capital assets is consumed during the process of income earning, his total earnings are not his net earnings because a portion of his total earnings must be set aside to provide for the replacement of the depreciated capital assets failing which the individual's earning capacity in the future will diminish. In this respect, what is true of an individual is also true for the economy as a whole. Thus, the definition of national income should allow for capital consumption allowance. Since national income

which are receipts in the hands of factor owners and indirect taxes (net of government subsidies, if any) from the money value of the final goods and services calculated at the market price. The rationale behind excluding these different items from the national income is that any component of the market price which does not represent the earnings of the factors of production generated in the production processes should not be included in the national income. It is, therefore, obvious that business transfer payments, indirect taxes and capital depreciation which must be included in the total cost of production for calculating the market prices of goods and services are not factor cost of production (factor income) and do not, therefore, represent a part of the national income. Consequently, these items must be deducted from

in order to arrive at the national income of that period. In brief, national income is the aggregate of the (i) wages and salaries, including supplements thereto (without deducting taxes and social security contributions); (ii) net income received from rents and royalties; (iii) income received from interest; and (iv) profits, whether earned by the corporate or non-corporate private business sector before deducting the income-tax. National income can also be calculated according to the sector of origin of income in the economy. Wages, salaries and supplements thereto are paid by business firms, by governments, by non-profit private institutions, by households, by foreign residents, firms and organizations. Each one of these sectors may be further
Introduction to Macroeconomics NOTES Self - Learning Material 19 subdivided. For example, the government sector could be divided into Central government, state governments and local self government bodies, such as the municipal and district boards, town area committees, cantonment boards, etc. National income (NI) is defined as the total income earned by the people of a country through their ownership of resources used in the production of final goods and services during a specific period of time, i.e., usually one year. Gross Domestic Product (GDP)

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the total market value of all final goods and services produced in

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the total market value of all final goods and services produced in

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market value of all final goods and services produced in the country within a specific time period,

i.e., usually one year. Though national income is created by the production of GDP, the value of production does not necessarily result in earned income. Therefore, national income can be generated from (GDP) after making certain adjustments. Related totals: GDP, NDP, GNP, NNP Concept of GDP Of the various measures of national income used in national income analysis, GNP is the most important and widely used measure of national income.

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It is the most comprehensive measure of the nation's productive activities. The GNP is defined as the value of all final goods and services produced

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It is the most comprehensive measure of the nation's productive activities. The GNP is defined as the value of all final goods and services produced

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GNP is defined as the value of all final goods and services produced

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GNP is defined as the value of all final goods and services produced during a

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is defined as the value of all final goods and services produced

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is defined as the value of all final goods and services produced

specific period, usually one year,
plus incomes earned abroad by the nationals minus incomes earned locally by the foreigners. The GNP so defined is identical to the concept of gross national income (GNI). Thus, GNP = GNI. The difference between the two is only of procedural nature. While GNP is estimated on the basis of product- flows, GNI is estimated on the basis of money income flows, (i.e., wages, profits, rent, interest, etc.). Concept of National Product In dealing with the concept of national product , we should distinguish between its gross and net variants. Moreover, it must also be explained that there is a distinction between national product and domestic product. National product, like national income, is a flow concept.

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It can be defined as the total output of final goods and services produced by the nationals

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defined as the total output of final goods and services produced by the

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defined as the total output of final goods and services produced by the

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defined as the total output of final goods and services produced by the

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defined as the total output of final goods and services produced by the nationals or residents of a country

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defined as the total output of final goods and services produced by the nationals or residents of a country

acting in their roles as factors of production during any given period of time, say in one year. Since the total number and

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the amount of goods and services that an economy produces during

the year is enormous, seemingly like 'Pandora's box,' it is customary to define the national product in terms

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of the total money value of the final goods and services produced by the residents of a country.

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of the total money value of the final goods and services produced by the residents of a country.

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of the total money value of the final goods and services produced by the residents of a country.

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the total money value of the final goods and services produced by the residents of a country.

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the total money value of the final goods and services produced by the residents of a country.

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value of the final goods and services produced by the residents of a

National product may, therefore,
be
defined

70% **MATCHING BLOCK 86/683** SA 17.4.23 Macroeconomiics(2).doc (D164309062)

as the total money value of all the final goods and services produced by the residents of a country during

69% **MATCHING BLOCK 84/683** W

the total money value of all the final goods and services produced by the residents of a country

77% **MATCHING BLOCK 87/683** SA 4-PRINCIPLES OF MACRO--GE Eco(Hons.) Sem-II SL ... (D143600893)

the total money value of all the final goods and services produced by the residents of a country during any given period of time,

77% **MATCHING BLOCK 88/683** SA economic_environment_for_business - Copy.docx (D143644113)

the total money value of all the final goods and services produced by the residents of a country during any given period of time,

62% **MATCHING BLOCK 89/683** SA Original_Macroeconomics-amp-Business-Environme ... (D117056979)

final goods and services produced by the residents of a country during any given period of time, usually one year .

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final goods and services produced by the residents of a country during any given period of time, usually one year .

To avoid the problem of double counting, national product may either be evaluated by multiplying the final goods and services by their market prices or by adding the values imparted to the intermediate goods and services by each stage or process of production. The important thing to remember in connection with the concept of national product is that it includes all those goods and services which are the result of the economic activities (productive services) of the residents or nationals of a country. It, therefore, includes even those goods and services which are produced by the

Introduction to Macroeconomics NOTES Self - Learning 20 Material residents of a country outside the geographical boundaries of that country, i.e., it includes the value of the productive services rendered by the nationals of a country outside the country in foreign countries. At the same time, it excludes the share of the foreigners' services in the total product raised within the economy. For example, the profit and interest income earned by the Birla brothers from their paper mill established in Nigeria will be included in India's national product while that portion of the total product raised in India which represents (in the form of tangible goods and services) the productive activities of the Germans, Americans and other foreign nationals will be excluded from India's national product. It is, therefore, obvious that the concept of national product is broader than the concept of domestic product which focusses attention only on the total output produced during any given time period (without bothering about who produced or raised it) within the geographical or territorial limits of the economy. In order to derive the national product from the domestic product, we must deduct from the domestic product the value of that part of the domestic product which represents the productive activities of the foreigners and add to it the value of the product raised by the nationals of the country outside the geographical limits of the economy, i.e., abroad. However, both the national product and domestic product are flow concepts. The relationship between the gross and net national product and the gross and net domestic product can be shown as below. Gross National Product ? Gross Domestic Product + Exports – Imports GNP? GDP + (X – M); and Net National Product ? Net Domestic Product + Exports – Imports NNP? NDP + (X – M) Only in the case of a closed economy—having no economic transactions with the outside world so that both the exports and the imports of the economy are zero—will the national product be equal to the domestic product. National product is gross or net.

during any given period of time by the residents of a country. The total output of final goods and services consists of the consumption and capital goods. However, the entire total output of new capital goods does not represent net increase in the capital stock (production potential) of the economy. A part of the total output or production of new capital goods is consumed in replacing the economy's existing capital stock consumed during the process of production of the final goods and services. Consequently, only a part of the total output of new capital goods represents a net increase in the economy's capital stock, i.e., net investment or capital formation. Net national product (NNP) is, therefore, the total output of consumer goods plus the net increase in the economy's total capital stock– production of new capital goods in excess of the replacement of the depreciated capital goods during any given period of time. In other words, the net NNP is equal to the output of consumer and government goods plus net investment in the economy during any given period of time.

Introduction to Macroeconomics NOTES Self - Learning Material 21 The difference between the GNP and the NNP follows from the exclusion and inclusion of capital depreciation or replacement investment. NNP is the residual gross national product after capital consumption allowance (CCA) is allowed. In other words, while the
gross

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national product is the total money value of the total final goods and services produced by the residents of a country

59% **MATCHING BLOCK 98/683** SA slm business eco macro - complete.docx (D44840960)

national product is the total money value of the total final goods and services produced by the residents of a country

62% **MATCHING BLOCK 99/683** SA 4-PRINCIPLES OF MACRO--GE Eco(Hons.) Sem-II SL ... (D143600893)

is the total money value of the total final goods and services produced by the residents of a country during any given time period,

62% **MATCHING BLOCK 100/683** SA economic_environment_for_business - Copy.docx (D143644113)

is the total money value of the total final goods and services produced by the residents of a country during any given time period,

77% **MATCHING BLOCK 101/683** SA BA IInd semester EC103 final2 AMU.docx (D142429509)

goods and services produced by the residents of a country during any given time period, which is usually

77% **MATCHING BLOCK 102/683** SA BA IInd semester EC103 final2 AMU.docx (D142326393)

goods and services produced by the residents of a country during any given time period, which is usually

taken as one year, before allowing for the replacement of the economy's capital equipment worn out in the process of production,

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the net national product is the total money value of all these final goods and services after providing for

65% **MATCHING BLOCK 107/683** W

the net national product is the total money value of all these final goods and services after providing for

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national product is the total money value of all these final goods and services

78% **MATCHING BLOCK 105/683** SA MEBE.pdf (D113066356)

national product is the total money value of all these final goods and services

national product is the total money value of all these final goods and services

product is the total money value of all these final goods and services

the maintenance of economy's total capital stock. Net national product can be derived by deducting from the gross national product capital consumption allowance. Statistically, the estimation of the gross national product is more accurate than the estimation of the NNP because depreciation of capital, i.e., the physical wear and tear and obsolescence of capital equipment is extremely difficult to estimate with perfect accuracy. Although the national product statisticians have made different estimates regarding the rate of depreciation of the economy's capital stock, nevertheless the degree of accuracy of these estimates is difficult to assess. Importance of Gross National Product (GNP) Gross national product (GNP) estimates enable the economists to analyse the overall performance of an economy. The usefulness of the GNP as a tool for analysing the aggregate performance of an economy both over the short period and the long period can be illustrated by the means of two examples. First, with the help of the GNP estimates it is possible to measure the performance of an economy over time by comparing the GNP of one time period with that of the other. Thus, the growth of the GNP over time tells us that the economic performance of the nation has been steadily improving over time. Estimates of the gross national product can also be used for analysing changes in the total purchases which are needed to ensure the maximum level of aggregate output in the economy. For example, consider the hypothetical Indian economy in which the final goods and services valued at 2,000 crore have been sold during 2010. A survey is made of country's total labour force and capital resources which shows that only 80 per cent of the country's total available labour force and capital resources were employed to produce these goods and services. An additional output of the final goods and services worth 500 crore could have been produced had the labour and capital been fully employed in the economy. This estimation furnishes the basis for determining one of the requirements for obtaining the maximum output of goods and services in the economy. Either the total money purchases should be 500 crore higher (prices remaining unchanged) in order to induce the entrepreneurs to produce the additional potential output of goods and services for which the necessary inputs are available in the economy or the general price level should fall by 20 per cent to enable the full employment output to be sold out with the existing total money supply in the economy. It is, therefore, obvious that the GNP estimates furnish us with an overall picture of the level and the rate of change of the aggregate economic activity in the economy. These estimates tell us about the goods
Introduction to Macroeconomics NOTES Self - Learning 22 Material and services which are being produced with the economy's total resources and the uses to which the total output of goods and services is being put. National product or income estimates also serve as significant indicators of the economic prosperity of a nation. Ceteris paribus , a higher national income means the availability of more goods and services in larger quantities which with a given population would mean higher per capita income. National income estimates by sector-of-origin furnish us with the important clues about the structure of the economy and the relative importance of different sectors in the economy based upon the contribution of each sector to the national product. Their comparison over different time periods shows the structural changes that have taken place in the economy through time. It is on the basis of the origin of national product in the different sectors of an economy that some economies are called agricultural economies while some others are labelled as the industrial economies or the exports-oriented economies. Estimates of the the national income and product also furnish us with meaningful information about the functional disribution of the national income and product which is very important for the taking of correct policy decisions bearing upon the community's economic welfare.

Gross National Product (GNP); Net National Product (NNP); National Income (

NI) and Other Related Macroeconomic Concepts Having discussed the meaning and importance of the

gross national product (GNP), net national product (NNP), national income (NI)

gross national product (GNP), net national product (NNP), national income (NI)

and other related macroeconomic concepts, it is easy to derive or compute the value of one aggregate economic variable from that of the other since there is a chain-relationship between the different aggregate income and product concepts. This relationship between the different related macroeconomic concepts can be explained in the given table. (crore) Gross National Product (GNP) Measured at the Market Price 500 Minus Capital Consumption Allowance (CCA) 50 EqualsNet National Product (NNP) Measured at the Market Price 450 Minus Indirect Business Taxes 50 Business Transfer Payments 10 Current Surpluses of Government Enterprises 15 Plus Government Subsidies 25 EqualsNational Income (NI) 400 Minus Undistributed Profits 30 Profits Tax 5 Employers' Conributions for Social Insurance 5 Employees' Contributions for Social Insurance 5 Plus Government Transfer Payments to Persons 15 Business Transfer Payments 8 Net Interest paid by Government 5 Interest Paid by Consumers 2 EqualsPersonal Income (PI) 385 Minus Personal Taxes (T p) 35 EqualsDisposable Personal Income (DPI) 350
Introduction to Macroeconomics NOTES Self - Learning Material 23 Minus Personal Saving (S p) 50 EqualsPersonal Outlays (PO) 300 In other words, NNP = GNP – CCA National Indirect Business Current Government Income (NI) = GNP – CCA + Business + Transfer + Surpluses of – Subsidies Taxes Payments Government Enterprises Personal National Undistributed Profits Employers' Income = Income – Profits + Tax + Contributions for + (PI) (NI) Social Security Insurance Employees' Government Business Net Interest Interest Contribu- – Transfer – Transfer – Paid by – Paid by tions for Payments Payments Government Consumers Social Security Insurance Disposable Personal Personal Personal = Income (PI) – Taxes (T P) Income (DPI) Disposable Personal = Personal – Personal Outlays (PO) Income (DPI) Saving (S P) The most important relationship between the national product and income concepts is the relationship between the three macroeconomic variables of the

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gross national product (GNP), net national product (NNP) and national income (NI)

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gross national product (GNP), net national product (NNP) and national income (

which has been shown in Figure 1.4. Transfer Payments Fig. 1.4 GNP; NNP and National Income (NI) Relationship
Introduction to Macroeconomics NOTES Self - Learning 24 Material Next in importance to the concepts of the GNP; NNP and national income (NI) is the concept of personal income which is the current income of persons or households derived from all sources. Unlike the three measures of national product (GNP, NNP and NI), personal income is not a correct measure of the national product because it includes certain items which do not represent economic activities and excludes certain other items which represent economic activities on the part of persons. In other words, various 'transfer payments' are included in the personal income while the deductions made from the national income on account of profits tax, undistributed corporate profits, social security contributions, etc., which represent persons' economic activities, are excluded from personal income. Personal income is, therefore, derived by deducting from the national income that part of it which is not paid to persons and by adding to that part of the national income which persons receive from those sources which do not form part of the national income. The relationship between the national income, personal income, disposable personal income and personal outlays has been shown in Figure 1.5. A significant fact brought out from these relationships is that the estimates of net national product calculated at the unit factor cost of production and those of the national income are identical. In other words, net national product calculated at the unit factor cost of production and national income are identical macroeconomic concepts. From this, it also follows as a corollary that the gross national product equals the national income plus capital stock's depreciation in a simple economy where the market price equals the factor cost of production per unit of output. Expressed differently, in such a simple economy—in which the government neither levies indirect taxes nor gives subsidies to business firms and also does not run public enterprises so that there is no problem of the current surpluses of government enterprises—the market price of final goods and services will not be different from the unit factor cost of production of such goods and services. Consequently, the net national product multiplied by the market price index will be equal to the sum total of the factor incomes earned in the processes of production. Furthermore, in such a simple economy the total expenditure incurred on the purchase of the net national product will also be equal to the national income. For this simplified economy, the fundamental income-product identity can be expressed as follows: National ? Net National ? Expenditure Incurred on Income Product Net National Product From the above identity relationship is derived the following identity relationship. National + Capital ? Gross National ? Expenditure Incurred on Income Consumption Product Gross National Product Allowance

Introduction to Macroeconomics NOTES Self - Learning Material 25 Fig. 1.5 National Income (NI); Personal Income (PI); Disposable Personal Income (DPI); Personal Saving (S P); Personal Qutlays (PO) Relationship Check Your Progress 3. What are the four components of national income? 4. What is GNP? 5. What is the difference between GNP and GNI? Introduction to Macroeconomics NOTES Self - Learning 26 Material 1.5 NATIONAL INCOME ACCOUNTING

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For measuring national income, the economy through which people participate in economic activities, earn their livelihood, produce goods and services and share the national products is viewed from three different angles. (1) The national economy is considered as an aggregate of producing units combining different sectors such as agriculture, mining, manufacturing and trade and commerce. (2) The whole national economy is viewed as a combination of individuals and households owning different kinds of factors of production which they use themselves or sell factor-services to make their livelihood. (3) The national economy may also be viewed as a collection of consuming, saving and investing units (individuals, households and government).

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For measuring national income, the economy through which people participate in economic activities, earn their livelihood, produce goods and services and share the national products is viewed from three different angles. (1) The national economy is considered as an aggregate of producing units combining different sectors such as agriculture, mining, manufacturing and trade and commerce. (2) The whole national economy is viewed as a combination of individuals and households owning different kinds of factors of production which they use themselves or sell factor-services to make their livelihood. (3) The national economy may also be viewed as a collection of consuming, saving and investing units (individuals, households and government).

Following these notions of a national economy,

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national income may be measured by three different corresponding methods: ?Net product method:

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national income may be measured by three different corresponding methods: ?Net product method:

when the entire

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national economy is considered as an aggregate of producing units. ?

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national economy is considered as an aggregate of producing units. ?

Factor-income method: when the national economy is considered as a combination of factor-owners and users. ? Expenditure method: when the national economy is viewed as a collection of spending units. The procedures which are followed in measuring the national income in a closed economy—an economy which has no economic transactions with the rest of the world—are briefly described here. The measurement of national income in an open economy and adjustment with regard to income from abroad will be discussed subsequently. Net output or value-added method The net output method is also called the value-added method. In its standard form, this

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method consists of three stages: (1) Estimating the gross value of domestic output in the various branches of production. (2) Determining the cost of material and services used and also the depreciation of physical assets. (3) Deducting these costs and depreciation from gross value to obtain the net value of domestic output. The net value of domestic product

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method consists of three stages: (1) Estimating the gross value of domestic output in the various branches of production. (2) Determining the cost of material and services used and also the depreciation of physical assets. (3) Deducting these costs and depreciation from gross value to obtain the net value of domestic output. The net value of domestic product

thus obtained is often called the value added or income product which is equal to the sum of wages, salaries, supplementary labour incomes, interest, profits, and net rent paid or accrued. Let us now describe the stages (i) and (ii) in some detail.

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Measuring gross value For measuring the gross value of domestic product, output is classified under various categories

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Measuring gross value For measuring the gross value of domestic product, output is classified under various categories

on the basis of the nature of activities from which they originate.
Introduction to Macroeconomics NOTES Self - Learning Material 27 The output classification varies from country to country depending on (i) the nature of domestic activities, (ii) their significance in aggregate economic activities, and (iii) availability of requisite data. For example, in the US, about seventy-one divisions and subdivisions are used to classify the national output; in Canada and the Netherlands, classification ranges from a dozen to a score; and in Russia, only half a dozen divisions are used. According to the CSO publication, fifteen sub categories are currently used in India. After the output is classified under the various categories,

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the value of gross output is computed in two alternative ways: (i) by multiplying the output of each

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is computed in two alternative ways: (i) by multiplying the output of each category of sector by their respective market price and adding them together, or (ii) by collective data about the gross sales and changes in inventories from the account of the manufacturing enterprises and computing the value of GDP on the basis thereof. If there are gaps in data, some estimates are made thereof and gaps are filled. Estimating cost of production

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is computed in two alternative ways: (i) by multiplying the output of each category of sector by their respective market price and adding them together, or (ii) by collective data about the gross sales and changes in inventories from the account of the manufacturing enterprises and computing the value of GDP on the basis thereof. If there are gaps in data, some estimates are made thereof and gaps are filled. Estimating cost of production

The next step in estimating the net national product is to estimate the cost of production including depreciation.

Much more difficult is the task of estimating depreciation since it involves both conceptual and statistical problems. For this reason, many countries adopt the factor-income method for estimating their national income. However, countries adopting the

where input data are adequately available)

Traditionally, depreciation is calculated at some percentage of capital, permissible under the tax laws. In some estimates of national income, the estimators have deviated from the traditional practice and have instead estimated depreciation as some ratio of the current output of final goods.

the income method and the

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factor-share method. Under this method, the national income is calculated by adding up all

89% MATCHING BLOCK 136/683 W

factor-share method. Under this method, the national income is calculated by adding up all

the

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incomes accruing to the basic factors of production used in producing the national product.

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incomes accruing to the basic factors of production used in producing the national product.

Factors of production are conventionally classified as land, labour, capital and organization. Accordingly, the national income equals the sum of the corresponding factor earning. Thus, National Income = Rent + Wages + Interest + Profit. However, in a modern economy, it is conceptually very difficult to make a distinction between earnings from land and capital, on the one hand, and between the earnings from ordinary labour and entrepreneurial functions, on the other. For Introduction to Macroeconomics NOTES Self - Learning 28 Material the purpose of estimating national income, therefore, factors of production are broadly grouped as labour and capital. Accordingly, national income is supposed to originate from two primary factors, viz., labour and capital. In some activities, however, labour and capital are jointly supplied and it is difficult to separate the labour and capital contents from the total earnings of the supplier. Such incomes are termed as mixed incomes . Thus, the total factor-incomes are grouped under three categories: (i) labour incomes, (ii) capital incomes, and (iii) mixed incomes. 1.Labour incomes:

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Labour incomes included in the national income have three components: (i) Wages and salaries paid to the residents of the country including bonus and commission, and social security payments; (ii) Supplementary labour incomes including employer's contribution to social security and

91% MATCHING BLOCK 140/683 W

Labour incomes included in the national income have three components: (i) Wages and salaries paid to the residents of the country including bonus and commission, and social security payments; (ii) Supplementary labour incomes including employer's contribution to social security and

employee's

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welfare funds, and direct pension payments to retired employees; (iii) Supplementary labour incomes in kind, e.g., free health and education, food and clothing, and accommodation, etc. Compensations in kind in the form of domestic servants and

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welfare funds, and direct pension payments to retired employees; (iii) Supplementary labour incomes in kind, e.g., free health and education, food and clothing, and accommodation, etc. Compensations in kind in the form of domestic servants and

such

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other free-of-cost services provided to the employees are included in labour income. War bonuses, pensions, service grants are not included in labour income as they are regarded as 'transfer payments'. Certain other categories of income, e.g., incomes from incidental jobs, gratuities, tips, etc., are ignored for lack of data. 2.Capital

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other free-of-cost services provided to the employees are included in labour income. War bonuses, pensions, service grants are not included in labour income as they are regarded as 'transfer payments'. Certain other categories of income, e.g., incomes from incidental jobs, gratuities, tips, etc., are ignored for lack of data. 2.Capital

incomes: According to the

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Studenski, capital incomes include the following capital earnings: (i) Dividends excluding intercorporate dividends. (ii) Undistributed before-tax profits of corporations. (iii) Interest on bonds, mortgages, and saving deposits (excluding interests on war bonds, and on consumer-credit). (iv) Interest earned by insurance companies and credited to the insurance policy reserves. (v) Net interest paid out by commercial banks. (vi) Net rents from land, buildings, etc., including imputed net rents on owner-occupied dwellings. (vii) Royalties. (

80% **MATCHING BLOCK 147/683** W

Studenski, capital incomes include the following capital earnings: (i) Dividends excluding intercorporate dividends. (ii) Undistributed before-tax profits of corporations. (iii) Interest on bonds, mortgages, and saving deposits (excluding interests on war bonds, and on consumer-credit). (iv) Interest earned by insurance companies and credited to the insurance policy reserves. (v) Net interest paid out by commercial banks. (vi) Net rents from land, buildings, etc., including imputed net rents on owner-occupied dwellings. (vii) Royalties. (

63% **MATCHING BLOCK 145/683** SA 4-PRINCIPLES OF MACRO--GE Eco(Hons.) Sem-II SL ... (D143600893)

insurance policy reserves. (v) Net interest paid out by commercial banks. (vi) Net rents from land, buildings, etc., including imputed

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insurance policy reserves. (v) Net interest paid out by commercial banks. (vi) Net rents from land, buildings, etc., including imputed

viii) Profits of government enterprises. The data for the first two items is obtained mostly from the firms' accounts submitted for taxation purposes. But the definition of profit for national accounting purposes differs from that employed by taxation authorities. Therefore, some adjustments in the income tax data becomes, necessary. The data adjustments generally pertain to (i) excessive allowance of depreciation made by the firms, (ii) elimination of capital gains and losses since these do not reflect the changes in current income, and (iii) elimination of under or overvaluation of inventories on book-value.
Introduction to Macroeconomics NOTES Self - Learning Material 29 3.Mixed income: Mixed incomes include earnings from (a) farming enterprises, (b) sole proprietorship (not included under profit or capital income), and (

100% **MATCHING BLOCK 148/683** W

c) other professions, e.g., legal and medical practices, consultancy services, trading and transporting, etc. This category also includes the incomes of those who earn their living through various sources as wages, rent on own property, interest on own capital, etc. All

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c) other professions, e.g., legal and medical practices, consultancy services, trading and transporting, etc. This category also includes the incomes of those who earn their living through various sources as wages, rent on own property, interest on own capital, etc. All

the three types of incomes, viz., labour incomes, capital incomes and mixed

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incomes added together give the measure of national income by

W

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incomes added together give the measure of national income by

the factor-income method. Expenditure method The expenditure method is also known as the final product method. It measures national income in the final stages of expenditure. In order to evaluate

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the total national expenditure, either of the following methods can be followed: first, all the money expenditures at market price are computed and put together, and second, the computation of the

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the total national expenditure, either of the following methods can be followed: first, all the money expenditures at market price are computed and put together, and second, the computation of the

sum of the value of all the products that have been disposed off, in order to estimate

80% MATCHING BLOCK 154/683 W

the total national income. The following items of expenditure are taken into account under the first method: ?Private consumption expenditure ?Direct tax payments ?Payments to the non-profit institutions and charitable organizations (schools, hospitals, orphanages, etc.) ?Private savings. Under the second method, the following items are considered: (a) private consumer goods and service (b) Private investment goods ?Public goods and services, and ?Net investment abroad. Under the second method, the data required can be collected with greater ease and accuracy.

80% MATCHING BLOCK 155/683 W

the total national income. The following items of expenditure are taken into account under the first method: ?Private consumption expenditure ?Direct tax payments ?Payments to the non-profit institutions and charitable organizations (schools, hospitals, orphanages, etc.) ?Private savings. Under the second method, the following items are considered: (a) private consumer goods and service (b) Private investment goods ?Public goods and services, and ?Net investment abroad. Under the second method, the data required can be collected with greater ease and accuracy.

Hence, it is more widely used than the first method. Treatment of net income from abroad We have so far discussed methods of measuring the national income of a ‘closed economy’. However,

99% **MATCHING BLOCK 156/683** W

most economies are open in the sense that they carry out foreign trade in goods and services and financial transactions with the rest of the world. In the process, some nations get net income through foreign trade while some lose their income to foreigners. The net earnings or loss in foreign trade affects the national income. In measuring the national income, therefore, the net result of external transactions are adjusted to the total. Net incomes from abroad are added to, and net losses to the foreigners are deducted from the total national income arrived at through any of the three methods. Briefly speaking, all exports of merchandise and of services like shipping, insurance, banking, tourism, and gifts are added to the national income. All the imports of the corresponding items are deducted from the value of

99% **MATCHING BLOCK 157/683** W

most economies are open in the sense that they carry out foreign trade in goods and services and financial transactions with the rest of the world. In the process, some nations get net income through foreign trade while some lose their income to foreigners. The net earnings or loss in foreign trade affects the national income. In measuring the national income, therefore, the net result of external transactions are adjusted to the total. Net incomes from abroad are added to, and net losses to the foreigners are deducted from the total national income arrived at through any of the three methods. Briefly speaking, all exports of merchandise and of services like shipping, insurance, banking, tourism, and gifts are added to the national income. All the imports of the corresponding items are deducted from the value of

the national
Introduction to Macroeconomics NOTES Self - Learning 30 Material output to arrive at the approximate measure of the

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national income. To this is added the net income from foreign investment. These adjustments for international transactions are based on the international balance of payments of the nations.

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national income. To this is added the net income from foreign investment. These adjustments for international transactions are based on the international balance of payments of the nations.

Social Accounting Social accounting is termed as an action taken by a business so as to add value to its operational influence on society. Social accounting involves a company to thoroughly analyse its operations and understand the kind of impact its activities have on society. One important point to remember is that social accounting does not revolve around the type of assets that financial accounting involve, but centres around business behaviour and its impact. This type of evaluation can be experienced by any business, irrespective of its size. Social accounting was initiated in the second half of the 20 th century. Social accounting originates from the persuasion of environmental movements and the influence it has on large corporations and businesses. The government and the public at large also play a very significant role in coercing businesses to be more transparent about their operations and the implications of these operations. Through the medium of social accounting, an attempt is made to put a number on the costs and benefits of a business' activities vis-à-vis the society and environment. For instance, the following activities will help a business to evaluate or measure the impact of its operation on society, in particular the environment: (i) By measuring its smoke emission and its effects in surrounding areas (ii) Involvement in community (iii) Charitable contributions in nearby areas (iv) Measure the effectiveness of its hiring programme to evaluate the region's unemployment rate. The main function of social accounting in contrast to financial accounting is to understand its contribution (or lack of) to society. Its major concern involves business behaviour that contributes to the betterment of people and society as a whole. Some other phrases used for social accounting include environmental accounting, corporate social reporting and corporate social responsibility. Since social accounting does not focus on financial reporting aspects of a business, it is sometimes referred to as non-financial reporting or sustainability accounting. Sustainability is applicable to the entire operations of a business. This suggests that a company needs to make an analysis whether it is sustainable in terms of a social, environmental, cultural and financial perspective. A company can evaluate its capability to initiate and sustain it is commitment to function in such a manner that it proves to be beneficial to society. The process of social accounting can be performed by any business even if their main focus is limited to growth and profitability. Other organizations such as governmental agencies, non-profit organizations and charitable institutions can also adopt social accounting. Social accounting may be summarized as an activity that deals with accountability as it requires an organization to put its best practices in operation that will help in the overall well-being of the society and environment.
Introduction to Macroeconomics NOTES Self - Learning Material 31 Input-Output Accounting W.W. Leontief developed the input-output analysis. The input-output analysis explains the industrial interrelationships and inter-dependencies in the economic system. This suggests that the inputs of one industry are the outputs of another industry and vice versa. This analysis also explains the production of inputs, outputs and intermediate goods in the process of production and their role in producing outputs. This process eventually results in equilibrium between supply and demand in the economy. One important point to remember is that input-output analysis implies in a state of equilibrium, the money value of the aggregate output should be equivalent to the sum total of the money values of inter-industry inputs including the sum of the money values of inter-industry outputs. Therefore, the input-output analysis interprets the inter-industry flows of outputs and their relationships with the goods and services demanded. This method proves to be an improvement over the national income accounting method. Input-Output Table With the help of a transaction matrix, national income can be estimated through the input-output accounting method. The transaction matrix explains how the total output of one industry becomes the inputs for other industries and for final demand. In Table 1.2 the

are given. The table represents a hypothetical input-output matrix. The breakdowns of industries have been given horizontally as well as vertically. The table rows also represents the amount of outputs sold by an industry to final buyers and the amount of inputs bought from every other industry and from imports and factor services, known as primary inputs because they are not produced by the industries in the country. Table 1.2 Input-Output Transaction Matrix (in Crores) Purchasing Inputs Total Sector Gross Selling Sector Agriculture Manufacturing Other Final Demand Output Agriculture - 15 5 22 42 Manufacturing 12 - 17 16 45 Other 8 12 - 30 50 Imports 7 5 8 7 27 Primary Input 15 13 20 - 48 Gross Total Input 42 45 50 75 212 For example, the first horizontal row in Table 1.2 describes the output from the agricultural sector, which consists of the following: (a) Manufacturing sector: 15 crores (b) Other sectors: 5 crores (c) Final demand (This includes exports, capital, government and personal consumption): 22 crores Total Gross output of the agriculture sector: 42 crores
Introduction to Macroeconomics NOTES Self - Learning 32 Material This 42 crores includes 20 crores of intermediate products and 22 crores of final demand. In a similar manner the other rows represent the same. One important point to remember is that the row total should be equivalent to

the total of the economy in the input-output table. Therefore, the total gross output must be equal

to the total gross input of the economy. Importance of Input-Output Accounting The input-output table is used in national income accounting as it gives an extensive and detailed breakdown of macro-aggregates and money flows. This analysis is also put to use for national economic planning. This model also gives important information regarding the structural co-efficient of the different sectors of the economy for a given period of time. This information can be used for the optimum allocation of the economy's resources for a desired result. Shortcomings of Input-Output Accounting Analysis The analysis in input-output accounting is based on the assumption that the constant co-efficient of production is unrealistic. On certain occasions some industrialists may use different capital structures, in which case the assumption proves to be invalid. Another drawback of the input-output accounting analysis is that it does not specify as to why inputs and outputs are if a particular pattern in the economy. Lastly, the assumption of co-efficient of production does not include the possibility of a factor substitution. Flow of Funds Accounting In macroeconomic analysis, we study the transactions matrix or the flow-of-funds diagram to understand the pattern of transactions that take place between different sectors of the economy. Taking a three sector economy having the household, business and the government sectors, the transactions between these three classes of transactors may be conveniently summarized by means of the following transactions matrix or the flow-of-funds diagram (Table 1.3). This transactions matrix or the flow-of-funds diagram shows the transactions or market relationships which exist between the three classes of transactors—households, business firms and government—in the economy. Moving across the row, we find the sales made by each transactor to the other transactors while a movement down the column shows the purchases made by each transactor from the other transactors. A cell-wise study of this transactions matrix shows the following activities. Cell 1 shows that the households sell their domestic labour services to other households. Cell 2 shows that the households sell labour services to the business firms. They also sell to the firms old bonds (debentures) when the firms retire these bonds on maturity. Cell 3 shows that the households sell labour services to the government. They also sell bonds to the government when the government retires these bonds on maturity. Cell 4, being merely the sum of cells 1, 2 and 3, shows the total amount of money which flows into the households consequent upon the sale of their labour services to themselves, to the firms and to the government and the sales of bonds to the business firms and the government. Introduction to Macroeconomics NOTES Self - Learning Material 33 Cell 5 shows that the firms sell consumption goods and services to the households. They also sell new bonds to the households. Cell 6 shows that the firms sell investment or capital goods to the other firms in the economy. Cell 7 shows that the firms also sell goods to government. These goods are either collectively consumed or are added to the community or public capital stock. This shows that in certain cases the free market mechanism fails as a resource allocation device because some goods cannot be efficiently produced or consumed privately. Either a producer cannot charge a price for the goods he provides or a consumer cannot prevent the community from enjoying the commodity for which he has paid a price. These cases are known as the familiar externality or neighbourhood effects, the classic example being provided by the lighthouses constructed in the high seas to guide the ships against dangers in the voyage. If a private shipping company constructs a lighthouse for the use of its own ships, it cannot force a payment from the other users of the service of the lighthouse. Alternatively, the ship-owners would be reluctant to pay for the services of a lighthouse when they cannot prevent the other piratical ship-owners from enjoying the services of the lighthouse for which we have paid a price. Such goods are called collective or public goods and can be charged for their costs only in the form of taxes if these goods are produced by the government. Table 1.3 Transactions matrix or the flow-of-funds diagram Transactors Buy Down the Columns Households Firms Government 1. Domestic 2. Labour 3. Retired 4. Total labour services bonds money Households services inflow to Retired Labour households. bonds services Sum of 1, 2 and 3 5. Consumer 6. Investment 7. Collective 8. Total money goods and goods consumption inflow to Firms services and firms. investment Sum of New bonds goods 5, 6 and 7 9. New 10. New 11. 12. Total Transactors money, money money Sell Across new bonds, inflow to the Rows collective government. Government goods and Sum of 9 services and 10 (for taxes) 13. Total money 14. Total money15. Total money 16. Total money expenditure expenditure expenditure inflow and by households. by firms. by expenditure Sum of 1, 5 Sum of 2, 6 government. in the and 9 and 10 Sum of 3 economy and 7 by the three sectors Cell 8 shows that the total money inflow to the firms (business sector) is the sum of the total money expenditure of cells 5, 6 and 7 representing the total purchases made from the firms by the households, firms and government.

Introduction to Macroeconomics NOTES Self - Learning 34 Material Cell 9 shows that the government makes available to the households the services of public goods discussed for cell 7. Although the government does not directly charge any price for these goods, nevertheless, it levies an indirect charge in the form of taxes which it collects from the users of public utility goods and services. Cell 10 which shows only 'new money' reveals that the government may finance the purchase of goods and services by paying the firms with the new money issued by it. Cell 11 is blank showing that the government does not transact with itself. Cell 12 shows the total money inflow to the government sector and this amount is the composite of cells 9 and 10. Cells 13, 14 and 15 are the sums of the respective columns above them. Cell 16 is simply the sum of the cells in the last total column (i.e., Cells 4, 8 and 12) as also the sum of the last total row. Balance of Payments Accounting Balance of payments account of a country refers to the

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systematic recording of all economic transactions with the rest of the world in a specific time period, i.e., one year.

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systematic recording of all economic transactions with the rest of the world in a specific time period, i.e., one year.

Basically, balance of payment accounts is the statistical representation of the character and dimensions of the country's economic relationships with the rest of the world. It is quite similar to the flow of funds accounting, with the exception that it involves transactions between nations instead of within a nation. The principle of double-entry bookkeeping—like business accounts—is used to construct balance of payments account of a country. Balance of payment accounting is distinguished from business accounting on the basis of debit-credit placement. In balance of payment accounting credits (payments received) are shown on the left side and debits (payments paid) are shown on the right side. However, in business accounting it is vice versa. Debits are shown on the left side and credits are shown

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on the right side of the balance sheet. Under the balance of payments

account, the principle items presented on the credit side include the following: (a) Exports of goods and services, unrequited receipts in the form of gifts, etc., from foreigners (b) Borrowing from abroad, investments by foreigners in the country (c) Official sale of reserve assets including gold to foreign countries or international agencies Under the balance of payment account, the main items presented on the debit side include the following: (a) Import of goods and services (b) Transfer of payments to foreigners, which include foreign countries, investments by residents to foreign countries (c) Official purchase of reserve assets or gold to foreign countries or international agencies
Introduction to Macroeconomics NOTES Self - Learning Material 35 According to the principle of double-entry bookkeeping, the debit and credit items have been represented vertically in the balance of payments account. Horizontally, they are divided into three categories, which are as follows: ?Current account ?Capital account ?Official settlements account or the official reserve assets account Three accounts of a Country A are shown in Table 1.4. Table 1.4 Balance of Payments Account of Country A Debits Credits 1. Current Account A) Exports of Goods and Services: Merchandise expors +30 --- +30 Travel and Transportation Services: +2.5 Income on investments abroad +4.5 Other +2.4 +9.4 Total exports of goods and services +39.4 B) Inports of goods and services −25.5 −25.5 Services: Travel and Transportation −4.6 Income for foreign investments in the country −2.4 Other −4.8 −11.8 −37.3 Total imports of goods and services Balance on goods and services (total of A−B) +2.1 Unilateral Transfers (net) −0.9 Current account balance +1.2 2. Capital Account A) Transaction in countryA's assets and investments abroad (net) (a) Private Direct −2.5 Portfolio −1.6 Short term −0.8 −4.9 b) Government excluding official reserve Assets −1.7 Total (a+b) −6.6 B) Transaction in foreign assets and investments In country A (net) relate to 'Credits' (a) Private Direct +0.2 Portfolio +1.8 Short term +2.4 +4.4 (b) government excluding official reserve assets +1.2 Total (a+b) +5.6 capital account balance (A−B) −1.0 Merchandise exports and imports are the most significant items in current accounts. Balance of trade represents the difference between exports and imports of a country. In case the exports exceed imports, the balance of trade proves to

Introduction to Macroeconomics NOTES Self - Learning 36 Material be favourable. However, if imports exceed imports, then the balance of trade becomes unfavourable. In Table 1.4 the balance of trade is depicted to be favourable. Under capital account, two types of transactions have been shown, i.e., private and government excluding official reserve assets. (i) Private transactions: This includes all types of investments—direct, portfolio and short-term. (ii) Government investments: This includes loans from and to foreign official agencies. The capital account balance shows a deficit. The official settlement account reveals a transaction in Country A's official reserve assets (net), where it has been presented as a credit item. It is very important that the three accounts be equal in accordance with the theory of double-entry book-keeping as balance of payments of a country, always balances in the accounting sense. 1.6 NATIONAL INCOME AND ECONOMIC WELFARE The term 'welfare' is difficult to define precisely although all of us are familiar with it. Consequently, it has been variously approached and defined. The concepts of 'welfare', 'social welfare', 'economic welfare', etc., are all elusive. Thus, even a great economist of Arthur Cecil Pigou's eminence has stated: 'Welfare, however, is a thing of very wide range. There is no need here to enter upon a general discussion of its content. It will be sufficient to lay down more or less dogmatically two propositions; first, that the elements of welfare are states of consciousness and, perhaps, their relations; secondly, that welfare can be brought under the category of greater and less.' Welfare has been defined in the dictionary as a 'state of faring or doing well, freedom from want, a state of prosperity.' It is a 'state' of the person or group of persons and is a stock concept rather than a flow concept. In economics, we are, however, usually concerned with the group or community welfare. Thus, welfare is a function both of the quantity and quality of the final goods and services, changes in the quantity and quality of these goods and services and the pattern of their distribution in the community. National Income and Economic Welfare The early economists had hinted at some sort of positive correlation between national income or aggregate production and economic welfare of the community. Thus, as between a nation with the per capita income of 1,000 and another with the per capita income of 2,000, we can say with a fair degree of confidence that the latter is better off than the former. Pigou and others have stressed that national income and a community's material or economic well-being are positively so correlated that an increase in the former causes an improvement in the latter, provided the distribution of national income is not changed against the poor. Stressing this

Introduction to Macroeconomics NOTES Self - Learning Material 37 positive relationship between national income and economic welfare Pigou has stated: 'It is evident that, provided the dividend accruing to the poor is not diminished, increases in the size of the aggregate national dividend if they occur in isolation without anything else whatever happening, must involve increases in economic welfare.' The statement that an increase in the national income or dividend causes an increase in the material well-being of the community is, however, subject to certain limitations. First , it should never be forgotten that notwithstanding some rough kind of positive correlation between the aggregate production and overall welfare of a community, neither individual nor aggregate welfare is subject to any direct measurement. The second limitation of this proposition is regarding the change in the distribution of national income or product against the poor. Third , the increase in the national product should not result from coercing the people to work more than they wish to do. The material well-being of a community consists of the balance of satisfaction derived from the use or enjoyment of the national product over the dissatisfaction involved in producing it. Consequently, when an increase in the national product comes about as the result of a disproportionate increase in the amount of effort made or disutility or pain experienced in producing it, it might well be that the dissatisfaction suffered by working for longer hours may exceed the enjoyment experienced from consuming the additional national product. For example, if the larger national product is obtained by forcing the people to work for 18 hours a day under trying unhealthy conditions, it is almost certain that the satisfaction derived from consuming the extra product would be enormously less than the dissatisfaction caused by forcing the people to put in extra labour (involved in working for longer hours) and additionally under unhealthy conditions. Fourth , aggregate welfare represents a 'state' of people or community and as such it is a stock concept. The aggregate production or, for that matter, the aggregate consumption is regarded as a measure of aggregate welfare on the prior assumption that higher welfare is not possible without higher consumption which is not possible without higher production. Moreover, as Kenneth E Boulding has very rightly stated, 'consumption is rarely a good in itself; it is a "cost" of maintaining certain states, and production is what has to be done to overcome this cost. Measures of production or consumption, therefore, can easily fail to measure welfare on this account.' We may illustrate this point by taking the example of cold countries such as the United State of America or Canada which have to produce and consume fuel for space heating—central heating of the buildings—to ward-off the severe cold. The production and consumption of fuel in the cold countries is included in the national product of these countries. Consequently, these countries will have higher national product compared to the national product of the temperate climate countries, such as India, where the climatic rigours of nature are experienced neither in the form of severe cold nor in the form of scorching heat. Does the higher national product of the cold countries on account of the large fuel production and consumption mean that the people there enjoy higher material welfare compared with the people living in the salubrious temperate climate countries where the national

Introduction to Macroeconomics NOTES Self - Learning 38 Material product is relatively small because in these countries, fuel for keeping the people warm is not produced? The answer is clearly in the negative. Indeed, it is a sign of the poverty and not of the prosperity of the cold countries. The fifth limitation is that, national product cannot serve as an infallible measure of the community welfare since it pays no heed to the increasing deterioration of the environment as a result of higher production of the material goods and services in the country. The increasing tempo of industrialization has created serious ecological problems causing social strains and health hazards in modern life. A sulphuric acid plant which produces acid whose whole value is included in the national product also pollutes the atmosphere by emitting poisonous fumes which people inhale. Similarly, a tannery which produces the leather goods whose value is included in the national product pollutes the river water which people drink risking great health hazards. The mass automobile production and consumption in the United States of America, Germany and Japan has created the problems of road accidents, air pollution through emission of fuel smoke and traffic congestion to overcome which anti-pollutants and traffic signals and lights have to be produced. Their production represents the social cost of maintaining a certain 'state' called welfare. In short, the community bears the cost of private production. This social cost should be deducted from the value of the products of the factories which are included in the national product if the national product has to serve as a reliable measure of economic welfare. The total product of a scarce resource available to society necessitates our evaluating the external diseconomies of production. This involves the making of value judgements which is too difficult a job for the national accountant to undertake. Consequently, the gross national product does not correctly measure social welfare. It only measures the extent of the success of the economy in providing the productive capacity from which social welfare can be achieved. Perhaps the most popular misconception about national income accounts is the belief that these have been devised for measuring social welfare. Notwithstanding the fact that some relationship does exist between the gross national product and social welfare, it is not deep and exact. National income and product accounts were, in fact, devised to measure changes in the level of aggregate economic activity and not in the quality of life. A typical example can convince us that the gross national product accounts were never intended to measure social welfare. As national income and following it personal incomes rise, the number of cars, buses and scooters per head also increases. However, the increase in the number of automobiles on the roads pollutes the atmosphere in the cities increasing the incidence of respiratory diseases. The increase in the number of diseases raises the incomes of hospitals, doctors, nurses, drug companies, etc. All this is duly recorded as an increase in the national product. This increase in the national product does not, however, imply an increase in social welfare. Just as a rich man is not by all means always a happy man, so also a materially rich and prosperous nation, i.e., an affluent society does not always stand for a happy nation because materialism is never an unmixed blessing. It is reasonably true to state that economic prosperity increases the material comforts

Introduction to Macroeconomics NOTES Self - Learning Material 39 which are regarded necessary for happiness. After a certain stage, however, increasing material prosperity is accompanied by the deteriorating social 'milieu' or environment with its attendant adverse repercussions on the aggregate community welfare. The sixth limitation is that national product estimates do not take into account the varying demands for leisure. A country, such as Switzerland or a state in a country such as Kashmir or Himachal Pradesh in India, inhabited by simple people living in lovely natural scenic beauty enjoying the salubrious climate have a smaller gross domestic product because the people prefer to produce and consume less material goods and enjoy more leisure by being in close touch with the scenic beauty of nature for longer hours because by doing so they derive greater satisfaction compared to the alternative situation in which they may have more material goods at their disposal at the heavy cost of being cut-off from the close contact with nature and its scenic beauty. People living in the temperate climate countries consume more free goods although they have less access to economic goods. In a country where nature has been unkind to mankind reflected in the former's niggardliness, lakes, forests and other natural sceneries have to be artificially created. Consequently, leisure in such a country will command a price and will, therefore, be included in that country's national product. As against this, people of a beautiful country where nature has provided rich flora and fauna amidst beautiful lakes and lofty mountains enjoy boating and mountain climbing as free goods. Consequently, the aggregate welfare of people of this country will be greater than the aggregate welfare of the people of a country where nature has shown its utter niggardliness. 'This is perhaps part of a more general problem in which the existence of free goods, or goods which have zero price in some cases but not in others, seriously distorts the meaning of the aggregate product, for free goods do not appear in it and yet they contribute to welfare.' The last, seventh limitation is that an increase in the national income does not always bring increased happiness to all people in society. Plenty itself breeds a 'throw-away' attitude to things in life. Gifts lose their power to move when a person has 'everything' and when wealth is in so much abundance that no sacrifice is entailed in bestowing it. As Bernard Shaw had once very correctly remarked 'discontent is the mainspring of progress' reflected in the rising gross national product. In an affluent society peoples' satisfactions, as Thorstein Bunde Veblen observed, depend not only on the innate utility of the goods they buy but also on their status value. To a person in a high consumption society, it is not his absolute real income that counts as much as his relative income and his position in the structure of national income. Consequently, he may feel aggrieved with a 15 per cent rise in his income if the incomes of others have risen by 30 per cent. The more this attitude prevails—and the ethos of an affluent society tends to whip it—the more futile is the objective of higher income for the society as a whole. Economic Welfare and Social Welfare Once peoples' satisfactions come to depend almost wholly on relative income or on some other status index, a sustained rise in the level of consumption made

Introduction to Macroeconomics NOTES Self - Learning 40 Material possible by a rise in the national income yields little additional satisfaction to society even in the absence of all spill-over costs. Indeed, the obsessive concern with status and income and, in consequence, a lifetime devoted to nursing one's prospects goes far towards draining away the real joy from one's spirit. It has been well said that although man cannot live without bread, he does not live by bread alone. If it is conceded that once the subsistence levels have been passed—as these certainly have in the West—sources of peoples' more enduring satisfaction spring from mutual trust and affection, from sharing happiness and sorrow, from developing bosom friendship, from giving love and accepting it, from open-hearted companionship and laughter. If it is further conceded that in a civilised society the joy of living is augmented primarily by the sense of wonder inspired by the unfolding of nature, by the perception of beauty inspired by great art and by the renewal of faith and hope inspired by the heroic and good deeds; if this is conceded, then surely unremitting attempts to harness the greater part of men's energies and ingenuity to the task of amassing an ever greater assortment of material possessions cannot add much to peoples' happiness or welfare and one can ask if the present-day higher material standard of living has really increased our sense of well-being. One can legitimately ask the question: Are we as a nation actually happier with today's much larger collection of material goods and services at our disposal than were our great grandparents with a much smaller basket of the material goods and services in their possession? Alas! despite the plethora of material goods and services at our command, the social statistics do not seem to indicate any increase in the general happiness of the community. For instance, the air-conditioned cars have not helped in lowering the divorce rate in the highly materialistic western societies. Today, the savants, the good and virtuous people who spoke words of wisdom and consoled us in our woes and difficulties seem to have all disappeared and we are all around surrounded by the rascals and the wicked who derive comfort from seeing us in difficulties. There are no real sympathizers in whom we can confide. Today, we may boast of having a host of acquaintances but the bosom friend, in whom we could confide and who always came to our rescue in times of difficulties has altogether disappeared. Life has become akin to a rudderless boat with no meaning and destination. The Americans and others who abound in material riches, have been found trekking in the Himalayas, the old Buddhist monastries and the other religious shrines situated in the forlorn secluded places far from the madding crowd in their quest of the much- sought-after real happiness in life at the cost of giving away their material possessions. Indeed, social welfare depends upon the social milieu and social ethos. The social milieu is the composite of the economic milieu and the non-economic milieu. While the economic milieu largely consists of the material goods and services available for consumption to the community, the non-economic milieu comprises of the active presence of the gentlemen, philosophers, savants, religious-minded and god-fearing people, the good and virtuous people, law-abiding citizens who show respect and concern for the elderly persons and the love for children and the eminent poets, dramatists, novelists, singers, dancers, painters, etc., who entertain

Introduction to Macroeconomics NOTES Self - Learning Material 41 and provide higher non-material food in ample measure to sustain life. An increase in the national income will lead to an increase in the social welfare only if in the process of creating the higher national income the non-economic component of the social welfare or milieu also increases pan passu or at least is not adversely affected. To assume, however, that when national income increases the non- economic welfare also increases or at any rate is not adversely affected is utterly unrealistic. Today, the eminent philosophers, saints, poets, gentlemen, writers, painters, musicians, sculptors, artists, honest and fearless people who provide succour and comfort to people in distress have either disappeared or have been marginalized as men of no consequence. Respect for life and property of fellow citizens, concern in others' grief and the spirit of fellow feeling which dominated social life in the past have all disappeared leaving an unfathomable vacuum in social harmony. Undoubtedly, while the past-India of eminent poets, novelists and dramatists' days which among many others, to mention only a few, included Mirza Ghalib, Meer, Haali, Zonk, Sauda, Kalidas, Tulsidas, Munshi Prem Chand, Mahadevi Verma, Nirala, etc., was economically poor judged from the present-day reckoning, but it was free from the phenomenon of present-day materialistic life full of serious physical and mental strains. The above positive elements of the non-economic part of the social milieu have now been replaced by violence, hatred, arson, loot, kidnapping, rape, atrocity and an active presence of criminals all around. Politicians, crooks and assumed protectors of life and property freely move hand in glove with the known criminals. Moral and ethical considerations have given way to greed and scandals. Religion which teaches tolerance and love—the two basic foundations of any good and civilized life—is today abhorred. Morning prayers in the schools and colleges which helped our children in making them god-fearing and good citizens have now become a thing of the past. Religion appears to have become an easy prey of state secularism. Law and order machinery has become ineffective with the law-abiding citizens and good people fearful to move out of their dwellings after sunset. Gentlemen in the community have either totally disappeared or else have been marginalized. To get social recognition and respect the only sole criterion is one's total of wealth, not his past heritage and the means adopted by him to acquire wealth. With such a dismal state of affairs, can it be legitimately concluded that an increase in the national income will always cause an increase in the social welfare? Can we take pride in calling ourselves members of a civilized society? We are all fully aware of the fact that in the present-day world with greater economic prosperity, the quality of life has fast deteriorated. Good and virtuous people called 'gentlemen' have become conspicuously absent, all moral values have become a mass casualty while the corrupt and dishonest have taken an upper hand in society. Respect for law and order has become a thing of the past. Families are breaking away and the divorce rate graph is asymptotically rising. In such a dismal situation, can we legitimately say that higher national income will always lead to higher social welfare? The answer to this is obvious and a self-evident 'no'.
Introduction to Macroeconomics NOTES Self - Learning 42 Material An increase in the national income will cause an increase in the community's aggregate social welfare through causing an increase in the community's economic or material welfare if and only if the non-economic part of the social milieu is not simultaneously adversely affected. This, however, is unlikely to happen and our present experience belies this assumption. Consequently, an increase in the economic welfare is not an infallible indicator of a similar increase in the social welfare. Today, in the midst of economic prosperity, real happiness has eluded us. Each one of us has become an island cut-off from the others in the vast sea of humanity. Increased economic prosperity has bred selfishness, egoism and individualism with unbearable mental and physical strains that have often manifested in frequent heart attacks and other serious fatal ailments. Check Your Progress 6. What are the different ways in which the value of gross output is computed? 7. What does input-output analysis help us understand? 8. Define the two types of interactions under capital account. 9. When does aggregate increase in income bring about increase in welfare in the economy? 1.7 ANSWERS TO 'CHECK YOUR PROGRESS' 1. Macroeconomics is essentially the study of the behaviour and performance of the economy as a whole. More importantly, it studies the relationship and interaction between the 'factors or forces' that determine the level and growth of national output and employment, general price level, and the balance of payments positions of an economy. 2. The stock variables refer to the quantity of a variable given at a point in time, The flow variables, on the other hand, are the variables that are expressed, per unit of time, e.g., per hour, per week, per month, or per year, e.g., GDP, consumption, saving, investment, exports, imports, etc. 3. National income is the aggregate of the (i) wages and salaries, including supplements thereto (without deducting taxes and social security contributions); (ii) net income received from rents and royalties; (iii) income received from interest; and (iv) profits, whether earned by the corporate or non-corporate private business sector before deducting the income-tax. 4. Gross National Product is the most important and widely used measure of national income.

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It is the most comprehensive measure of the nation's productive activities. The GNP is defined as the value of all final goods and services produced

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GNP is defined as the value of all final goods and services produced during a

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GNP is defined as the value of all final goods and services produced

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is defined as the value of all final goods and services produced

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is defined as the value of all final goods and services produced

specific period, usually one year,
plus incomes earned abroad by the nationals minus incomes earned locally by the foreigners. 5. The GNP so defined is identical to the concept of gross national income (GNI). Thus, GNP = GNI. The difference between the two is only of procedural nature. While GNP is estimated on the basis of product flows,
Introduction to Macroeconomics NOTES Self - Learning Material 43 GNI is estimated on the basis of money income flows, (i.e., wages, profits, rent, interest, etc.). 6.

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The value of gross output is computed in two alternative ways: (i) by multiplying the output of each

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is computed in two alternative ways: (i) by multiplying the output of each category of sector by their respective market price and adding them together, or (ii) by collective data about the gross sales and changes in inventories from the account of the manufacturing enterprises and computing the value of GDP on the basis thereof. 7.

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is computed in two alternative ways: (i) by multiplying the output of each category of sector by their respective market price and adding them together, or (ii) by collective data about the gross sales and changes in inventories from the account of the manufacturing enterprises and computing the value of GDP on the basis thereof. 7.

The input-output analysis explains the industrial interrelationships and inter- dependencies in the economic system. This suggests that the inputs of one industry are the outputs of another industry and vice versa. 8. Under capital account, two types of transactions have been shown, i.e., private and government excluding official reserve assets. (i) Private transactions: This includes all types of investments—direct, portfolio and short-term. (ii) Government investments: This includes loans from and to foreign official agencies. 9. An increase in the national income will cause an increase in the community's aggregate social welfare through causing an increase in the community's economic or material welfare if and only if the non-economic part of the social milieu is not simultaneously adversely affected. 1.8 SUMMARY ?P. A. Samuelson: "

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Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

62% **MATCHING BLOCK 176/683** SA B.A. Prog principles Macro Eco-I.doc (D110585671)

Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

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Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

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Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

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Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

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Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

overall level of a nation's output, employment, prices, and foreign trade. ?What microeconomics treats as constants, macroeconomic treats them as variables and what macroeconomics treats as constants, microeconomics treats them as variables. ?The transfer of money also involves the exchange of the productive services, it will not be counted as income from the macroeconomic point of view. ?Though national income is created by the production of GDP, the value of production does not necessarily result in earned income. Therefore, national income can be generated from (GDP) after making certain adjustments. ?The important thing to remember in connection with the concept of national product is that it includes all those goods and services which are the result of the economic activities. ?Only in the case of a closed economy—having no economic transactions with the outside world so that both the exports and the imports of the economy are zero—will the national product be equal to the domestic product. ?The circular flow of income forms the basis for all models of the macro- economy, and understanding the circular flow process is key to explaining how national income, output and expenditure are created over time.
Introduction to Macroeconomics NOTES Self - Learning 44 Material ?Factors of production flow from the households to the factor market and from the factor market to the firms. Goods and services produced by the firms flow from the firms to the households. Factor and product flows make the product flows or real flows. Product flow generates money flow. ? Withdrawals means withholding money incomes as idle cash balance. Withdrawals are also called leakages. Injection, on the other hand, means money expenditure in addition to factor incomes. ?The total factor-incomes are grouped under three categories: (i) labour incomes, (ii) capital incomes, and (iii) mixed incomes. All the three types of incomes, viz., labour incomes, capital incomes and mixed

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incomes added together give the measure of national income by

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incomes added together give the measure of national income by

the factor-income method. ?The expenditure method is also known as the final product method. It measures national income in the final stages of expenditure. ?Social accounting is termed as an action taken by a business so as to add value to its operational influence on society. ?The main function of social accounting in contrast to financial accounting is to understand its contribution (or lack of) to society. ?The input-output analysis interprets the inter-industry flows of outputs and their relationships with the goods and services demanded. This method proves to be an improvement over the national income accounting method. ?According to the principle of double-entry bookkeeping, the debit and credit items have been represented vertically in the balance of payments account. Horizontally, they are divided into three categories, which are as follows: Current account, Capital account, Official settlements account or the official reserve assets account. ?An increase in the national income will cause an increase in the community's aggregate social welfare through causing an increase in the community's economic or material welfare if and only if the non-economic part of the social milieu is not simultaneously adversely affected. 1.9 KEY TERMS ?National Income: It is the aggregate of individuals' incomes excluding transfer receipts or payments. ?

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Gross Domestic Product (GDP): It is the total market value of all final goods and services produced in the country within a specific time period. ?Gross National Product (GNP): It is the value of all final goods and services produced

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Gross Domestic Product (GDP): It is the total market value of all final goods and services produced in the country within a specific time period. ?Gross National Product (GNP): It is the value of all final goods and services produced

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Gross Domestic Product (GDP): It is the total market value of all final goods and services produced in the country within a specific time period. ?Gross National Product (GNP): It is the value of all final goods and services produced

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Gross Domestic Product (GDP): It is the total market value of all final goods and services produced in the country within a specific time period. ?Gross National Product (GNP): It is the value of all final goods and services produced

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Gross Domestic Product (GDP): It is the total market value of all final goods and services produced in the country within a specific time period. ?Gross National Product (GNP): It is the value of all final goods and services produced

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Gross Domestic Product (GDP): It is the total market value of all final goods and services produced in the country within a specific time period. ?Gross National Product (GNP): It is the value of all final goods and services produced

during a
specific period,
usually one year, plus incomes earned abroad by the nationals minus incomes earned locally by the foreigners. Introduction to Macroeconomics NOTES Self - Learning Material 45 ?National product:

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It is the total money value of all the final goods and services produced by the residents of a

60% **MATCHING BLOCK 190/683** SA slm business eco macro - complete.docx (D44840960)

is the total money value of all the final goods and services produced by the residents of a country during

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is the total money value of all the final goods and services produced by the residents of a country during any given period of time,

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is the total money value of all the final goods and services produced by the residents of a country during any given period of time,

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final goods and services produced by the residents of a country during any given period of time, usually one year. ?

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final goods and services produced by the residents of a country during any given period of time, usually one year. ?

Net national product: It can be derived by deducting from the gross national product capital consumption allowance. ? Injections: It is the amount that is spent by the households and/or firms in addition to their current incomes generated within the regular economy. ?Net product method: It is a method in which the entire

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national economy is considered as an aggregate of producing units. ?

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national economy is considered as an aggregate of producing units. ?

Factor-income method: It is a method in which the national economy is considered as a combination of factor-owners and users. ?Expenditure method: It is a method in which the national economy is viewed as a collection of spending units. ?

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Balance of payments: It is the systematic recording of all economic transactions with the rest of the world in a

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systematic recording of all economic transactions with the rest of the world in a specific time period, i.e., one year. ?

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systematic recording of all economic transactions with the rest of the world in a specific time period, i.e., one year. ?

Welfare: It is the 'state of faring or doing well, freedom from want, a state of prosperity.' 1.10 SELF-ASSESSMENT QUESTIONS AND EXERCISES Short-Answer Questions 1. What are the limitations of Macroeconomics 2. List the three micro-macro paradoxes. 3. What is the importance of GNP? 4. Mention the assumptions in a two-sector economy. 5. What are the various factor on which the output classification varies from country to country? 6. Mention the three categories under which you can group the total factor income. 7. Write a short note on the concept of welfare. Long-Answer Questions 1. Describe the significant reasons for studying macroeconomics. 2. Derive the relationship between GNP, NNP and NI. 3. Explain circular flow of economy in a four-sector economy. 4. Describe the three ways of computing national income.
Introduction to Macroeconomics NOTES Self - Learning 46 Material 1.11 FURTHER READING Mankiw, N Gregory. 2010. Macroeconomics . New York: Worth Publishers. Shapiro, Edward. 1996. Macroeconomic Analysis . New Delhi: Galgotia Publication. Jha, R. 1999. Contemporary Macroeconomic Theory and Policy . New Delhi: New Age International. Gupta, SB. 2011. Monetary Economics: Instruments and Policy . New Delhi: S Chand & Co.
Theory of Employment NOTES Self - Learning Material 47 UNIT 2 THEORY OF EMPLOYMENT Structure 2.0 Introduction 2.1 Objectives 2.2 Classical Theory of Employment 2.3 Keynesian Theory of Employment 2.3.1 Aggregate Supply Function 2.3.2 Propensity to Consume/Consumption Function 2.3.3 Propensity to Save/Saving Function 2.3.4 Propensity to Invest/Investment Function 2.3.5 Aggregate Demand 2.3.6 Effective Demand 2.3.7 Equilibrium Level of Employment 2.4 Principles of Multiplier 2.5 Accelerator Principle 2.6 Answers to 'Check Your Progress' 2.7 Summary 2.8 Key Terms 2.9 Self-Assessment Questions and Exercises 2.10 Further Reading 2.0 INTRODUCTION In the classical economic theory, full employment is a rule in the long period. Deviations from it are viewed only as temporary exceptions. Full employment did not, however, rule out the existence of some unemployment in the economy. John Maynard Keynes successfully attacked the classical explanation of the determination of aggregate employment, output and general price level. It was the assumption of a given volume of total output, rather than its composition and technique of production, which was severely attacked by Keynes. In the Keynesian theory, all the different sectors of the system remain tied together and all the variables are determined together.

classical theory of employment because of its reliance on unrealistic assumptions. In this unit, you will learn about the classical and Keynesian theory of employment, aggregate demand and supply functions, multiplier and accelerator principle and propensity to consume, save and invest. 2.1

Define classical theory of employment ?Describe Keynesian theory of income and employment

Theory of Employment NOTES Self - Learning 48 Material ?Analyse aggregate demand and aggregate supply ?Explain integration of real and monetary sectors through IS & LM Function ?Describe the principles of multiplier ?Explain accelerator to consume ?Define propensity to consume and save 2.2 CLASSICAL THEORY OF EMPLOYMENT The classical economists had not expounded a single systematic theory of output and employment. This however should not mean that the classical economist had not given thought to the issue of how aggregate output is determined in an economy. They had, in fact, made certain postulates about output and employment. The modern economists have, however, reinterpreted the postulates given by the classical economists, collected pieces of economic thoughts, and reconstructed the classical theories of output and employment. This section deals with the classical theories of output and employment. Let us begin with a brief review of the classical postulates. Classical Postulates The classical economists had, in their approach to macroeconomics issues, assumed certain aspects of the economy to be given. They provided deductive logic but little empirical support to their assumptions. Their assumptions were called by Keynes as 'postulates of the classical economies'. The main postulates of the classical economists are described as follows: 1.There is always full employment: The classical economists postulated that all employable resources—labour and capital —of a country are always fully employed in the long run. If there is unemployment at any time, then there is a tendency towards full employment, provided there is no external or government interference with 'the functioning of the economy. In the classical view, full employment does not mean that all the resources are fully employed—there might be frictional and voluntary unemployment in the state of full employment. 2.The economy is always in the state of equilibrium: The classical economists postulated that an economy—is always in the state of equilibrium. They believe that full employment of resources generates incomes, on the one hand, and goods and services, on the other. The value of goods and services is always equal to income. The income earners spend their entire income. This implies that the entire output of goods and services is sold out. There is no general overproduction and there is no general underproduction . The classical postulates of full employment and equilibrium are based on the assumption that the economy works on the principles of laissez-faire . A laissez-faire system is one in which: (i) There is complete absence of government control or regulation of private enterprise, except to ensure free, competition.
Theory of Employment NOTES Self - Learning Material 49 (ii) There is complete absence of monopolies and restrictive trade practices— if there is any, it is eliminated by law. (iii) There is complete freedom of choice for both the consumers and the producers. (iv) The market forces of demand and supply are fully free to take their own course. 3.Money does not matter: The classical economists treated money only as a medium of exchange. In their opinion, the role of money is only to facilitate the transactions. It does not play any significant role in determining the

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output and employment. The levels of output and employment are determined by the

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output and employment. The levels of output and employment are determined by the

availability of real resources, that is, labour and capital. The classical view in brief

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The classical economists held the view that, an economy based on laissez-faire principles,

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classical economists held the view that, an economy based on laissez-faire principles,

is always in the state of equilibrium at full employment. The free market mechanism ensures optimal allocation of resources so that marginal productivity of factors in all industries is the same. The work force is fully employed at the market wage rate. Actual output equals potential output. There is neither underproduction nor overproduction.

the 'invisible hands' of demand and supply come into operation and bring

law that 'supply creates its own demand' is generally attributed to a French economist, Jeane Baptiste Say (1767–1832). The logic behind this law is that supply of goods itself generates sufficient income to generate a demand equal to the supply of goods. This is how supply creates its own demand. Say's law is regarded as the 'beginning of sound thinking in macroeconomics.' This law can be explained in the context of both a barter and a monetized economy. In a barter economy , people tend to specialize in the production of goods or services which they can produce relatively more in an efficient way, though they consume, many other goods and services. They acquire other goods and services they consume in exchange for their own produce. When they offer their produce in barter for other goods, they create demand for other goods. For example, a farmer offers his surplus produce (say, wheat) to the weaver in exchange for cloth. Thus, he creates demand for cloth. The weaver who is in need of wheat produces surplus cloth which creates demand for wheat. Thus, production of wheat creates demand for wheat. In this kind of an economy, there cannot be overproduction or under production. The reason is, in a barter economy, people produce goods for own consumption. They produce what they consume and they produce as much as they consume—the part of produce bartered away for other goods is included in their consumption. So there is no underproduction. Also, people do not produce in excess of their consumption needs. Therefore, there cannot be overproduction.
Theory of Employment NOTES Self - Learning 50 Material If there is under or overproduction at some point of time, it is due to wrong calculation of the consumption need. Say's law applies equally well to the monetized economy used as medium of exchange, that is, goods are bought and sold with the use of money. In a monetized economy, the logic of 'supply creates its own demand' works somewhat differently. Production in a market economy is meant for sale in the market. Production of goods requires employment of factors of production—land, labour, capital and entrepreneurship. The employment of factors of production generates money income in the form of wages, interest, rent and profits. By spending their money income on the goods they produce, they create demand. It follows that if there is production, there is income, and if there is income, there is demand for goods including demand for goods whose production creates income. Thus, supply creates its own demand in a market economy. In the opinion of J.B. Say, since supply creates an equal demand, there is neither overproduction nor underproduction. No unemployment under classical system As mentioned here, classical economists postulated full employment to be a normal affair, that is, there cannot be general unemployment in a capitalist economy. In their opinion, full employment ensures that actual outputs equal the potential output. Full employment coincides with equilibrium level of output. In the classical view, total production is always sufficient to maintain the economy at the level of full employment in a free market economy. Unemployment, if any, is a temporary phenomenon. Whenever there is unemployment, wages decrease. Decrease in wage rates makes employment of labour more profitable. This results in increase in demand for labour and unemployment disappears. However, classical economists did not rule out the existence of voluntary and frictional unemployment in the state of full employment. In their opinion, voluntary unemployment arises when: (a) Potential workers are unwilling to work at the prevailing wage rate at a slightly lower wage rate. (b) Workers go on strike (unpaid) for higher wages. (c) Rich persons are unwilling to work, that is, the idle rich. (d) Some persons prefer leisure or idleness to better life, that is, the case of the very poor, mendicants, sadhus and sanyasins. Frictional unemployment arises when workers remain temporarily out of job due to labour market imperfections, immobility of labour, seasonal nature of occupation as in agricultural activities, technological changes, natural calamities, wars, and so on. The existence of voluntary and frictional unemployment was consistent with the classical postulate of full employment. Classical Theory of Employment As mentioned earlier, classical economists had not developed any theory or model or employment. They believed that 'available resource' including 'employable

Theory of Employment NOTES Self - Learning Material 51 population', 'natural wealth' and 'accumulated capital equipment' determined employment. The classical theory of employment that we describe below was summarily reconstructed by Keynes in this general theory and was reconstructed by some of the early Keynesian critics of classical economics. The classical model of employment as reconstructed by Keynesians consists of two components: (i) Aggregate production function (ii) Labour supply and labour demand functions These two kinds of functions are used to show the determination of output and employment.

general price level under the condition of a given money supply. The aggregate production function The aggregate production function is central to the classical model as it determines simultaneously the aggregate output and employment. According to the classical economists, the national output of a country at any point in time depends on the capital and labour employed. The aggregate production function used in the reconstructed classical model can be expressed as: Y = f(K,N) ...(2.1) Where Y = aggregate real output, K = capital (fixed) , and N = amount of labour (homogeneous) required to produce Y. The classical production function assumes (i) the stock of capital (K) fixed, (ii) technology of production used by the firms is a given, and (iii) population is constant. The national output in the short run is therefore the function of the employment of labour drawn from the constant population. The model assumes also that the use of successive units of labour yields diminishing returns. In other words, marginal productivity of labour, defined as MP L = ?Y/?L, decreases with an increase in employment. The level of output at which MP L = 0 marks the level of maximum possible level of national output. Figure 2.1 presents the short-run aggregate production function under the assumption that capital (K) is constant and employment of labour yields diminishing returns. As Figure 2.1 shows, ?Y/?L (given by the slope of the production function) goes on decreasing as employment increases. O Y = F(K, N) Real Output (Y) Labour (N) Fig. 2.1 The Classical Production Function
Theory of Employment NOTES Self - Learning 52 Material Labour market: Labour supply and demand According to the classical theory of employment,

level of employment is determined by the labour supply and labour demand functions. In fact, both employment and wage rate are determined at the point of intersection between labour supply and labour demand curves. Before we explain the determination of employment in the neo-classical model, let us explain the labour supply and labour demand curves. Labour Market: Labour Supply and Demand Labour Supply curve Labour supply curve is expressed in terms of wages. Thus, it is important to keep in mind the concepts of real and nominal wages. ?Real wage (W r) is the amount of goods and services a labour can buy with his wages (W). It is adjusted for inflation. ?Nominal wage is the amount of money one is paid, it is not adjusted with the price level (P). ?Therefore, real wage (W r) can be defined as W/P.

increases with any increase in the real wage rate. As is widely known, this relationship holds only till the point of work-leisure trade-off. This trade-off is the choice between spending time for 'unsatisfactory' work time or indulge in pleasure inducing unpaid time (leisure). This is to say that initially, people are motivated to work more for higher wages but only till a certain point. Beyond the trade-off point, the relationship between work and leisure turns inverse, and the labour supply curve bends backward. The labour supply function (N s) assumes a positive relationship between real wages and labour supply, meaning it is an increasing function, sloping upwards and is written as N s = f(W r) ...(2.2) Where, N s = Labour supply function W r = real wages It is crucial to remember it is an increasing function of real wages. The supply of labour increasing with increasing real wage rate. The labour supply curve based on the function is presented in Figure 2.2.

Theory of Employment NOTES Self - Learning Material 53 O Real Wages (W) r Labour (N) N = F(W) s r Fig. 2.2 The Labour Supply Curve Labour Demand Curve Generally, the labour demand curve is expressed in terms of Marginal revenue productivity of labour (MRP L) and real wage rate (W r). Therefore, N d = f(W r , MRP L) ... (2.3) Where, N d = Labour demand function MRP L = MPP L × P But since in classical economics, market is assumed to be a perfect competition, price (P) remains constant. Therefore, we will take MPP L as the reference here. Therefore, to derive the demand for labour, keep in mind the short-run aggregate production function discussed earlier. It is the slope of the production function at different levels of employment which, when graphed, produces the MPP curve (MP L). More precisely, the first derivative of the production function gives the MPP L curve. As mentioned earlier, in classical theory, there is perfect competition and the main aim is to maximize profits. Therefore, labour will be employed until MPP L = Real wage rate (W r). That is MPP L = W r MPP L = W/P And so N d = f (W r) ... (2.4) The derivation of the total product and the MPP L curves is illustrated in panels (a) and (b) of Figure 2.3. Panel (a) presents a sample production function graphically. As shown in Figure 2.3, MPP decreases with increase in employment. In panel (b), the vertical axis measures the real wage which is the

Theory of Employment NOTES Self - Learning 54 Material same S as wage in kind. The MPP L curve can be treated as the labour demand curve . We know that, under competitive conditions, a profit maximizing firm employs labour where real wages (W r) equals MPP L . But remember, this is a decreasing function of real wages. A downward slope. This is to say, at a lower real wage rate, more labour will be demanded and at a higher wage rate, less labour will be demanded. Real Output (Y) O Y 1 Y 2 Y 3 Y 4 Y = I(K, N) N 6 N 5 N 4 N 3 N 2 N 1 (a) MPP and Real Wage O Y 1 Y 2 Y 3 Y 4 N 6 N 5 N 4 N 3 N 2 N 1 (b) Y 5 W r W 2 W 1 MW = MPP r L MW = MPP r L Labour Labour Fig. 2.3 Derivation of Demand Curve Determination of Employment and Real Output The aggregate labour production, demand and supply curves, we have used up till now can be used to illustrate the determination of full employment and the aggregate real output in the classical model. The determination of

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labour market equilibrium is shown in panel (a) of Figure 2.4. The labour demand and

supply curves intersect at point E. This is the labour market equilibrium point. This is to say that at this equilibrium point E, the demand for and supply of labour are equal. This point of intersection, E determines the equilibrium wage rate (OW r) and full employment of labour (ON*). Given the short-run conditions, this is the level of full employment. We will use this derivation to now determine the real output. This will be done by juxtaposing the production function (as shown in Figure 2.1), with labour-market equilibrium of Figure 2.4 (a). The short-production function (Figure 2.1) is reproduced in panel (b) of Figure 2.4 at the bottom of panel (a) on the same scale of labour. As noted earlier, the national output in the short run is the function of labour employment, capital remaining constant. As shown in panel (a), full employment of labour is determined at ON* at real wage EN*. The ordinate EN* extended downward to the production function in panel (b) determines the level of national output at OY". In panel (b), the extended ordinate ERN* intersects the production function at point R. A horizontal line drawn from point R to the vertical axis determines

Theory of Employment NOTES Self - Learning Material 55 the equilibrium level of national output at Y*. Thus, employment and output are simultaneously determined in the classical model. Fig. 2.4 Determination of Equilibrium Output An important feature of the classical model is that

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factors operating on the supply side of the market determine the level of employment and

output. As shown here,

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labour market equilibrium is determined by the demand for and supply of labour. The

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market equilibrium is determined by the demand for and supply of

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market equilibrium is determined by the demand for and supply of

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is determined by the demand for and supply of labour. The

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is determined by the demand for and supply of labour. The

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is determined by the demand for and supply of labour. The

labour demand curve is however, derived from the production function based on a given technology determined exogenously. The labour demand curve is therefore, in a sense, a datum. It is the labour supply, which is a function of real wages, that plays a more important role in the determination of the labour market equilibrium and employment. And employment determines the level of output. Thus, in the classical model, employment and output are determined solely by

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the factors operating on the supply side of the labour market. Theory of Employment

NOTES Self - Learning 56 Material Determination of Income and Employment with Savings and Investment Say's Law of Market has a major drawback in that it does not deal with saving. This is because according to Prof. Say, people spent all their income on the consumption, which we know is not true. People certainly do some saving. According to classical economists, every rupee saved by households will be invested by businessmen, that is, Investment expenditure= Savings done by households Therefore, there is no question of deficiency of demand. According to classical economists, the rate of interest will bring savings and investment into equilibrium, as shown in Figure 2.5. I O X Y S E T Rate of Interest Saving and Investment r 2 r 2 r Fig. 2.5 Capital Market Equilibrium As shown in the Figure 2.5, there is

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a negative relationship between the investment demand and rate of interest. At a higher rate of interest, the

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the investment demand is less than the intended supply of savings. On the other hand at a lower rate of interest, the demand for investment exceeds the supply of savings.

The equilibrium rate of interest has been determined with the intersection of investment demand and supply saving curve. In other words we can say that

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at the equilibrium rate of interest, the demand for investment is just equal to the supply of

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the equilibrium rate of interest, the demand for investment is just equal to the supply of

W

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the equilibrium rate of interest, the demand for investment is just equal to the supply of

62% MATCHING BLOCK 229/683 SA Macro Economics I.pdf (D138997544)

the equilibrium rate of interest, the demand for investment is just equal to the supply of

71% MATCHING BLOCK 237/683 SA Introductory Microeconomics.pdf (D110811121)

rate of interest, the demand for investment is just equal to the supply of

83% MATCHING BLOCK 239/683 SA Sem 1_M23ECO2DC.docx (D165393069)

rate of interest, the demand for investment is just equal to the supply of savings.

In equation form, I = S Keynes' criticisms on full employment equilibrium Prof. J. M. Keynes has criticized the classical theory of income and employment on several grounds. Some of the most important objections of Prof. Keynes are as follows: 1.Unrealistic assumptions of full employment condition: According to Prof. Keynes the assumption of full employment is fundamentally wrong. According to him, there is always a possibility of underemployment, and it is a normal phenomenon. According to him, the condition of underemployment is more realistic.
Theory of Employment NOTES Self - Learning Material 57 2.Undue importance to long period: Keynes normally deals with the economic issues according to the viewpoint of short run. That's why he has criticized the classical theory of income and employment on this ground.

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According to him, 'in the long-run, we are all dead.'

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According to him, 'in the long-run, we are all dead.'

So, it is of no use to say that in long-run, everything will be all right. 3.Keynes's denial of Say's Law of Market:

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The classical theory of income and employment completely depends upon Say's Law of Market,

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The classical theory of income and employment completely depends upon Say's Law of Market,

them, there is no question of overproduction. Prof. Keynes completely disagreed with this point of view. According to him there is a possibility of supply exceeding demand; it can further cause disequilibrium in the economy. He has further criticized the self-adjustment theory. According to him, there is no automatic self- adjustment in the economy. 4.Keynes's denial of Pigou's wage cut policy: Prof. Keynes has also criticized the Pigou's view on a general fall in wages and prices in the time of depression will remove unemployment and automatically restore full employment in the economy if market mechanism is allowed to work freely without any obstruction by trade unions and government. According to him, a general fall in wages will not bring about increase in employment because the reduction in wages will reduce aggregate demand for goods. Keynes put forward the view that wages are not only the cost of production, they are also incomes of the workers which constitute the majority of the population of a country. As a result of a general fall in wages, the incomes of the workers will fall due to which aggregate demand will decline. As a result of decline in the aggregate demand, level of production will have to be reduced and less labour will be employed than before. It will create more unemployment rather than reducing it and finally lead to depression. 2.3 KEYNESIAN THEORY OF EMPLOYMENT You have already seen the important objections raised by Keynes against the classical theory of employment. In the period between 1929-33, the great depression occurred in the capitalist countries. This led to huge levels of unemployment, shutting down of factories and losses in national incomes. As per the classical economists, the situation of unemployment is automatically adjusted in the perfect competition economy, but as the real market situation during the time would have it, people could see that the situation of massive unemployment was not automatically going anywhere. There was excess of productive capacity. And the classical economic thought was proving to be wrong. In this background, Keynes wrote the General Theory of Employment, Interest and Money , providing a fresh perspective to the income and employment theory used up till now. One of the important points raised by Keynes was that unlike previously assumed, full-employment is not the general status of an advanced capitalist economy but underemployment equilibrium is. Keynes also introduced the propensity to consumer, marginal efficiency of capital, multiplier effect and liquidity preference concepts. These will be discussed in this and the next unit. Theory of Employment NOTES Self - Learning 58 Material Keynes assumes in his theory that the capital, population, labour, labour efficiency and technology are constant. Therefore, Keynesian theory of income and employment can be referred to as a short run theory. Since these factors remain constant, in the Keynesian theory, the amount of employment is directly dependent on the level of production and national income. Employment of more labour is what will lead to an increase in the income and output. And consequently, higher level of national income will result in greater employment and vice versa. This is why, it is said that Keynesian theory of employment and income are the same as the factors of determination remain the same, barring the diagrams for representation. Another important assumption to keep in mind is that the prices and wages and not easily adjusted to keep the demand and supply in balance, which is to say that in his theory, he assumes that the prices remain constant. 2.3.1 Aggregate Supply Function When undertaking production, entrepreneurs hire labour and they look towards the cost of production (including wages) as well as the amount received from the sale of output. If the difference is positive, it is considered that the hiring was a good decision. This is to say that if the entrepreneurs do not receive back the investment on the employment of labourers, they will not provide further employment.

by
those labourers employed, at any given level of employment of labour. In simple words, this the total cost of production of employing a certain number of labourers. There will be an increase in the aggregate supply price with an increase in the amount of employment of labour. The Keynesian aggregate supply curve depicts the relationship between the employment of number of workers and the receipts which the firms in the economy will received from employing them. The prices remain constant. In order words, Keynesian aggregate supply function (curve) is the representation of the relationship between the aggregate supply price and the number of labourers' employment. Factors Affecting the Aggregate Supply Curve Supply is fundamentally dependent on the conditions of factors of production including the level of capital stock, the state of technology and the nature of production. But we have already mentioned earlier, that in short run production function, the factors remain constant. In such a scenario, only the rise in the employment of labour will increase the output levels. But the increase in employment and output will result in increased cost of production. Regardless of the constant, diminishing or increasing returns on the production function, cost of production will increase will additional workers are employed. Consequently, more workers will be employed only when it is profitable in terms of increased revenue covering the costs. This is why there is an upward slope towards the right in the aggregate supply curve.

Theory of Employment NOTES Self - Learning Material 59 The conditions (physical and technical) of the factors of production affect the slope of the aggregate supply curve. Therefore: ?The aggregate supply curve will be straight line if the marginal cost of production does not rise with increase in output. ?The slope of the aggregate supply curve will however go on increasing with the increase in employment of labour in case the diminishing returns occur. ?The slope of aggregate supply curve will increase if there is rise in the wage rate on the increase in the employment of labour. Bear in mind, Keynes was of the opinion that in depression and recession conditions where there is massive unemployment, the wage rate will remain constant even if there is an increase in the employment of labour to increase production. With the change in the conditions of the factors of production, the AS curve will also change its shape. But in the short term, these are assumed to be constant. For instance, in the times of depression, the focus of the economies is the employment of idle resources in terms of capital and manpower to increase the level of production with the increase in demand and not improving the production techniques. This is why, AS curve is assumed to be constant by Keynes and more focus is paid to the aggregate demand in his theory. In times of recession, the focus of economies is on increasing the aggregate demand. This is so that equilibrium may be achieved at the full employment level. With the rise in AD curve, it will move in the upwards direction and cut AS on a comparatively more on the right side. This means that the number of labourers employed will also increase. Consequently with the attainment of full employment, there will not be a scope to increase aggregate demand as it will result in inflation. This will demand a rightwards shift in the AS curve which will be possible on with the improvements in the production technologies. This will then create inflationary situation. AS curve starts by sloping upwards in the right direction when the number of men is increased slowly, the pace of rise is slow in the beginning but later rises quite rapidly. This movement of increase at increasing is due to the diminishing returns. At full employment, it is not possible to increase employment, even when the demand rises. This is why at full employment levels; the AS curve is vertical in shape. 2.3.2 Propensity to Consume/Consumption Function The Keynesian concept of consumption function stems from the fundamental psychological law of consumption which states that there is a common tendency for people to spend more on consumption when income increases, but not to the same extent as the rise in income because a part of the income is also saved. The community, as a rule, consumes as well as saves a larger amount with a rise in income. An enquiry about the determinants of consumers' demand may be restated in terms of the concept of the 'consumption function' which denotes the general
Theory of Employment NOTES Self - Learning 60 Material income-consumption relationship. Like the familiar microeconomic market demand curve of a commodity which shows the different quantities of a particular good or service which will be demanded at the different prices, ceteris paribus, per any given time unit, the consumption function shows the total expenditure which, ceteris paribus, consumers will make on the purchase of consumer goods and services at different levels of income. The most widely accepted hypothesis about consumption is that its major determinant is the disposable personal income. The income-consumption relationship, for which the economists have coined the term 'consumption function', was originally called 'the propensity to consume' by a British economist, John Maynard Keynes. According to Keynes, the propensity to consume is the functional relationship X between Y W (a given level of income expressed in terms of wage- units) and C w (the expenditure on consumption out of that level of income) so that– C w = X (Y w) Although Keynes has listed several objective and subjective factors

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in his book, The General Theory of Employment, Interest and Money

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in his book, The General Theory of Employment, Interest and Money

as co- determinants of consumption spending, he has singled out income as the main determinant of consumption. Following the notation used earlier, aggregate consumption as a function of aggregate income may be expressed as C = f (Y). The short-period consumption function takes the general form of the straight-line CC in Figure 2.6 and is expressed in the form of equation C = a + bY, where a is the constant positive amount of autonomous consumption which is unrelated to income and bY is the induced consumption which is determined by the level of income Y and the constant proportion of income b spent on consumption. Since the linear consumption function C = a + bY intersects the vertical axis above zero, consumption is positive at zero income and the slope of the consumption function is constant. This means that the consumption-income ratio—the average propensity to consume—is falling as income is increasing while the marginal propensity to consume—the marginal consumption-income ratio—is constant. Fig. 2.6 Short Period Consumption Function While the short-run consumption function intersects the vertical axis above the point of origin of the axes showing a non-proportional income-consumption
Theory of Employment NOTES Self - Learning Material 61 relationship, the long-run consumption function passes through the point of origin of the axes as shown in Figure 2.7. This shows that in the long-run total consumption bears a proportionality relationship to total income. Consequently, both the long- run

are constant and equal. The general form of the long-run consumption function may be expressed by the equation C = bY, where b is the constant slope of the consumption function. The only restriction is that b is constant, less than one and more than zero. In Figure 2.7, the average propensity to consume (APC) equals the marginal propensity to consume (MPC) corresponding to all the different levels of income since the consumption function C = bY passes through the point of origin of the axes. Fig. 2.7 Long-run Consumption Function Modern Theory of Consumption The post-Keynesian empirical studies made on the income-consumption relationship show that the short-run consumption function has a smaller slope relatively to the slope of the long-run consumption function. During the inter-war period, economists who estimated the consumption function for the US economy accepted Keynes' statement that even in the long run, a smaller proportion of income is consumed as income increases. Consequently, the APC falls as income increases. This was represented by a linear consumption function of the form C = a + bY, where a < 0 and 1 < b < 0 = constant. In this consumption function, b is the marginal propensity to consume and no difference is made between the short-run and the long-run marginal propensities to consume. Several functions estimated during the inter- war period showed results clearly fitting this pattern and explained the data very well. Economist, Arthur Smithies and others used such a function to predict the post-war demand for the American economy. This consumption function shows that the basic long-run income-consumption relationship was one of non- proportionality. This type of the Keynesian consumption function was, however, subsequently discarded as not being very useful in explaining the actual consumer behaviour because it was found that in the post-war period—1946 and 1947—the level of consumption was far above that predicted by the simplified consumption function of the form

Theory of Employment NOTES Self - Learning 62 Material C = a + bY. This simplified consumption function was also discarded on additional grounds. The consumption function of the form C – a + bY implies that the income-consumption ratio (C/Y) falls as income increases, i.e. , the percentage of total income spent on consumption falls as income increases. On this basis, the saving-income ratio must increase as income increases. On the basis of a non-proportional income- consumption relationship, a sufficiently high level of investment was deemed necessary for attaining full employment in the post-war period. It was, however, experienced that government expenditure of even a smaller magnitude that was predicated by such a consumption function resulted in inflation. The non-proportional income-consumption relationship was controverted by Simon Kuznet's now well-known study of the national income and consumption expenditure for the American economy during the period 1869 to 1929 which showed that the ratio of total consumption to national income (C/Y) had remained constant while income had quadrupled. Simon Kuznet's finding was supported by Raymond Goldsmith's study relating to consumption and personal income. According to economist, Goldsmith, 'a main enduring characteristic' of saving was the long-term stability of the aggregate personal saving at approximately one- eighth of income. This means that the long-run income-consumption ratio (C/Y) was stable at seven-eighth of income. While the income-consumption ratio (C/Y) has been constant over the long period of time, the cross-section data shows that the income-consumption ratio (C/Y) decreases as income increases. Moreover, studies also show that the C/Y ratio fluctuates cyclically—consumption decreases much less than proportionately during minor recessions and even increases sometimes in the face of falling income. In short, the empirical findings show a proportional relationship between income and consumption during the long period and a non-proportionality relationship during the short period. Figure 2.8 explains the short-run and long-run consumption functions. In the figure aa, bb and dd are the short-run consumption functions showing that the income-consumption ratio (C/Y) decreases as income increases. The long-run proportionality consumption function 0C = bY shows, however, that the income-consumption ratio C/Y remains constant regardless of the level of national income. Fig. 2.8 Short-run and Long-run Consumption Functions
Theory of Employment NOTES Self - Learning Material 63 Reconciliation of the Short Period and Long Period Consumption Functions Different hypotheses have been developed by the economists in order to explain the apparent contradiction between the short-run non-proportional and the long- run proportional income-consumption relationship. According to the various studies made to study this relationship, while the long-run income-consumption ratio (C/Y = APC) has been constant, the short-run income-consumption ratio (C/Y) decreases as income increases. Thus, the consumption function takes two different forms on the basis of the short or long period. The short-run consumption function takes the form of equation C = a + bY while the long-run consumption function takes the form of equation C = bY. 2.3.3 Propensity to Save/Saving Function Having explained the Keynesian consumption function, we turn to derive the Keynesian saving function in this section. Like consumption, saving (S) is also the function of income (Y), i.e., S = f(Y) Since, in two-sector model, Y = C + S , consumption and saving functions are counterparts of one another. Therefore, if one of these functions is known, the other can be easily obtained. For example, if consumption function is given as C = a + bY , then saving function can be derived as follows. We know that S = Y – C ...(2.5) By substituting consumption function, C = a + bY for C in Eq. (2.5), we get S = Y – (a + bY) =– a + (1 – b)Y ...(2.6) Equation (2.6) gives the saving function in which '1 – b' is marginal propensity to save (MPS). It can be proved as follows: Since Y = C + S ? ?

S Y = 1– C Y Since C Y = b, by substitution, we get MPS = 1 – b. Numerical Example: Let us now show the derivation of saving function through a numerical example. Let consumption function be given as C = 100 + 0.75 Y ...(2.7)

Theory of Employment NOTES Self - Learning 64 Material Given the Eq. (2.7), Eq. (2.6) can be written as S = Y – (100 + 0.75 Y) = – 100 + (1 – 0.75) Y = – 100 + 0.25 Y ...(2.8) The consumption and saving functions are graphed in Fig. 2.9. The 45° line shows income-consumption relation with Y = C at all levels of income. In the analysis of national income determination, it also shows the total sale proceeds, i.e., the value of the total planned output. The schedule C = 100 + 0.75 Y gives the income-consumption relationship – consumption being a linear function of income. The schedule S = – 100 + 0.25 Y is the saving schedule derived from the consumption schedule. The saving schedule shows the income-saving relationship. Fig. 2.9 Income, Consumption and Savings Schedules 2.3.4 Propensity to Invest/Investment Function According to Keynes,

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investment refers to real investment which adds to capital equipment. It leads to increase in the levels of income and production by increasing the

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leads to increase in the levels of income and production by increasing the production and purchase of capital goods. Investment thus includes new plant and equipment, construction of public works like dams, roads, buildings, etc., net foreign investment, inventories and stocks and shares of new companies. Marginal propensity to

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purchase of capital goods. Investment thus includes new plant and equipment, construction of public works like dams, roads, buildings, etc., net foreign investment, inventories and stocks and shares of new companies.

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Marginal propensity to invest is the ratio of change in investment to change in income. The

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Marginal propensity to invest is the ratio of change in investment to change in income.

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Marginal propensity to invest is the ratio of change in investment to change in income. The

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ratio of change in investment to change in income. The marginal propensity to invest

shows how much of one additional unit of income will be used for investment purposes. Typically, investment increases when income increases and vice versa. We will learn about the investment function in detail in Unit 3.

Theory of Employment NOTES Self - Learning Material 65 2.3.5 Aggregate Demand Aggregate demand price refers to the expected expenditure from the employment of a given number of workers for the production of goods and services. Similar to the aggregate supply price, the aggregate demand price too varies with the level of employment. This is because the consumption expenditure changes with the different income levels. The following are the important components of the aggregate demand: ?Consumption demand ?Investment demand ?Government expenditure and ? Net exports (Exports-Imports) For understanding Keynesian theory of employment, we will be concerned with the first two components only: consumption and investment demand. Consumption demand is concerned with the propensity to consume and disposable income. Propensity to consume is dependent on several factors including price levels, rate of interest, willingness to save, aspiration to mimic others' standards of living, etc. The changes in these factors will result in the movement of the consumption function. For instance, higher level of disposable income will result in an increased consumption demand. Investment demand is dependent on

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two factors: rate of interest and marginal efficiency of capital (

expected rate of return). It is the latter which is more of an agent of change in terms of investment. When it comes to entrepreneurs, this is pretty simple, in the sense that greater rate of return will induce entrepreneurs to invest more. But for businesses, profit making opportunities is what drives investment. In this sense, businesses rely on expected consumer demand, taxation and changes in technology to assess investment demand. Therefore, dynamic business expectations, make investment demand volatile. Thereby affecting the aggregate demand. As per Keynes, in the short run, the consumption function remains constant while the consumption demand increases with the rise in income. 2.3.6

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Effective Demand Effective demand refers to the willingness and ability of consumers to purchase goods at different prices. It shows the amount of goods that consumers are actually buying - supported by their ability to pay. Effective demand excludes latent demand - where the willingness to purchase goods may be limited by the inability to afford it - or lack of knowledge. In Keynes's macroeconomic theory, effective demand is the point of equilibrium where aggregate demand = aggregate supply. The importance of Keynes' view is that effective demand may be insufficient to achieve full employment due to unemployment and workers without income to produce unsold goods.

Theory of Employment NOTES Self - Learning 66 Material 2.3.7 Equilibrium Level of Employment Number of Persons Employed O X N 2 N F Involuntary unemployment Y Receipts E AD AS Fig. 2.10 Determination of Employment Now that you have learnt about

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the concepts of aggregate demand and aggregate supply curves, let's derive the equilibrium level of employment. The

X- axis shows the amount of employment and the receipts from the employment on the Y-axis. As you have learnt earlier, the aggregate supply curve shows the level the revenue which must be received by suppliers for employing a certain number of workers, the aggregate demand curves show the revenue from the different levels of employment which the entrepreneur receives. In case of perfect competition, the entrepreneurs will keep on increasing the level of employment until the profits are earned. These opportunities exist so long as the supply price for employing a certain number level of employment is less than the aggregate demand. Meaning that the employers will keep employing additional labours until the AD is greater than AS. At the point where AD= AS, this will be the equilibrium point, for after this it will no longer be profitable for the employers to employ additional workers. This is to say that the additional cost of increasing production by hiring more labour will no longer be covered since the AD will be lower. Therefore, the intersection point of AD and AS curve is the equilibrium point, where the revenue which the entrepreneurs expect will be equal to the revenue they do receive from employee a certain number of workers. In conclusion, the following points about the Keynesian theory of employment must be kept in mind: The level of employment directly affects the level of income and output for a nation. Therefore, if there is a certain level of capital and technology, when you increase the labour, the aggregate level of output will also be increased. The magnitude of effective demand refers to the addition of consumption and investment demand at the intersection point of AS and AD curve.

Theory of Employment NOTES Self - Learning Material 67 Check Your Progress 1. What is a laissez-faire system of economy? 2. What is always the state of a laissez-fair economy as per the classical economists? 3. To whom is law that 'supply creates its own demand' attributed to? 4. What is the relationship assumed by the labour supply function (N s) between real wages and labour supply? 5. What does the Keynesian concept of consumption function stems from? 6. What are the components of aggregate demand? 2.4 PRINCIPLES OF MULTIPLIER The theory of income determination under static conditions, i.e., under the assumption that factor that affect the equilbrium level of income remain constant. Include factors such as (i) investment, (ii) government taxes, (iii) government spending, and (iv) exports and imports. These factors, however, do not remain constant. They keep changing over time. Changes in these factors change the equilibrium level of income by a multiple. Multiplier refers to a number which is multiplied by the change in the determinants of national income gives the total increase in the national income. National income determinants include (i) investment, (ii) government expenditure, (iii) taxes, and (iv) foreign trade – exports and imports. Accordingly, there is investment multiplier , government expenditure multiplier , tax multiplier , and foreign trade multiplier . It is important to note that investment, government taxes and expenditure, and exports and imports change the equilibrium income by a multiple of the change in these factors, called multiplier . This aspect change in equilibrium income is discussed under the theory of multiplier . Theory of multiplier is the subject matter of this section. Investment Multiplier in Static And Dynamic Setting Invest multiplier is a virtually a number which multiplied by an increase in investment (?I) gives the resulting increase in national income (?Y). Specifically, investment multiplier equals ?Y/?I. How investment generates additional multiple income is a continuous process of investment generating income, income generating consumption and, in turn, consumption generating income, and so on. In economics jargon, this process is called a dynamic process . So the total increase in income (?Y) cannot be known until the dynamic process of income generation ends. However, economists, especially Keynes, have devised a theory by which investment multiplier can be worked out and ?Y can be known straightaway. This system of working out multiplier assumes static conditions of the economy. It is based on the assumption that there is no time lag between ?I. and ?Y. This is called static multiplier . We will explain multiplier theory under both static and dynamic settings.
Theory of Employment NOTES Self - Learning 68 Material Before we discuss the process and working of the investment multiplier, let us show graphically what happens to the equilibrium level of income when aggregate demand schedule (C + I) shifts upward due to increase in investment (?I).

in Fig. 2.11. The initial aggregate demand schedule is shown by C + I schedule. It intersects aggregate supply schedule (C + S) at point E 1 where the equilibrium level of national income is Y 1 . Let us suppose now that I increases to I + ?I causing an upward shift in investment schedule from I to I + ?I. This causes an upward shift in aggregate demand schedule as shown by the schedule C + I + ?I. With the shift in aggregate demand schedule, the equilibrium point of national income shifts from E 1 to E 2 and national income increases from Y 1 to Y 2 . The increase in national income (? Y) may be obtained as ?Y = Y 2 – Y 1 The increase in the national income, ?Y, is the result of ?I. A question arises here: 'Is there any definite relationship between ?Y and ?I?' If yes, what determines this relationship? These questions take us to the theory of multiplier . Fig. 2.11 Shift in Aggregate Demand Function and Increase in National Income The Static Multiplier Static multiplier is also known as 'comparative static multiplier', 'simultaneous multiplier', 'logical multiplier', 'timeless multiplier', or 'lagless multiplier'. The concept of static multiplier assumes that the change in investment and the resulting change in income are simultaneous. There is no time lag between the change in investment and the resulting change in income. Static multiplier also assumes that there is no change in MPC of the various recipients of incomes as the economy moves from one equilibrium position to another. It ignores the process by which changes in income and consumption expenditure lead to a new equilibrium. Also, static multiplier assumes income distribution and consumers' preferences to remain unchanged.
Theory of Employment NOTES Self - Learning Material 69 To understand the concept and working of static multiplier, let us first look at the relationship between ?Y and ?I. This can be done by comparing the two equilibrium levels of national income. At equilibrium point E 1 , Y 1 =C + I Since C = a + bY , by substitution, we get Y 1 =a + bY 1 + I = ? ? 1 1 ? ? a I b ...(2.9) Similarly, at equilibrium E 2 , Y 2 =C + I + ?I = a + bY 2 + I + ?I = ? ? 1 1 ? ? ? ? a I I b ...(2.10) By subtracting Eq. (2.9) from Eq. (2.10), we get ?Y = ? ? 1 1 a I I b ? ? ? ? – ? ? 1 1 a I b ? ? ?Y = 1 1 I b ? ? ...(2.11) Equation (2.11) gives the relationship between ?Y and ?I. It reveals that ?Y is 1/(1 – b) times ?I. Therefore, 1/(1 – b) is the multiplier (m). The value of multiplier can be obtained by dividing both sides of Eq. (2.11) by ?I. That is, Y I = 1 1–b ...(2.12) Thus, multiplier (m) = 1 1–b ...(2.13) This multiplier has been obtained udner static conditions. Therefore, this is static multiplier.

Since ?Y is the result of ?I, the multiplier so defined is called investment multiplier. The Determinant of the Investment Multiplier . Note that in Eq. (2.13) ' b' stands for the MPC (i.e., b = MPC). It may therefore be concluded that MPC is the determinant of the value of investment multiplier. The higher the MPC, the greater the value of the investment multiplier. Theory of Employment NOTES Self - Learning 70 Material This relationship is illustrated in the following table. MPC m 0.00 1.00 0.10 1.11 0.50 2.00 0.75 4.00 0.80 5.00 0.90 10.0 1.00 ? MPS and the Multiplier The value of investment multiplier can also be obtained through the marginal propensity to save (MPS). In Eq. (2.13), 1 – b is the same as 1 – MPC. We know that 1 – MPC = MPS. Therefore, m = 1 1 1–MPC MPS ...(2.14) Numerically, if MPC = 0.75, MPS = 0.25, Then investment multiplier, m = 1 4 0.25 The multiplier may therefore be also defined as the reciprocal of MPS. If MPS is known, m can be easily obtained. The Dynamics of Multiplier The concept of dynamic multiplier is also known as period or 'sequence' multiplier. Dynamic multiplier does not make the assumptions of the static multiplier. Dynamic analysis of the multiplier traces the process by which equilibrium of national income shifts from one position to another. In real life, income level does not increase instantly when autonomous investment is made. In fact, there is a time-lag between increase in income and consumption expenditure. The process of dynamic multiplier may be described as follows. Suppose that autonomous investment increases by 100, i.e., ?I = 100. Assume also that MPC = 0.8, and there is no other expenditure than the consumption expenditure. When autonomous investment increases by 100, it subsequently increases the income of the recipients by 100, i.e., in the first round of expenditure- income process, ?I = 100 = y 1 . The recipients of 100 spend 80 (= 100 × 0.8) on consumer goods and services. In the second round, those who supply goods and services worth 80, receive an additional income of 80. Let us call this income as y 2 . Thus y 2 = 80. Of this, they spend 64 (= 80 × 0.8). This results in an additional income (y 3) of 64 to those who supply consumer goods and services. This process continues till the value of ?y ? 0. Note that the value of ?y decreases in the subsequent rounds of income and expenditure, i.e., y 1 < y 2 < y 3 .... The whole series of ?y generated by ?I = 100 may be written as ?Y =y 1 + y 2 + y 3 ... y n–1 =y 1 + y 1 (b) + y 1 (b 2) + y 1 (b 3) ... y 1 (b n)

Theory of Employment NOTES Self - Learning Material 71 ?Y = 100 + 100(0.8) + 100(0.8) 2 + 100(0.8) 3 ... + 100(0.8) n–1 = 100 + 80 + 64 + 51.20..... ? 0 = 499.999 = 500 After having calculated the income (?Y) generated over time, the value of multiplier (m) can be obtained as m = Y I = 500 100 = 5 The process of dynamic multiplier may be generalised as follows. The whole series of additional incomes generated by ?I over time may be written as ?Y =?y + ?y(b) + ?y(b) 2 ???? y(b) 3 ... ?y(b) n–1 =?y(1 + b + b 2 + b 3 . . . b n–1)... By using the formula for summing a geometric series, we get ?Y =?y 1 1–b ? ? ? ? ? ? ...(2.15) Since ?y = ?I, we may rewrite Eq. (2.15) as Y = 1 1– I b From this equation, the multiplier (m) may be obtained as m = 1 1– Y I b ...(2.16) Note that the value of dynamic multiplier is the same as static multiplier. The Working of Multilier Process The working of multiplier process under dynamic conditions can be explained further by an example. Suppose a one-time autonomous investment = 100; MPC = 0.8; and all saving are hoardd or kept as idle cash balance. The multiplier process under these conditions is illustrated in the Table 2.1. Table 2.1 Working of Multiplier Process Round of income generation I Y Y MPC = (0.8) Unused Savings ( ) Amount in Rs Round 1 Round 2 Round 3 Round 4 Round 5 — — Round Last Total 100 — — — 100 — — — — 100.00 80.00 64.00 51.20 40.96 — — 0.00 500.00 80.00 64.00 51.20 40.96 32.76 — — 0.00 400.00 20.00 16.00 12.80 10.24 8.20 — — 0.00 100.00

Theory of Employment NOTES Self - Learning 72 Material As can be seen in Table 2.1, the initial autonomous investment (?I) of 100 generates an additional income (?Y) of 100. Out of this additional income, 80 = 100 × 0.80 is spent on consumption and the saving 20 = 100 – 80 is held as idle cash balance. The consumption expenditure of 80 creates an additional income of 80 for those who supply goods and services. Out of 80, 64 = 80 × 0.80 is spent on consumption. This process continued until ?C and ?Y are reduced to zero. When all additional income (?Ys) are added, the total additional income generated by one-time autonomous investment of 100 reaches 500. Now the investment multiplier can be obtained as follows. Investment multiplier= ?Y/?I = 500/ 100 = 5. Limitations of Investment Multiplier Despite its important uses in macroeconomic analysis, the concept of multiplier has certain limitations which should be borne in mind while using this concept. The first limitation of the multiplier theory is related to the rate of MPC. If the rate of MPC is lower in an economy, the rate of multiplier will also be lower too. As a corollary of this, since MPC in a less developed country is comparatively higher, the multiplier there must be higher than in the developed countries. This may however not be true in real practice because of other limitations of multiplier. Second , the working of investment multiplier assumes that those who earn income as a result of certain autonomous investment would continue to spend a certain percentage of their newly earned income on consumption. This assumption may not hold in real practice since people may like to spend a part or whole or their additional income on (i) payment of past debts; (ii) purchase of existing durable goods and other assets, like old houses, second hand cars, etc. (iii) shares and bonds from the shareholders and bond-holders; and (iv) purchase of imported goods. These are known as leakages in the consumption flows, which reduce the rate of multiplier. For example, let us suppose that a building contractor earns 50,000 from a contract, which he pays to his creditor. His creditor buys an old house. The person who sells the house buys an imported car. The money thus keeps circulating but is never spent in the manner that can generate demand for new consumer goods. In this case, multiplier will be 1. The other leakages are holding idle cash, deposits in foreign banks, etc. Third , the working of multiplier is based on the assumption that the goods and services are available in adequate supply. But, if goods and services are in scarcity, the actual consumption expenditure will be reduced whatever the rate of MPC. Consequently, the multiplier will be reduced. If expenditure continues to increase in face of scarcity, it generates inflation, and not the real income.

Theory of Employment NOTES Self - Learning Material 73 Finally , under the condition of the full-employment, the theory of multiplier will not work because additional goods and services cannot be produced or additional real income generated. Despite its limitations, the concept of multiplier is an import tool in analysing the process and the forces of economic fluctuations in an economy. In addition, the concept of multiplier is useful in analysing the impact of public expenditure, taxation and foreign trade on the economy. Foreign Trade Multiplier The foreign trade multiplier works on the similar principle as investment multiplier. Foreign trade consists of exports and imports. Exports from a country depend on the foreign demand for its goods and services depending on a number of factors including prices, foreigners' income, competitiveness of prices, income elasticity of foreign demand, level of income and also the level of exports. Similarly, imports of a country depend on the level of domestic prices, level of income, competitiveness of domestic prices against import prices, income elasticity of demand for foreign goods, and also the level of exports. Accounting for all these factors in a simple model is a very difficult proposition. Therefore, a simple model will be used to show the derivation of foreign trade multiplier. The foreign trade multiplier refers to

of domestic investment on exports. Consequently, with the rise of exports, there is an increase in income of people in the export industry leading to the creation of demand. It is crucial to remember here that marginal propensity to save (MPS= ?S/ ?Y) and marginal propensity to import (MPM= ?M/ ?Y) are both the driving factors. Therefore, the larger the two propensities, the small the value of multiplier and vice versa. Simply, speaking the when the exports of a country increases, the exporters receive a greater income, since the demand from the foreign also increase, the factors of production are also increased. This results in

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the income of the owners of the factors of production. The national income rise by the

multiplier amount. Let's now deduce

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the foreign trade multiplier. The national income is defined as Y = C + I + X – M Where Y= national income C= national consumption I= total investment X= exports and M= imports The same can be written as Y C = I + X S = I + X (Since S= Y-C) S+ M= I+ X

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the foreign trade multiplier. The national income is defined as Y = C + I + X – M Where Y= national income C= national consumption I= total investment X= exports and M= imports The same can be written as Y C = I + X S = I + X (Since S= Y-C) S+ M= I+ X

Theory of Employment NOTES Self - Learning 74 Material This is to say that at the equilibrium levels of income the total of savings and imports should be equal to the total of investment and exports. National investment is composed of two elements: Domestic (I d) and foreign investment (I f) . Therefore, I = S I d + I f = S And I f = X- M Therefore, I d + X – M= S I d + X = S+ M Which is the same as the equilibrium condition. The foreign trade multiplier coefficient is K f So K f = ? Y/?X And "X = ?S + ?M Now we will divide both the sides by ?Y and so we will get: = Or = And we know that K f = ?Y/?X so, K f = Now divide the denominator by ?Y and you get K f = And since MPS= and MPM= K f = Which as we mentioned earlier, means that the value of the multiplier is inversely related to the values of marginal propensity to save and the marginal propensity to import.
Theory of Employment NOTES Self - Learning Material 75 Now that you have seen the derivation. Let's learn about the assumptions of the foreign trade multiplier: ?Full employment prevails in the domestic economy. ?There is no direct link between the domestic and foreign country involved in the foreign trade ?There is no foreign repercussion effects. ?There is a fixed exchange rate system. ?There is no accelerator. ?There is no change in government expenditure. ?There is no presence of exchange controls or tariff barriers. ?Domestic investment does not change. ?This is applicable only for two countries. ?The multiplier assumes no time lag. Applicability of Multiplier Theory to LDCs According to

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the multiplier theory, the higher the MPC, the higher the

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the multiplier theory, the higher the MPC, the higher the

rate of multiplier. It is equally true that the lower the income, the higher the MPC. The World Bank Development Reports show that

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the less developed countries (LDCs) have a lower per capita income

and lower rates of saving and investment compared to the developed countries (DCs). The lower rate of saving indicate that LDCs have a relatively higher MPC. This implies that multiplier must be higher in LDCs than in developed countries (DCs). And, therefore, a given amount of autonomous investment should result in a much higher employment and output in LDCs than in DCs. It follows that the rate of economic growth resulting from additional investment must be much higher in the LDCs than in DCs. But that is not true: the multiplier and the rate of growth are both lower in LDCs compared to those in DCs. This creates a paradoxical situation which is called 'Keyne's MPC and the multiplier paradox.' It is, therefore, generally agreed that the logic of Keynesian multiplier does not apply to the LDCs. The reason for non-applicability of the multiplier theory to the LDCs is that the assumptions and conditions under which Keynes had formulated his theories do not hold for the LDCs. Keynes had developed his theories in the background of the Great Depression during the early 1930s. The Great Depression had affected mostly the developed countries, that is, the countries which had grown beyond the stage of, what Rostow called, 'take-off.' Besides, Keynesian theory of multiplier assumes: (i) a high level of industrial development, (ii) involuntary unemployment, (iii) existence of excess capacity, and (iv) elastic supply curves. It is a widely known fact that most of these assumptions do not hold in the LDCs. V.K.R.V. Rao had examined the issue of applicability of the Keynesian multiplier in the case of India, then a typical LDC, in the early 1950s. He found that the assumptions under which multiplier theory was developed do not hold for the underdeveloped countries. Instead, as he pointed out, an underdeveloped country is characterized by:
Theory of Employment NOTES Self - Learning 76 Material (i) a predominant agricultural sector, (ii) a vast disguised unemployment, (iii) low level of capital equipment, (iv) low level of technology and technical know how, (v) a small proportion of wage employment to the total, (vi) a vast non-monetized sector, and (vii) a vast sector producing for self-consumption. "Under these circumstances, the multiplier principle does not work in the simple fashion visualized by Keynes primarily for the industrialized economies." Besides, he adds that the very nature of the agricultural economy makes agricultural supply relatively inelastic. Even in the industrial sector, supply of good and services is constrained by limited production capacity, limited supply of inputs and gestation lag of new production plans. There is therefore a considerable time leg between the increasing demand and forthcoming supply. "This tends to widen the difference between the multiplier linking up increments of money investment with increments of money income and that linking up increments of investment with increments of total output with the result that money incomes and prices rise much faster than real income and output." For this reason too the multiplier theory does not apply to LDCs in real terms though it does work in monetary terms. However, this should not mean that the multiplier theory applies to the developed countries exactly as construed in theory. The application of the multiplier theory has its limitations in developed countries also, as pointed out above. For instance, given the saving rate of about 20 percent in the US during the 1990s, the value of multiplier should theoretically be 5. But, in reality it has been found to be 1.4. Furthermore, the multiplier theory has been found to work in developed countries more vigorously in the early stages of recovery from depression because of excess capacity than during the period of boom. Leakages in the Multiplier Process The theory of multiplier process is based on certain unrealistic assumptions. (i) that there are only two uses of the income generated by an one-time autonomous investment—consumption, given the MPC, and saving held as idle cash balance, (ii) there is no taxation or government expenditure, and (iii) there is no trade deficit or exports equal imports. These assumptions are unrealistic in the sense that, in reality, income earners spend or use their additional incomes in several different ways and on other items; government imposes tax on incomes; and, in all countries, there are imports and exports or trade deficits. The incomes spent form the purposes other than consumption and saving are called leakages from the income stream. Leakages from the income stream reduce the value of multiplier. In this section, we discuss the different kinds of leakages and their effect on the multiplier.

Theory of Employment NOTES Self - Learning Material 77 (i)Payment of the past debts: Households, especially those with low incomes, borrow to buy goods and services. When their income increases, they save and repay their past debts. The lenders who recover their loans spent it on repayment of their own debts instead of consuming it. This process continues, at least, with a part of the newly generated income. In this process, a part of the newly generated income keeps circulating in repayment of debts. This is considered as a leakage in the process of income generation. Due to this leakage, marginal propensity to consume (MPC) decreases and, therefore, the value of multiplier decreases. (ii) Purchase of existing wealth and consumer durables: Sale and purchase of old items of property and consumer durables like shares, bonds, houses, car and other second-hand goods, is a common practice in all the economies. In economic sense, this is another form of leakage from the income stream created by the new investment. If a part or total of newly generated income is continuously spent on such items and it never returns to consumption stream. Due to this kind of spending, MPC decreases. The decrease in MPC decreases the value of multiplier. (iii) Income taxation by the government: From multiplier theory point of view, income taxes, or all direct taxes for that matter, are considered as another form of leakage from the income stream. In case tax revenue is held by the government as idle cash balance, it is treated as a withdrawal from the income stream and hence it reduces the value of multiplier. In practice, however, government imposes taxes and spends the tax revenue. Suppose the government spends as much as it spends, i.e. , government expenditure equals the tax revenue. This is called balanced budget policy . As we have discussed above, balanced budget multiplier is always equal to one. That is, it does not depend on the value marginal propensity to consume. Therefore, ?Y = ?G. (iv) Import of goods and services: The multiplier theory is based on the assumption that the entire newly generated income is spent on the domestic goods and services. This may not be the case always. The newly generated income may be wholly or partly spent on imported consumer goods and service, As a result, country's income flows out to foreign countries. This is yet another and a very important kind of leakage from the income stream. The leakage of income caused by imports reduces the income flows in the country. Therefore, the income (?Y) generated by additional investment, ?I, decreases and, therefore, the value of multiplier (?Y/?I) decreases. This case of leakage applies also to the countries having both exports and imports but having trade deficits. A country has trade deficit when its imports exceed its exports, as is the case of India. Other Constraints on the Multiplier In addition to the leakages, there are some other constraints which limit application of the multiplier process in income generation. An important constraint in the multiplier process is the state of full employment . In case the economy is in the sate of full employment, additional demand created by the additional money income

Theory of Employment NOTES Self - Learning 78 Material resulting from additional investment does not lead to creation of additional output. Consequently there is no increase in real output. It leads only to inflation. Yet another constraint in the process of multiplier is created by the resource imbalance or structural imbalance between labour and capital, e.g., being in excess supply and capital being scarce, as is the case in the less developed countries. This kind of resource imbalance limits the scope of production and generation of real income. Additional investment under the condition of resource imbalance creates conditions of inflation, not the generation of real income. In spite of these limitations, however, the theory of multiplier has a good deal of application in estimating the result of growth efforts made the countries and of development programmes initiated by the government and in estimating the possible growth rate. 2.5 ACCELERATOR PRINCIPLE Although the discussion of the acceleration principle owes much to the pioneering efforts of Erik Lundberg, Paul A. Samuelson, Roy F. Harrod, John R. Hicks, William J. Baumol, Richard M. Goodwin and others, it is also found in the pre- Keynesian literature. Its origin is traceable in the writings of Albert Aftalion, CF Bickerdike, Ralph George Hawtrey and Ragnar Frisch. The best-known early study of the acceleration principle is found in John Maurice Clark's article titled 'Business Acceleration and the Law of Demand' published in The Journal of Political Economy in March 1917. Clark studied the fluctuations in the railroad traffic and the demand for railroad cars. His main conclusion was that the demand for railroad traffic fluctuated more closely with the change in the railroad traffic than with the level of the railroad traffic. This, in brief, is the naive acceleration principle which stresses a certain fixed relationship between changes in the capital stock and changes in the aggregate output. After Clark, not much headway was made until Ragnar Frisch's well-known article published in 1933 opened the vast possibilities of new development on the subject. Among the more recent contributions, mention may be made of the studies made by John R. Hicks and Paul A. Samuelson who have ascribed trade cycle to the interaction of the multiplier and the accelerator. Great interest in the study of acceleration principle— relation as Harrod called it—was aroused by Roy F. Harrod's excellent work published in 1936. According to Harrod, accelerator played a significant role in the generation of the trade cycle. Highlighting it, Harrod wrote: 'It is a relation which has, indeed, been noted by learned writers often enough ..... Its simplicity, ineluctability, and independence of all special theories as to the workings of the cyclical process demand for it pride of place.' The acceleration principle states that the demand for capital goods varies directly with the change in the level of aggregate output. The extent of change in the demand for capital goods depends on the capital-output ratio and the change in the level of output. Since the change in aggregate output depends on the change in aggregate expenditure or aggregate demand which itself equals the change in the level of equilibrium income, we might say that total investment in the economy

Theory of Employment NOTES Self - Learning Material 79 in any given time period depends on the change in the aggregate demand which in equilibrium equals the increase in the national income plus the replacement investment which is assumed constant. Thus the gross investment in the economy during any given time period t will be equal to the increase in the national income during that time period times the capital-output ratio (K/Q) plus the replacement of capital consumed in the process of production. Designating the 'capital-output ratio' or 'capital coefficient' by v, the aggregate income of time periods t and t – 1 by Y t and Y t _ 1 respectively and the replacement investment by R, the gross investment (I g) in any given time period t will be– (I g)t = v (Y t – Y t–1) + R ...(2.17) = v ? Y t + R ...(2.18) The average capital-output ratio v = (K/Q) is called the accelerator or relation. where I gt =

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gross investment in period t, v = accelerator, Y t = national output in period t, Y t -1= national output in the previous period (t—1), and R = replacement investment

The equation simply conveys that the gross investment for the time period t is equal to the accelerator multiplied by the change in output from period t-1 to t plus the replacement investment. The rigid acceleration principle in its naive form, however, assumes a given fixed relationship between capital and output. It states that the net induced investment in any given time period t is entirely a function of the growth of final output in that time period, i.e., (I n) t = v (Y t – Y t–1) ... (2.19) (I n) t = v?Y t ...(2.20) or (I n) t = ?K t = v?Y t 3 ...(2.21) According to Equations (2.20) and (2.21), the net investment in the economy in any given time period t is acceleration times the change in the aggregate output or income in that time period. Expressed differently, the accelerator states that if the aggregate output stayed at a high level but ceased growing, then the net investment would eventually become zero. This has been shown in Figure 2.12 where so long as the aggregate output shown by the aggregate output curve 0 Q is increasing over time, the net investment shown by the curve I n I n is positive. It is, however, falling because the aggregate output per time period is growing at a diminishing rate. The negative slope of the net investment curve reflects the diminishing positive slope (growth) of the aggregate output curve. When the slope of the aggregate output curve becomes zero, the net investment also becomes zero, i.e., when the aggregate output attains the plateau, the net investment in the economy becomes zero.
Theory of Employment NOTES Self - Learning 80 Material Fig. 2.12 The Acceleration Principle The acceleration principle expressed in equation (2.21) states that if the existing capital stock of the economy is fully utilized, i.e., if there is no redundant capital in the economy and if the capital-output ratio (K/Y) is fixed, a given increase in the final output will require an increase in the economy's total capital stock which will be equal to the increase in the aggregate output times the accelerator. If the value of the accelerator exceeds one, the required increase in the aggregate capital stock will exceed the increase in the demand for final output. In short, with an accelerator of more than one, a given increase in the aggregate demand for the final output will magnify the derived demand for the capital stock needed to produce the additional output. The extent to which the demand for capital stock or investment will be magnified as a result of the given increase in the demand for final output will depend on the durability of the capital goods and the value of the accelerator. Given the value of the accelerator, greater the the durability of the capital equipment, more violent will be the fluctuations in the investment demand consequent upon any given change in the demand for final output. Greater durability of the capital goods and a high accelerator reinforce each other causing explosive oscillations in the demand for capital or investment goods and vice versa. The acceleration principle is useful for the analysis of the downturn and of the long-run growth. To an extent, the theory of pump-priming rests on the acceleration principle. Apart from helping in the formulation of the trade cycle models, it has also helped in the formulation of neat models of long-run economic growth path of the economy. The acceleration principle has also been usefully employed in explaining the changes in the investment in inventory stocks and in the durable consumer goods. Assumptions The simple acceleration principle is based on several assumptions. First, it is essential for the operation of the principle that the total capital stock of the economy

Theory of Employment NOTES Self - Learning Material 81 must be fully utilized. In other words, there should be no idle or surplus plant capacity present in the economy. Consequently, the acceleration principle becomes non-operative in depression when due to the presence of idle or surplus plant capacity in the economy the output can be increased without requiring any increase in economy's capital stock. This essential condition for the operation of the acceleration principle was stated by J. M. Clark in his well-known article in these words: '.... the first increase in demand for finished products can be taken care of by utilizing the excess producing capacity which an industry using much machinery habitually carries over a period of depression. Thus, they do not need to buy more equipment the instant the demand begins to increase.' In other words, the operation of the acceleration principle is asymmetrical. Secondly, it is assumed that the firms increase their capital stock to meet the increase in the demand for their products promptly without considering the nature of the increase in the demand, i.e., the firms add to their plant capacity even if the increase in the demand for their products is short-lived and temporary. Thirdly, the naive acceleration principle assumes a fixed capital-output ratio. Consequently, changes in the capital-output ratio under the impact of technological improvements are ruled out. The fourth assumption is that the acceleration principle assumes that there is no ceiling to investment, i.e., the capital goods' supply function is perfectly elastic placing no barrier on the expansion of capital stock when needed. The acceleration theory assumes that it does not matter how rapid is the increase in the demand for final products. The necessary capital goods can be immediately produced so that the optimum capital stock and the actual capital stock are always equal. The fifth assumption is that the naive acceleration principle assumes that an increase in the rate of output growth is accompanied by an

the aggregate output does not alter the structural composition of the aggregate output. Lastly , the acceleration theory assumes that the capital goods are perfectly divisible in any required size. Criticism The acceleration principle has been criticized on several grounds. The assumption of constant capital-output ratio has been vehemently criticized. It has been argued that the empirical studies do not lend support to the assumption of fixed accelerator. In this age of rapid scientific advancement, technology has been fast changing over time. Even if the technology was assumed to remain static, the extent of the needed increase in the capital stock consequent upon a given increase in the demand for final output will depend on the distribution of this increase in the demand for total output between different goods and services produced by the different industries with different capital-output ratios. If the increase in the demand for output was concentrated on the demand for the products of high accelerator industries, a greater increase in the capital stock would be needed compared with

Theory of Employment NOTES Self - Learning 82 Material the situation in which the demand was concentrated on the products of low accelerator industries. Secondly, by disaggregating the investment by industries it can be shown that net investment in the economy might take place even if the total output has not increased. A redistribution of the existing aggregate demand for goods may cause, through the accelerator, more net investment in those industries which experience an increase in the demand for their products compared with the disinvestment in those industries which are faced with a falling demand for their goods because disinvestment in any industry cannot exceed the rate at which the capital stock is consumed. Thirdly, the acceleration theory ignores the role of expectations in the investment decisions of the firms. Entrepreneurs will not increase their plant capacity even if the demand for their products has increased unless they expect the increase in the demand to be permanent, According to Jan Tinbergen, the acceleration principle cannot accurately depict the formation of investment decisions. David McCord Wright has rejected the acceleration principle as an unimportant factor in the firms' investment decisions. Entrepreneurs are influenced by many factors other than the current increase in the demand for their products while making investment decisions. Past memories affect reactions to present events. Regardless of the state of the present demand, firms will not increase their existing plant capacity unless their expectations about the future warrant it. According to Simon Kuznets, if the equipment is more durable, the entrepreneurs will be more wary before installing additional equipment in response to an increase in the demand for their products. The fact that in their investment decisions, firms are alive to distant possibilities divorced from the current market changes restricts the utility of the acceleration principle for purposes of analysis. The fourth criticism is that full capacity which is a prerequisite for the operation of the acceleration principle, is absent in the early stages of the cyclical upswing. Consequently, the operation of the accelerator is asymmetrical as between the cyclical upswings. Stating this weakness of the acceleration principle, Tinbergen writes: 'Very strong decreases in consumers' goods production must not occur. If the principle were right, they would lead to a corresponding disinvestment and this can only take place to the extent of replacement. If annual replacement amounts to 10 per cent of the stock of capital goods, then a larger decrease in this stock than 10 per cent per annum is impossible. A decrease in consumers' goods production of 15 per cent could not lead to a 15 per cent decrease in physical capital as the acceleration principle would require. It is interesting that this limit is sharper the greater the duration of life of the capital goods considered'. Tinbergen has also criticized the acceleration principle as being useless in practice. Since full capacity is a prerequisite for the operation of the acceleration principle, according to Tinbergen, statistical evidence shows that this condition is very rarely, if ever, met with in practice. The fifth criticism is that the acceleration principle ignores the technical factors in investment. Capital equipment may be bulky and indivisible and the use

Theory of Employment NOTES Self - Learning Material 83 of additional plant would be justified only when the demand for output has increased considerably. This factor is all the more important because usually what is added is not a single machine but a complex of machines. For example, when the demand for railway traffic increases, additional capacity will not be employed unless the increase in the traffic demand justifies the running of an additional train and the construction of the additional rail track, etc. If net investment is to be strictly a function of the rate of growth of output, units into which the stock of capital equipment is divisible must be the same as those into which the output is divisible. In other words, corresponding to each output unit there must exist an appropriate capital equipment unit to produce that output unit. This is not, however, possible. Indivisibility of the capital plant is at the root of the economies of scale in production. Criticizing the acceleration principle, Hutt has stated that the 'sophisticated accelerationists contend that net accumulation (S) will tend to vary directly with the rate of growth of output, so that– S = dO K dt I contend, on the contrary, (a) that the magnitude replacement + net accumulation tends to vary in direct proportion to output and with the rate of change in output; (b) that the magnitude net accumulation ('investment') is arbitrarily related to output because it is an overlap dependent upon the rate of decumulation (consumption); and (c) that fallacy lurks in the concept of the time increment, for when output is related to the provision of assets, the minimum comparable time unit is the economic life of the assets.' The sixth point of criticism is due to the acceleration principle which ignores the role of movements in the rate of interest on causing fluctuations in the investment schedule due to reactions through the monetary sector. Moreover, changes in income are partly discounted by the business firms. Consequently, these changes do not cause equal changes in expected output. Further, it is criticized due to a serious drawback of the acceleration theory in that it assumes that all investment is a function of change in income ?Y while only a component of the net investment is a function of change in income ?Y. Lastly, the naive acceleration principle does not take into account the limits on the rate of investment. The theory assumes that the supply function of capital goods (and that too in the short run) is perfectly elastic so that it is possible to increase the capital stock to any extent required by the increase in the demand for output. In reality, however, it is not so. In the light of all these criticisms of the acceleration principle, one might ask: to what extent, if any, does the simple acceleration principle explain the changes in investment which we see around us? Although the acceleration principle does not operate as effectively in practice as the theory assumes, however, it works to some extent. For example, who can deny that entrepreneurs' decisions to add to their capital stock are partly influenced by the increase in the demand for their products? Although the acceleration principle cannot explain the lower turning point of the cycle, it is, however, useful in the analysis of the down-turn and of the

Theory of Employment NOTES Self - Learning 84 Material long-run growth of the economy. In short, the acceleration principle, together with the other factors, helps in explaining the cyclical oscillations which are observed in the investment activity in the economy. On account of these limitations, various attempts have been made to modify the simple acceleration theory described above in several ways. One modification is to assume that the firm's capital requirements are related to the previous period's output rather than to current output such that K t is proportional to Y t–1 rather than to Y t . Consequently, net investment in any given time period t is functionally related to an increase in the immediately preceding time period's income ?Y t–1 (= Y t–1 – Y t–2). Although this version of the acceleration principle is an improvement over the naive version in certain respects yet the limitations mentioned above still apply. Goodwin and Chenery have suggested a stock-adjustment version of the acceleration principle. Interaction between the Multiplier and Accelerator The acceleration and the multiplier principles have been combined into a single model to show their interaction. This follows from the fact that an increase in the investment or consumption spending involving either the multiplier or the accelerator has an impact on the other depending on the presence or absence of the excess plant capacity in the economy. In other words, an increase in the autonomous investment increases output and income which in turn increases consumption. The induced consumption increases the induced investment (if there is no excess plant capacity in the economy) via the acceleration principle. The chain of causation between the multiplier and the accelerator is roughly of the following structure: ?I a ? ?Y ? ?C ? ?I i ? ?Y ? ?C ? ?I i Different multiplier-accelerator models have been constructed by the economists to show how the fluctuations in the level of aggregate economic activity come about and how these can be self-generating. However, any desired result can be obtained by choosing the appropriate values for the accelerator (v) and the marginal propensity to consume (b). Explosive trade cycle will be produced if the sum of the values of v and b is high; if this sum is low, cyclical fluctuations in income will occur, the magnitude of the fluctuations depending on the chosen values of the accelerator and the marginal propensity to consume. If their sum is close to 1, the oscillations will be small. If it is more than 1, the oscillations will be large. A very large v combined with a high b leads to an increasing rate of growth of income. It is the value of v which determines the degree and the kind of the trade cycle which is generated. If v is zero, the multiplier would simply work its way out without causing any cyclical fluctuations. When the value of v is high, income explodes following an increase in the autonomous component of the aggregate demand (investment or consumption) and the multiplier is overpowered. For a value of v between 0 and 5, high cyclical fluctuations will occur. For a high value of v, the explosive cycles with increasing size will occur. A smaller value of v produces the damped trade cycles. At some in-between moderate value of v, perfectly symmetrical trade cycles will be produced. The working of the multiplier and the accelerator can be understood with the help of the following equations and Table 2.2.

Theory of Employment NOTES Self - Learning Material 85 Y t = C t + I t ...(2.22) C t = a + bY t–1 ...(2.23) I t = I A + v (Y t–1 – Y t–2) ...(2.24) In equation (2.23), the consumption function shows that the induced consumption has one time period lag in relation to income, i.e., the consumption of any given time period t depends on the income of the immediately preceding time period t – 1 . In equation (2.24), the investment demand function shows that the induced part of total investment has a two time period lag in relation to income, i.e., net induced investment in time period t is a function of the increase in income in the preceding time period t–1 or of ?Y t–1 . Thus, both a second-order lag and an accelerator are required to generate a business cycle. Taking the value of v as 3, the value of b as 0.5, the value of the autonomous consumption a as 10, the value of the autonomous investment I A as 50 and the initial equilibrium income as 120 corresponding to which the induced consumption is 60, we assume that there is an increase of 10 units in the autonomous investment. Under the impact of the interaction between the multiplier and the accelerator, the aggregate income will increase in the manner as shown in Table 2.2. Table 2.2 Interaction of the Multiplier and Accelerator Time Autonomous Induced Consumption Total Income Period Investment Investment I A I i = v(Y t–1 – Y t–2) C = a + bY t–I Y = C + I A + I i (v = 3) (b = 0.5) 1 2 3 4 5 t – 2 50 0 10 + 60 120 t – 1 50 0 10 + 60 120 t 60 0 10 + 65 135 t + 1 60 30 10 + 65 165 t + 2 60 105 10 + 82.5 257.5 t + 3 60 277.5 10 + 128.75 476.25 t + 4 60 656.25 10 + 238.12 964.38 ... ... The table shows that consequent upon a given increase in the aggregate autonomous investment, the aggregate equilibrium income grows through an explosive path through time and there are no oscillations. This is so because the value of the accelerator v chosen is high (it is 3) while

not low. Check Your Progress 7. Define static and dynamic multiplier. 8. What are the unrealistic assumptions of multiplier process? 9. Define Keynes's MPC and the multiplier paradox.

Theory of Employment NOTES Self - Learning 86 Material 2.6 ANSWERS TO 'CHECK YOUR PROGRESS' 1. A laissez-faire system is one in which: (i) There is complete absence of government control or regulation of private enterprise, except to ensure free, competition. (ii) There is complete absence of monopolies and restrictive trade practices— if there is any, it is eliminated by law. (iii) There is complete freedom of choice for both the consumers and the producers. (iv) The market forces of demand and supply are fully free to take their own course. 2.

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The classical economists held the view that an economy based on laissez- faire principles,

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classical economists held the view that an economy based on laissez- faire principles,

is always in the state of equilibrium at full employment. 3. The law that 'supply creates its own demand' is generally attributed to a French economist, Jeane Baptiste Say. 4. The labour supply function (N s) assumes a positive relationship between real wages and labour supply, meaning it is an increasing function, sloping upwards. 5. The Keynesian concept of consumption function stems from the fundamental psychological law of consumption which states that there is a common tendency for people to spend more on consumption when income increases, but not to the same extent as the rise in income because a part of the income is also saved. 6. The following are the important components of the aggregate demand: ?Consumption demand ?Investment demand ?Government expenditure and ?Net exports (Exports-Imports) 7. Static multiplier is also known as 'comparative static multiplier', 'simultaneous multiplier', 'logical multiplier', 'timeless multiplier', or 'lagless multiplier'. The concept of static multiplier assumes that the change in investment and the resulting change in income are simultaneous the concept of dynamic multiplier is also known as period or 'sequence' multiplier. Dynamic multiplier does not make the assumptions of the static multiplier. Dynamic analysis of the multiplier traces the process by which equilibrium of national income shifts from one position to another. 8. The theory of multiplier process is based on certain unrealistic assumptions. (i) that there are only two uses of the income generated by an one-time autonomous investment—consumption, given the MPC, and saving held as idle cash balance, (ii) there is no taxation or government expenditure, and (iii) there is no trade deficit or exports equal imports.
Theory of Employment NOTES Self - Learning Material 87 9. The rate of economic growth resulting from additional investment must be much higher in the LDCs than in DCs. But that is not true: the multiplier and the rate of growth are both lower in LDCs compared to those in DCs. This creates a paradoxical situation which is called 'Keynes's MPC and the multiplier paradox. 2.7 SUMMARY ?The simple Keynesian theory of income, output and employment determination can be studied either through the aggregate income- expenditure approach in the form of Y = C + I or through the aggregate saving-investment approach in the form of S = I. ?The Keynesian theory has been criticized as being 'too static' in the sense of being concerned with equilibrium conditions during the short period in which technology and capital stock are given and are not likely to change. ?

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The supply of labour (N s) is a function of real wages. The supply of labour

increases with any increase in the real wage rate. ?The MPP L curve can be treated as the labour demand curve . We know that, under competitive conditions, a profit maximizing firm employs labour where real wages (W r) equals MPP L . ?But remember, this is a decreasing function of real wages. A downward slope. This is to say, at a lower real wage rate, more labour will be demanded and at a higher wage rate, less labour will be demanded. ?In the classical model, employment and output are determined solely by the factors operating on the supply side of the labour market. ?In this background, Keynes wrote the General Theory of Employment, Interest and Money , providing a fresh perspective to the income and employment theory used up till now. One of the important points raised by Keynes was that unlike previously assumed, full-employment is not the general status of an advanced capitalist economy but underemployment equilibrium is. ?

price refers to the expected expenditure from the employment of a given number of workers for the production of goods and services. Similar to the aggregate supply price, the aggregate demand price too varies with the level of employment. ?The level of employment directly affects the level of income and output for a nation. Therefore, if there is a certain level of capital and technology, when you increase the labour, the aggregate level of output will also be increased. The magnitude of effective demand refers to the addition of consumption and investment demand at the intersection point of AS and AD curve.

Theory of Employment NOTES Self - Learning 88 Material ?The investment multiplier and the marginal propensity to consume are related in such a manner that higher the marginal propensity to consume, higher is the investment multiplier and vice versa. ?The investment multiplier and the marginal propensity to save are inversely related such that a high marginal propensity to save denotes a low investment multiplier and vice versa. ?The initial increase in the autonomous investment by increasing the aggregate income occasions simultaneously induced increase both in the consumption and investment spending in the economy ?A given increase in the autonomous investment apart from causing an increase in consumption spending, also increases the investment and consequently brings about a larger increase in income compared with the simple model in which the induced investment is absent. ?The multiplier associated with simultaneous change in government spending and taxation is called fiscal multiplier. ?When the government keeps its spending and taxation in balance, it is called balanced budget. ?The lower rate of saving indicates that LDCs have a relatively higher MPC. ?The multiplier theory has been found to work in developed countries more vigorously in the early stages of recovery from depression because of excess capacity than during the period of boom. 2.8 KEY TERMS ?Aggregate demand: It is the sum of total money spend in an economy on the purchases of consumption and investment goods by the consumers and entrepreneurs. ?General Equilibrium: The equilibrium in the real sector is defined in terms of the equality between the aggregate saving and aggregate investment. ?

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Marginal Propensity to consume: It is the ratio of change in consumption to the change in income. ?

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Marginal Propensity to consume: It is the ratio of change in consumption to the change in income. ?

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Marginal Propensity to consume: It is the ratio of change in consumption to the change in income. ?

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Marginal Propensity to consume: It is the ratio of change in consumption to the change in income. ?Marginal Propensity to save: It is the

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Marginal Propensity to consume: It is the ratio of change in consumption to the change in income. ?Marginal Propensity to save: It is the ratio of change in

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is the ratio of change in consumption to the change in income. ?Marginal Propensity to save: It is the ratio of change in savings to the change in

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Marginal Propensity to save: It is the ratio of change in savings to the change in income. ?

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Marginal Propensity to save: It is the ratio of change in savings to

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Marginal Propensity to save: It is the ratio of change in savings to the change in income. ?

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ratio of change in savings to the change in income. ?Investment multiplier: It is the

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multiplier defined as the ratio of the change in national income due to change in

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defined as the ratio of the change in national income due to change in investment. ?Fiscal multipliers: It is

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defined as the ratio of the change in national income due to change in investment. ?Fiscal multipliers: It is

the changes in fiscal policy of the government that cause change sin equilibrium income. ?Expenditure multiplier: The multiplier associated with change in government expenditure is called government. ?Tax multiplier taxation: It leads to decrease in the national income by a multiple of additional taxation.
Theory of Employment NOTES Self - Learning Material 89 2.9 SELF-ASSESSMENT QUESTIONS AND EXERCISES Short-Answers Questions 1. What is laissez- faire? 2. Briefly explain how there is no unemployment under classical system. 3. Write short note on effective demand. 4. Write short note on propensity to save. 5. Write a short note on the relationship between multiplier and accelerator. Long-Answer Questions 1. Describe the relationship between the aggregate demand and aggregate supply curve. 2. Discuss the main postulates of classical economics. 3. Examine the propensity to consume or consumption function. 4. Describe the relationship between the great depression and the multiplier theory. 5. Explain the investment multiplier with the algebraic derivation. 6. What is accelerator principle? Explain its assumptions and criticisms. 2.10 FURTHER READING Mankiw, N Gregory. 2010. Macroeconomics . New York: Worth Publishers. Shapiro, Edward. 1996. Macroeconomic Analysis . New Delhi: Galgotia Publication. Jha, R. 1999. Contemporary Macroeconomic Theory and Policy . New Delhi: New Age International. Gupta, SB. 2011. Monetary Economics: Instruments and Policy . New Delhi: S Chand & Co.
Investment and Liquidity NOTES Self - Learning Material 91 UNIT 3 INVESTMENT AND LIQUIDITY Structure 3.0 Introduction 3.1 Objectives 3.2 Investment Function 3.3 Marginal Efficiency of Capital 3.3.1 Factors Affecting Investment Function 3.4 Keynesian Theory of Liquidity Preference and Liquidity Trap 3.4.1 Criticism Against Liquidity Preference Theory 3.4.2 Discounting Rate 3.5 Answers to 'Check Your Progress' 3.6 Summary 3.7 Key terms 3.8 Self-Assessment Questions and Exercises 3.9 Further Reading 3.0 INTRODUCTION Investment is one of the most important components of economics. One cannot imagine macroeconomics without investment. It determines both long-term and short-term situation of an economy and one must have firm grip on future investment to understand the future state of economy. Liquidity refers to how long and at what cost it takes to convert an investment into cash. Liquidity or a lack thereof causes more financial problems than almost any other aspect of finance. In this unit, you will learn about the investment function, marginal efficiency of capital, factors affecting investment function, Keynesian theory of liquidity preference and liquidity trap and discounting rate. 3.1

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OBJECTIVES After going through this unit, you will be able to: ?

Describe investment function ?Explain marginal efficiency of capital ?Define the factors affecting investment function ? Analyse Keynesian theory of liquidity preference and liquidity trap ?Define discounting rate 3.2 INVESTMENT FUNCTION In the national income analysis, investment refers to that part of the aggregate output for any given time period which takes the form of construction of new
Investment and Liquidity NOTES Self - Learning 92 Material structures, installation of new capital equipment and positive changes in the business inventories in the economy. The value of this part of output, apart from changes in inventories, is measured by the amount of total outlay incurred on these items. Defined in this manner, investment can be either gross or net. From the gross investment, the replacement investment must be deducted in order to obtain the net investment in the economy. Investment (gross or net) includes the purchase of business structures such as manufacturing plants, construction of warehouses and stores and producers durables like lathes, milling machines, typewriters, calculators, computers and trucks. Investment also includes expenditure incurred on the construction of all residential structures including both the owner-occupied houses and rental housing. Any attempt to explain the aggregate investment spending in the economy during any given time period is faced with the difficulty that the different types of investment outlays are influenced by different factors. Consequently, no single theory can adequately explain all the forms of investment outlay. For instance, investment made in the owner-occupied residential construction is not significantly affected by the profit motive while the investment made in the industrial structures, rental housing and business inventories is primarily affected by the profit motive. Gross and Net Investment Investment is a flow concept while capital is a stock concept. By capital we mean

the accumulated stock of plant and equipment held by the business

sector. If the aggregate investment during any given time period for the economy is just equal to the replacement investment—investment needed to maintain the economy's existing total capital stock intact by providing for the wear and tear and for the accidental damage to machinery—the net investment, i.e., addition to the economy's total capital stock (?K) for that period will be zero. If during any given time period t, gross investment exceeds the replacement investment—investment required to provide for the capital consumed in the process of production—the net investment will be positive and the economy's total capital stock will increase to the extent of net investment, i.e., ?K t = I net . On the contrary, if the gross investment in the economy is less than the capital replacement requirement, net investment will be negative. Consequently, the economy's capital stock will also decrease and unless the capital-output ratio (K/O) falls, the economy's total production capacity will also decrease. It, therefore, follows as a first lesson in economic growth that if the economy has to grow over time, its capital stock must also grow. In fact, accelerated economic growth requires that along with the growth of the economy's capital stock, the capital-output ratio must also fall by constantly adopting the progressively capital-saving techniques of production. Net investment represents an addition to the economy's total capital stock which, ceteris paribus, means an increase in the economy's total productive capacity. This is so because a larger physical capital stock used with the existing quantities of the other cooperating inputs—labour, technology and natural resources—would result in the larger total physical output although the additional output due to the employment of additional capital units would diminish as the capital stock continues to increase.

Investment and Liquidity NOTES Self - Learning Material 93 In the real world, however, other things do not remain the same as the economy's total capital stock grows over time. As the capital stock in the economy grows over time, the labour force also grows both quantitatively and qualitatively (in the form of increased labour productivity) and the production techniques improve. Whether we assume a given 'state of arts' or technological improvements taking place in the economy and creating a demand for investment necessitated by modernization of the firm's plants and equipment for the economy as a whole, net investment increases the economy's aggregate productive capacity. Motivation for Investment In the free enterprise market economy, entrepreneurs' investment decisions are primarily influenced by the profit motive. Businessmen purchase capital goods either to replace their depreciated plants or to expand their plant capacity because by doing so they expect to make profit. This is not, however, to deny the influence of other factors in a firm's investment decision; still the main motive is the expected profitability of any given investment outlay. Other influences related to profit are the presence of excess plant capacity, pressure of demand on the capacity, tax laws, cost of obtaining the necessary funds, technological changes and innovations, desire to maintain a hold on the market, position of the firm's financial reserves needed to finance the plant expansion, etc. In estimating the total profit which may be expected to accrue to a firm, three elements are crucial: first, the total expected income flow from the capital project or good during the useful life of the project; secondly, the purchase price or cost of the capital good; and thirdly, the market rate of interest or the cost of financing the capital good or project. Since the expected income flows from any given capital good relate to an uncertain future period, forecasting is unavoidable. Consequently, the crucial factor in the firm's evaluation of the total profitability of any given investment outlay is its estimated total income flows which the firm expects to receive over the entire life of the capital good. Since the estimation of the expected annual income flows and the useful life of the plant is an exercise in future forecasting, both these are uncertain. Forgetting for the present the problem of future forecasting, let us assume that the firm estimates the useful life of the capital good (machine) as 5 years after which it would become scrap with zero or negligible value. The physical productivity of the capital good will be the increase in the total output of the firm in each one of the 5 years due to the addition of this machine to the firm's existing capital stock. The expected physical product for each year multiplied by the expected price at which each year's additional output can be sold measures each year's expected gross money income flows which will accrue to the firm by installing the additional machine. From this estimated gross income or total sales revenue for each year, the total cost incurred by the firm on the purchase of raw material, labour, power, etc., on this additional output should be deducted, to arrive at the expected net income flow yielded by the machine in each year. The series of expected annual net income flows during each one of the 5 years may be designated as R 1 , R 2 , R 3 , R 4 , and R 5 , where the term R refers to the expected annual net income flows and the subscripts 1, 2, 3, 4 and 5 refer to the first, second, third, fourth and fifth year respectively.

Investment and Liquidity NOTES Self - Learning 94 Material Assuming that the sum of the annuities R 1 , R 2 , R 3 , R 4 , and R 5 is greater than the cost or purchase price of the capital good, can the positive difference between the sum of the series of expected annuities and the purchase price of the machine be regarded as the estimated profit which will accrue to the firm over its five-year life? Can we get the expected average profit per year by dividing these figures by five? Can we obtain the rate of return on investment by dividing this figure by the purchase price of the machine? The answers to all these questions are in the negative. The excess of income flow over the cost of the capital good (machine) is not profit because while the expected income flows will accrue in annual instalments, the entire cost of the capital good is incurred in a lump sum at the time of its purchase. To ignore the time difference between the present capital outlay and the future expected annual income flows (assuming these income flows were certain to accrue to the firm) is to treat the present rupee equivalent to the future rupee. As long as a lender can receive a positive rate of interest, a rupee which is to be received in future will not be worth a rupee in present. In order to find out the present worth of the future expected annual income flows, these flows must be discounted at some proper rate. In other words, let us suppose that the expected annual income flows have materialized. To make any meaningful comparison of the present cost or purchase price of the capital good with the expected annual income flows, the present value of these expected income flows must be computed by appropriately discounting them. The present discounted value of the future annual income flows, would depend on the rate at which these flows are discounted. Any given future income flow, if discounted at a lower rate will have a higher present value and vice versa. The discounting process by which a future sum is reduced as it is converted into its present value, is the reverse of the process of accumulation by which a present sum grows as it is carried into the future. For example, if the present value of 100 to be received after one year discounted at 5 per cent is 95.24, 95.24 loaned today at the 5 per cent rate of interest will become 100 after one year. Expected Annual Income Streams Present Value Discounted at 4% 5% 6% R 1 = 100 at the end of 1 year 96.15 95.24 94.34 R 2 = 100 at the end of 2 years 92.46 90.70 89.00 R 3 = 100 at the end of 3 years 88.90 86.38 83.96 R 4 = 100 at the end of 4 years 85.48 82.27 79.21 R 5 = 100 at the end of 5 years 82.19 78.35 74.73 Total ... ... 445.18 432.94 421.24 Given the values of the expected annual income flows R 1 , R 2 , R 3 , R 4 , and R 5 , their present values will be affected by the rate at which these values are discounted. An increase in the discount rate will decease their present values and vice versa. This is explained in the above table where the values of each of R 1 , R 2 , R 3 , R 4 , and R 5 expected annual income streams are 100. Discounting these values at the three different discount rates of 4, 5 and 6 per cent gives us three different sets of present values. Given the discount rate, each unit of the expected income

Investment and Liquidity NOTES Self - Learning Material 95 stream of 100 becomes smaller as the future advances. Apart from this, for any given year the present value of the same expected income stream of 100 falls as the rate at which it is discounted rises. The total at the bottom of each column represents the amount which if invested at the rate of interest mentioned at the top of each column would give an income flow of 100 annually for 5 years and thereafter nothing. Figures 3.1(A) and 3.1(B) illustrate the foregoing table showing that (1) for the same discount rate, the present value of 100 will be lower, longer is the future period involved; and (2) for the same future period involved, the present value will be smaller, higher is the rate used for the purpose of discounting. Figure 3.1(A) shows that the present value of 100 shrinks as the future period increases. In the figure, 100 to be received after one year in 2006 discounted at the rate of 6 per cent yields the present value of 100 in 2005 of 94.34; the sum of money to be received after 2 years in 2007 will be worth 89.00 in 2005 when discounted at 6 per cent. Similarly 100 to be received after 3, 4 and 5 years in 2008, 2009 and 2010 respectively discounted at 6 per cent would have the present value (2001) of 83.96; 79.21 and 74.73. Figure 3.1(B) shows that 100 to be received after 5 years in 2010 would be worth 74.73; 78.35 and 82.19 in 2005 if discounted at the 6, 5 and 4 per cent respectively. Suppose that the machine which is expected to yield an annual income of 100 for 5 years costs 432.94 in 2005. The question is: is this a profitable investment? From the information about the expected annual income flows and the present cost of the machine, we can only get the expected rate of return on the present cost price of the machine. In this case, the firm has to invest 432.94 on the machine from which it expects an annual income flow of 100 for 5 years. This gives a 5 per cent prospective rate of return on the funds invested in the machine over a period of 5 years. Will this 5 per cent rate of return induce the firm to invest in the machine? The answer to this question can be given only after knowing the cost of borrowing the necessary funds—

at which the firm can borrow funds to buy the machine exceeds the rate of return which the firm expects from investing the borrowed funds in the machine, it will not be worthwhile for the firm to purchase the machine. In other words, if the current market rate of interest is higher than 5 per cent, the firm will incur a net loss on the investment made on the purchase of machine. Consequently, it will not buy the machine. On the other hand, if the market rate of interest is lower than 5 per cent, the investment would be profitable and the firm would purchase the machine. Thus, the market rate of interest enters into the investment decision of the firm from the side of cost of funds of machine. Even if the firm does not borrow funds, in the market and finances the cost of the machine from its own funds it will not alter the decision-making process. In this case, it will compare the rate of interest at which it can lend its funds in the market with the expected rate of return on these funds when invested in the machine. We may, therefore, say that as a general rule it will pay the firm to invest in the machine if the expected rate of return on the investment made on it during its expected productive life exceeds the current market rate of interest and vice versa .
Investment and Liquidity NOTES Self - Learning 96 Material Fig. 3.1 Relation between Discount Rate and Present Value Check Your Progress 1. What does net investment represent? 2. List the elements to be considered in order to calculate the total profit of a firm.
Investment and Liquidity NOTES Self - Learning Material 97 3.3 MARGINAL EFFICIENCY OF CAPITAL Unlike the consumption function, the investment demand function was widely discussed and analysed in the pre-Keynesian literature. The investment behaviour theory depends upon the optimum capital accumulation theory. According to this theory of investment behaviour, the firm endeavours to maximize its present value, i.e., the properly discounted net income flows. This theory is consistent with the utility maximization approach to consumer behaviour. Where a perfect capital market exists, the firm would maximize its present value by investing in all those projects whose total expected returns' present net value is positive at the current market rate of interest. According to Irving Fisher, all productive investment projects can be ranked according to 'the rate of return over cost' of each project. Firms will continue to invest as long as this rate of return is higher than the market rate of interest because by doing so, they will increase their capital accumulation. Their capital accumulation will be optimum when the rate of return over the cost of the project equals the market rate of interest. When this situation has been reached, the firm will not make any further investment. This amounts to saying that the firm would be in equilibrium when the present value of the expected annual income flows from the investment project discounted at the market rate of interest equals the cost or supply price of the capital good. In other words, if the discount rate which equates

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the sum of the present values of the prospective annual yields to the present cost of the capital good (investment project) is equal to the market rate of interest, the

firm would be optimizing its total returns or net receipts. Denoting the expected annual flows of returns from the capital good during its useful life by R 1 , R 2 , R 3 , ..., and R n and the present cost (supply price) of the capital asset or project by C 0 , the discount rate which equates the cost or supply price of the capital good and the present value of the prospective annual yields flowing from it by r, the market rate of interest by i and the scrap value of the machine at the end of nth year by S n , the problem for the profit maximizing firm reduces to satisfying the following two conditions– C 0 = ? ? ? ? ? ? ? ? ? ? ? ? 3 1 2 4 2 3 4 ... (1) (1) (1) (1) (1) (1) n n n n R R S R R R r r r r r r ...(3.1) and r = i In the above equations, r is that rate of discount which equates the present cost of the capital good and the expected future annual returns from the capital good; it is known as the internal rate of return. John Maynard Keynes called this internal rate of return the marginal efficiency of capital (MEC). Expressed in Keynes' own words,

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the marginal efficiency of capital is 'equal to that rate of discount which would make the present value of the series of annuities given by the returns expected from the capital-asset during its life just equal to its supply price.'

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marginal efficiency of capital is 'equal to that rate of discount which would make the present value of the

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equal to that rate of discount which would make the present value of the series of annuities given by the returns expected from the capital-asset during its life just equal to its supply price.'

According to Keynes, the marginal efficiency of capital is the same thing as Irving Fisher's 'rate of return over cost'. Explaining this, Keynes has stated that 'Professor Fisher uses his 'rate of returns over cost' in the same sense and for precisely the same purpose as I employ 'the marginal efficiency of capital'.
Investment and Liquidity NOTES Self - Learning 98 Material The formula given in equation (3.1) for calculating the marginal efficiency of capital can be simplified by assuming that the expected future annual returns are uniform for all the years; the scrap price of the capital good is zero and the capital good lasts for a very long time so that the last term ? (1) n n R r in the equation will be very close to zero. Under these three assumptions: C = 1 (1) i i i R r ? ? ? ? which also shows that C = R/r or that r = R/C. This simple formula as well as the earlier one stress two facts. First , for a given supply price (

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cost) of the capital asset, the marginal efficiency of capital (r) will

increase when the expected annual returns from the capital asset increase and vice versa. Secondly, for a given expected annuity return (R), the r will fall if the cost of the capital asset increases and vice versa . We are now in a position to make the following important observations– 1. We can calculate the marginal efficiency of capital (r) for any capital good, given its supply price (C) and the expected flow of annual income streams (R s) during the expected productive life of the capital good. 2. By comparing the MEC (r) with the market rate of interest (i), it is possible to tell whether or not the capital investment would be profitable for the firm. 3. The difference between

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the marginal efficiency of capital r and the rate of interest i gives the

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the marginal efficiency of capital r and the rate of interest i gives the

net expected rate of return on the capital asset after allowing for all the costs including the interest cost on the funds tied-up in the capital asset over its productive life and the depreciation cost of the asset itself. For example, if r = 6 per cent and i = 4 per cent, the capital asset yields a net rate of return of 2 per cent. 4. Although both the MEC (r) and the market interest rate (i) are expressed as percentages, these are different from each other and each one is determined quite independently of the other. The firm's estimate of the MEC (r) does not in any way depend on the current rate of interest (i). It is, nevertheless, true to say that the profitability or otherwise of any given capital asset is determined by comparing these two rates. Investment for the firm in the given capital asset will be profitable if and only if the marginal efficiency of capital exceeds the market rate of interest, i.e., only if r < i . But the act of determining the profitability of any given capital good is different from calculating

whether or not a given capital good will be purchased by the firm. The market rate of interest does not determine the marginal efficiency of capital of the capital good. Marginal Efficiency of Investment In economics, expected rates of return on investment as additional units of investment are made under specified conditions and over a stated period of time. A comparison of these rates with the going rate of interest may be used to

Investment and Liquidity NOTES Self - Learning Material 99 indicate the profitability of investment. The rate of return is computed as the rate at which the expected stream of future earnings from an investment project must be discounted to make their present value equal to the cost of the project. As the quantity of investment increases, the rates of return from it may be expected to decrease because the most profitable projects are undertaken first. Additions to investment will consist of projects with progressively lower rates of return. Logically, investment would be undertaken as long as the marginal efficiency of each additional investment exceeded the interest rate. If the interest rate were higher, investment would be unprofitable because the cost of borrowing the necessary funds would exceed the returns on the investment. Even if it were unnecessary to borrow funds for the investment, more profit could be made by lending out the available funds at the going rate of interest. The British economist John Maynard Keynes used this concept but coined a slightly different term, the marginal efficiency of capital, in arguing for the importance of profit expectations rather than interest rates as determinants of the level of investment. 3.3.1 Factors Affecting Investment Function The relationship between the supply price or cost of the capital asset, the expected annual income flows from it, the marginal efficiency of capital and the market rate of interest may be stated in the following words. 1. An upward revision of the expected annual income streams, given the supply price of the capital asset, will raise the marginal efficiency of capital of the capital asset. 2. The expected annual income streams remaining unchanged, a fall in the supply price of the capital asset will raise the marginal efficiency of capital of the capital asset. 3. A fall or rise in the market rate of interest (i) does not affect the marginal efficiency of capital (r). It, however, affects the investment decision of the firm by affecting the profitability of any given investment project. Marginal Efficiency of Capital and Uncertainty Given the supply price of any capital asset and the expected annual income flows from it the calculation of the MEC is a matter of simple arithmetic. However, the estimate of income flows which are expected from the capital asset during its useful life is merely an exercise in forecasting the future which can never be certain so long as our knowledge about the future is imperfect. To a certain degree, the calculations of businessmen about the future returns expected from the capital asset depend on their current expectations. The uncertainty may range from a minimum to some unspecifiable maximum. In other words, the probability of certain expected income streams accruing to the firm from a capital good may range from very low to very high even close to one; it cannot, however, be one so long as the uncertainty—howsoever small it may be—about future remains. As a matter of fact, different people's decisions will be different due to the poor basis of knowledge on which the different estimates of future income flows from a given capital asset

Investment and Liquidity NOTES Self - Learning 100 Material are made. As Keynes has rightly stated: 'The outstanding fact is the extreme precariousness of the basis of knowledge on which our estimates of prospective yield have to be made. Our knowledge of the factors which will govern the yield of an investment some years hence is usually very slight and often negligible. If we speak frankly, we have to admit that our basis of knowledge for estimating the yield ten years hence of a railway, a copper mine, a textile factory, the goodwill of a patent medicine, an Atlantic liner, a building in the City of London amounts to little and sometimes to nothing; or even five years hence. In fact, those who seriously attempt to make any such estimate are often so much in the minority that their behaviour does not govern the market.' In the face of so much uncertainty, it is only to be expected that one man's appraisal will differ from that of another person. Very few investment decisions are the outcome of the exact calculations of the future yields. Most of our positive activities depend upon spontaneous optimism rather than on a cool mathematical expectation. According to Keynes, 'human decisions affecting the future, whether personal or political or economic, cannot depend on strict mathematical expectation, since the basis for making such calculations does not exist.''Businessmen play a mixed game of skill and chance, the average results of which to the players are not known by those who take a hand. If human nature felt no temptation to take a chance, no satisfaction (profit apart) in constructing a factory, a railway, a mine or a farm, there might not be much investment merely as a result of cold calculation.' Again Keynes stresses that 'most, probably, of our decisions to do something positive, the full consequences of which will be drawn out over many days to come, can only be taken as a result of animal spirits—of a spontaneous urge to action rather than inaction, and not as the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities. Enterprise only pretends to itself to be mainly actuated by the statements in its own prospectus, however, candid and sincere. Only a little more than an expedition to the South Pole, is it based on the exact calculation of benefits to come. Thus if the animal spirits are dimmed and the spontaneous optimism falters, leaving us to depend on nothing but a mathematical expectation, enterprise will fade and die...' Apart from the uncertainty about the marginal efficiency of capital, firms also have to think about the problem of obsolescence which arises due to technological improvement. Although the old capital good may be usable, due to the use of a more efficient capital good in the given line of production by its rivals, the firm has to discard the capital good long before it has been worn out or has even paid for itself. In the face of the increasing problem of obsolescence resulting from rapid technological progress, businessmen adopt the criterion of 'pay-off period' rather than the criterion of 'cash discounted flows' in their investment decisions. The greater is the threat of obsolescence under the growing impact of technological improvements in the methods of production, the shorter will be the pay-off period in which the capital asset must pay for itself. Consequently, the higher must be the expected rate of return if any given investment project has to be taken up as compared with the marginal efficiency of capital calculated in the absence of any obsolescence threat.

Investment and Liquidity NOTES Self - Learning Material 101 Capital Stock and Investment The aggregate marginal efficiency of capital is related to the aggregate capital stock in the economy in such a way that, other things remaining the same, the marginal efficiency of capital falls as the economy's total capital stock increases and vice versa. This is due to the operation of the tendency to diminishing returns in production as a consequence of which the ratio of increased output to increased capital, i.e., the marginal product of capital falls. Figure 3.2(A) shows the downward sloping MEC curve for the economy. The curve results from the diminishing marginal revenue product which falls due to the decrease in the marginal physical product of capital and the marginal revenue. When the aggregate capital stock in the economy is 0 K 1 , the MEC (r) is 0 r 1 per cent. As the total capital stock increases, the MEC falls. When the aggregate capital stock in the economy increases from 0K 1 to 0K 2 , the MEC falls from 0 r 1 to 0 r 2 per cent. Fig. 3.2 Relationship between Capital Stock and Investment Net investment–both for the firm and the economy–represents net addition to the existing capital stock. The profit-maximizing firm will add to its existing capital stock if and only if by doing so it adds to its total profit. The firm will be in equilibrium when the marginal efficiency of capital (r) equals the market rate of interest (i) at which it borrows the funds in the market to finance the purchase of the capital asset. When this situation is reached, the actual capital stock equals the desired or optimum capital stock, i.e., the firm has no incentive to add further to or reduce its existing capital stock when for that capital stock the profit-maximizing condition r = i holds. Thus every profit-maximizing firm would strive to achieve that capital stock for which the marginal efficiency of capital equals the market rate of interest. In Figure 3.2(B), when the actual capital stock is 0 K 1 , the marginal efficiency of capital 0 r 1 equals the market rate of interest 0 i 1 , i.e., 0r 1 = 0 i 1 . Thus, the desired capital stock equals the actual capital stock and the firms are in equilibrium. When corresponding to the actual capital stock 0 K 1 , the market rate of interest falls from 0 i 1 to 0 i 2 , the profit maximization condition r = i no longer holds. The marginal efficiency of capital exceeds the rate of interest, i.e., r < i. Consequently, at this lower rate of interest the desired capital stock increases from 0 K 1 to 0 K 2 while the actual capital stock is 0 K 1 . The shortfall between the desired capital stock 0 K 2 and the actual capital stock 0 K 1 , which equals 0 K 2 – 0K 1 = ?K, is removed by adding capital to the existing capital stock 0 K 1 by making investment to the extent of ?K(=0I 1) amount. Consequently, the increase

Investment and Liquidity NOTES Self - Learning 102 Material in the aggregate capital stock ?K represents the net investment of 0 I 1 amount in the economy. It is important to know the time dimension needed to bring the actual capital stock to the level of equality with the desired capital stock. In other words, will the desired capital stock be attained during any given time period, i.e., will the net investment for this time period be equal to

stock. If the supply curve of the capital goods is perfectly elastic throughout, net investment will be equal to the difference between the desired capital stock and the actual capital stock and the desired capital stock will be attained during a given single time period. It is possible, however, that the capacity of the capital goods producing industry is not large enough to make this possible during any given single time period or that the supply price (cost) of the capital goods increases. If the supply price of the capital goods is constant, the limit to the rate of investment per time unit will be determined by the production capacity of the capital goods producing industry. However, if the supply curve of the capital goods producing industry is positively sloping (production of capital goods is subject to diminishing returns), the rate of investment will be slower. This is so because higher the rate of investment, higher is the cost and lower is the rate of return. Consequently, the rate of return becomes equal to the rate of interest much quicker putting an end to further investment during any given time period. In such a situation, it will take longer for the desired capital stock to be achieved compared with the situation in which the supply curve of the capital goods producing industry is perfectly elastic upto a certain output and thereafter is perfectly inelastic. The net investment will take place at the rate just below that level of capital cost at which the rate of return equals the market rate of interest. Investment and the Rate of Interest According to the classical economists, investment was interest-elastic. This was important from the point of view of monetary policy because if this was the case, investment could be increased sufficiently enough by increasing the money supply. Particularly in a slump, a recourse to the easy money policy would have been sufficient to revive the economy and ensure full employment. John Maynard Keynes challenged this faulty classical view which held that the investment demand was highly interest-inelastic. According to Keynes, investment was influenced more by income rather than by interest rate except marginally. During depression when the marginal efficiency of capital suffers a near collapse, no amount of lowering of the interest rate would help revive the investment in the economy.
Investment and Liquidity NOTES Self - Learning Material 103 Fig. 3.3 Relationship between Investment and Rate of Interest Ever since the development of Keynesian economics, opinion among the economists has been sharply divided on the issue whether investment demand is highly elastic at very low rate of interest. While Frank H Knight and a few others have held that virtually unlimited investment outlets exist promising positive rate of return imparting high interest-elasticity to the investment demand function at low positive rate of interest, other economists have strongly held the view that investment will not increase significantly in response to any fall in the rate of interest no matter how close to zero it fell. On the basis of numerous reports based on interviews with corporation managers, Robert Eisner has stated that businessmen never consider interest rate changes at all or simply that such consideration never influences their investment decisions. This insensitivity of investment to current interest rate is ascribable to several factors, including the uncertainty of expectations, long gestation period for the new projects, long-range planning and the market imperfection. Undoubtedly, it has been experienced that in the typical recessions and depressions due to the depressed expectations of the entrepreneurs, the investment activity in the economy remains unaffected at low levels although the rate of interest falls to very low levels close to zero. According to Martin J Bailey, there are, however, certain investments whose approximate yield is fairly easy to figure out. For example, the investments made in land reclamation and land improvement almost certainly have some positive yield. The long-run net productivity (after deducting the cost of installation and maintenance of fertility) of the hilly land could be increased by flattening and grading, the hilly tracts of land which are at most good for grazing could be levelled and made arable while the marshy lands and lakes could be filled to make these arable. The filling of lakes and the ocean fringes, flattening and grading of hilly lands and the levelling of mountains in areas of assured rainfall are some examples of such investments which assure a huge backlog of investment opportunities at low rates of return on equity investment. Although investments made in such projects rarely promise high productivity to be considered worthwhile at current rates of interest, nevertheless they almost certainly have some positive yield to become

Investment and Liquidity NOTES Self - Learning 104 Material worthwhile at some low enough interest rates. 'Even if expectations were so bad that gross investment of the current types fell to zero and even if business were not expected to improve for ten or twenty years, there would be some positive rate of interest low enough to make investments worthwhile, given their durability.' Fig. 3.4 Relation between Fail of Interest Rate and Investment Demand Bailey's main assertion is that at very low interest rates the optimum capital stock would be enormous. Consequently, we would be faced with a veritable plethora of investment opportunities far in excess than the minimum needed for guaranteeing full employment in the economy. In support of his argument, Bailey has cited the example of filling in along the coast of the Gulf of Mexico from the Rio Grande to Miami to a distance of 50 miles seaward and topping it off with dredgings from the Mississippi in order to create land with a yield at least comparable to the best agricultural land available in the country. The price of capital services decreases when the rate of interest falls. Thus at some low enough interest rate, such investment would become profitable. Basically, Bailey's example shows that if the rate of interest fell low enough, the investment demand schedule would become very elastic as shown in Figure 3.4 by the I = I (Y 0 ; r) curve where the investment demand schedule II is highly interest elastic becoming almost flat at the low rate of interest of around 2 per cent. Recent empirical studies have, however, shown that the interest cost is generally of secondary consideration in making fixed investment. The investment demand schedule for fixed investment has very low interest elasticity. Consequently, the relationship between the rate of interest and investment is as shown in Figure 3.5. The figure shows that the investment demand is interest-inelastic unless the rate of interest is high. In the figure, investment is highly interest-inelastic up to the rate of interest of 14 per cent. Thereafter, it has moderate interest elasticity. The interest elasticity of investment demand, however, increases as the interest rate rises. Apart from the rate of interest, the other determinants of investment demand in the economy include the availability of institutional cheap and easy credit facilities, liquidity position of the firms, pace of technological progress, fiscal policy of the government, increase in population, state of business expectations, territorial expansion, economic development, discovery of new resources, the general price level, etc.

Investment and Liquidity NOTES Self - Learning Material 105 3.4 KEYNESIAN THEORY OF LIQUIDITY PREFERENCE AND LIQUIDITY TRAP Keynes developed analytically a very sound theory of demand for money what he called the liquidity preference theory. Keynesian theory explains why people prefer liquidity or holding cash. However, other economists interpret it as theory of demand for money. According to Keynes, money is demanded by the people for three motives : (i) Transaction motive, (ii) Precautionary motive, and (iii) Speculative motive. The demand for money for these motives is discussed here briefly. (i) Transaction demand for money. Transaction demand for money refers to money held by the people to carry out necessary transactions to meet the needs of life. People hold money for transaction purpose because there is often a time gap between need for expenditure and income earning. Income is earned periodically – weekly, monthly or annually. But need for spending money to buy goods and services arises regularly. Therefore, people hold money for transaction purpose. Money held for transaction purpose is termed as transaction demand for money. According to Keynes, demand for money depends on two factors: (i) income level, and (ii) rate of interest. As regards the relationship between income and money demand for

at constant prices. The relationship between transaction demand for money (M t) and income (Y) is expressed in function form as M t = f (Y) ...(3.2) According to Keynes, there is constant relationship between income (Y) and money demand for transaction motive. The empirical transaction money demand function is then expressed as M t = kY ...(3.3) (where k = ?M t /?Y, a proportion of income demanded for transaction purpose). The relationship between income and transaction demand for money is shown graphically in Fig. 3.5.

Investment and Liquidity NOTES Self - Learning 106 Material Fig. 3.5 Income and Transaction Demand for Money As regards the relationship between interest rate and transaction demand for money ,

The reason is that whatever the rate of interest, people have to pay for food, house rent, electricity bill, medical bill, kids' school fee, etc. However, if interest rate shoots up very high, people tend to economize on routine expenditure. The relationship between interest rate and transaction demand for money is shown graphically in Fig. 3.6. Fig. 3.6 Interest and

refers to the money held by the households and firms to meet contingent expenditure. The need for contingent expenditure arises due to unforeseen and unpredictable events like fire, theft, sickness, accidents, loss of job, etc. Since there are many uncertainties in human life, people hold some idle cash balance as safety measure. Keynes called money held with the purpose of meeting the contingent expenditure as the precautionary demand for money. According to Investment and Liquidity NOTES Self - Learning Material 107 him, precautionary demand for money also depends on the income level of the people. In other words,

M p = kY ...(3.4) (iii) Speculative

demand for money. According to Keynes, people hold a part of their income in the form of idle cash balance

hold a part of their income in the form of idle cash

hold a part of their income in the form of idle cash

for speculative purpose with the objective of taking advantage of changing market conditions, especially in money market. The money held in the form of idle cash balance for speculative purpose is the speculative demand for money. Money held for speculative purpose has an opportunity cost, i.e., the loss of interest on cash held as idle cash balance. In general, speculative demand for money depends on the market rate interest. If market rate of interest is very high, then the opportunity cost is very high and hence people hold smaller idle cash balance. When interest rate declines, the opportunity cost goes down and people hold a higher idle cash balance for speculative purpose. According to Keynes, therefore, speculative demand for money (M sp) is the function of interest (i), expressed as M sp = f (i) ...(3.5) The Liquidity Trap: Keynes has also pointed out a remote possibility of people holding a very large or unlimited amount of idle cash balance when market rate interest is critically very low. Keynes called this kind of idle cash holding as liquidity trap. It implies that at a critically low interest rate people fall in liquidity trap.

The relationship between market rate of interest and speculative demand for money is

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The relationship between market rate of interest and speculative demand for money is illustrated graphically in Fig. 3.7.

The relationship between market rate of interest and speculative demand for money is illustrated graphically in Fig. 3.7.

Fig. 3.7 The Speculative Demand for Money 3.4.1 Criticism Against Liquidity Preference Theory The liquidity preference theory of interest rate has not escaped criticisms. First , being completely a stock theory, the rate of interest in this theory is as much indeterminate as it was in the classical theory. According to Alvin H Hansen, 'the Keynesian theory, like the classical, is indeterminate. In the Keynesian case the money supply and demand schedules cannot give the rate of interest unless we already know the income level; in the classical case the demand and supply

Investment and Liquidity NOTES Self - Learning 108 Material schedules for saving offer no solution until income is known. Keynes' criticism of the classical theory applies to his own theory.' Second , the theory cannot explain the determination of the rate of interest in the long period because it focusses attention only on those factors which are relevant only in the short period. Third , the theory cannot explain the coexistence of the different interest rates on the basis of liquidity preference because interest rates will have to be perfectly uniform due to the perfect uniformity of money or cash balances. The Fourth criticism of this theory is that it is wrong to say that rate of interest is not the reward for 'saving or waiting as such.' Keynes blissfully forgets that without saving or waiting, investment funds cannot be obtained. Jacob Viner stated the correct position when he asserted that '

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without saving there cannot be liquidity to surrender... the rate of interest is the return for saving without liquidity.'

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without saving there cannot be liquidity to surrender... the rate of interest is the return for saving without liquidity.'

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without saving there cannot be liquidity to surrender... the rate of interest is the return for saving without liquidity.'

The Fifth criticism of the theory is that although in the short period at any given point of time the rate of interest will be such that the community's total holding of cash must be equal to the total existing stock of money but it is equally true that over a long period the rate of interest must tend to that level where the saving and investment flows are in equilibrium. Last , Keynes' basic proposition in his theory is that

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the rate of interest and the demand for money, more particularly the speculative demand for money,

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the rate of interest and the demand for money, more particularly the speculative demand for money,

are inversely related. According to Don Patinkin, 'Keynes' analysis of the implication of this dependence is repeatedly marred by a confusion (which characterizes the later Keynesian literature as well) between his basic proposition that the amount of money demanded is inversely dependent upon the rate of interest and the completely different proposition that the equilibrium rate of interest is inversely dependent on the amount of money. His discussion of the liquidity preference in The General Theory shifts uninhibitedly from one proposition to the other with never an indication that they are in any way not identical. More specifically, there is never a recognition that, in our terminology, the first of these propositions describes an individual experiment and the second a market experiment, and that the truth of the first does not imply the truth of the second.' 3.4.2 Discounting Rate The discount rate refers to the interest rate used in discounted cash flow (DCF) analysis to determine the present value of future cash flows. It is used in discounted cash flow analysis. Discounted cash flow analysis is a commonly followed valuation method used to estimate the value of an investment based on its expected future cash flows. Based on the concept of time value of money, the analysis helps assess the viability of a project or an investment by calculating the present value of expected future cash flows using a discount rate.

Investment and Liquidity NOTES Self - Learning Material 109 Check Your Progress 3. When will a firm be in equilibrium when referring to MEC and MEI? 4. What are the other determinants of investment demand in addition to the rate of interest? 5. What are the motives for which money is demanded by people, as per Keynes? 3.5 ANSWERS TO 'CHECK YOUR PROGRESS' 1. Net investment represents an addition to the economy's total capital stock which, ceteris paribus, means an increase in the economy's total productive capacity. This is so because a larger physical capital stock used with the existing quantities of the other cooperating inputs—labour, technology and natural resources—would result in the larger total physical output although the additional output due to the employment of additional capital units would diminish as the capital stock continues to increase. 2. In estimating the total profit which may be expected to accrue to a firm, three elements are crucial: first, the total expected income flow from the capital project or good during the useful life of the project; secondly, the purchase price or cost of the capital good; and thirdly, the market rate of interest or the cost of financing the capital good or project. 3. The firm will be in equilibrium when the marginal efficiency of capital (r) equals the market rate of interest (i) at which it borrows the funds in the market to finance the purchase of the capital asset. 4. Apart from the rate of interest, the other determinants of investment demand in the economy include the availability of institutional cheap and easy credit facilities, liquidity position of the firms, pace of technological progress, fiscal policy of the government, increase in population, state of business expectations, territorial expansion, economic development, discovery of new resources, the general price level, 5. As per Keynes, money is demanded by the people for three motives: trnasaction, precautionary and speculative motive. 3.6 SUMMARY ?As the capital stock in the economy grows over time, the labour force also grows both quantitatively and qualitatively (in the form of increased labour productivity) and the production techniques improve. ?The quantity of investment increases, the rates of return from it may be expected to decrease because the most profitable projects are undertaken.
Investment and Liquidity NOTES Self - Learning 110 Material ?The net investment will take place at the rate just below that level of capital cost at which the rate of return equals the market rate of interest. ?The rate of investment outlay in the economy per time period under the constant cost of production of capital goods ?John Maynard Keynes challenged this faulty classical view which held that the investment demand was highly interest-inelastic. ?The insensitivity of investment to current interest rate is ascribable to several factors, including the uncertainty of expectations, long gestation period for the new projects, long-range planning and the market imperfection. ?The liquidity preference arises due to

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the transactions motive, the precautionary motive and the speculative motive. ?

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the transactions motive, the precautionary motive and the speculative motive. ?

Keynes has also pointed out a remote possibility of people holding a very large or unlimited amount of idle cash balance when market rate interest is critically very low. Keynes called this kind of idle cash holding as liquidity trap. ?The discount rate refers to the interest rate used in discounted cash flow (DCF) analysis to determine the present value of future cash flows. Based on the concept of time value of money, the analysis helps assess the viability of a project or an investment by calculating the present value of expected future cash flows using a discount rate. 3.7 KEY TERMS ?Net investment: It represents an addition to the economy's total capital stock which, ceteris paribus, means an increase in the economy's total productive capacity. ?

good. ?Discount rate: It refers to the interest rate used in discounted cash flow (DCF) analysis to determine the present value of future cash flows. 3.8 SELF-ASSESSMENT QUESTIONS AND EXERCISES Short-Answers Question 1. What is the marginal efficiency of capital according to Keynes? 2. What is the relationship between marginal efficiency of capital and market rate of interest? 3. Mention the criticisms of liquidity preference theory of interest rate. 4. Write a short note on discounting rate.
Investment and Liquidity NOTES Self - Learning Material 111 Long-Answer Questions 1. Explain marginal efficiency of investment. 2. Elaborate on the factors affecting the investment function. 3. Examine the relationship between investment and the rate of interest. 3.9 FURTHER READING Mankiw, N Gregory. 2010. Macroeconomics . New York: Worth Publishers. Shapiro, Edward. 1996. Macroeconomic Analysis . New Delhi: Galgotia Publication. Jha, R. 1999. Contemporary Macroeconomic Theory and Policy . New Delhi: New Age International. Gupta, SB. 2011. Monetary Economics: Instruments and Policy . New Delhi: S Chand & Co.
Money NOTES Self - Learning Material 113 UNIT 4 MONEY Structure 4.0 Introduction 4.1 Objectives 4.2 Meaning and Functions of Money 4.3 Stock of Money and its Measures 4.4 Quantity Theory of Money 4.4.1 Cash Balances and Cash Transaction Approach 4.5 Inflation, Deflation and Recession: Definition, Causes and Effects 4.5.1 Inflation 4.5.2 Deflation 4.5.3 Recession 4.6 Answers to 'Check Your Progress' 4.7 Summary 4.8 Key Terms 4.9 Self-Assessment Questions and Exercises 4.10 Further Reading 4.0 INTRODUCTION Money is a species of a large group—one among the class of things which perform monetary functions in the economy. Money is only one among many kinds of financial assets which consumers, business firms, governments and other economic units hold in their asset portfolios. The demand for money is the desired holding of financial assets in the form of money: that is, cash or bank deposits. It can refer to the demand for money narrowly defined as M1 (non-interest-bearing holdings), or for money in the broader sense of M2 or M3. Money in the sense of M1 is dominated as a store of value by interest- bearing assets. However, money is necessary to carry out transactions; in other words, it provides liquidity. This creates a

a result of this trade-off regarding the form in which a person's wealth should be held. In economics, the money supply or money stock, is the total amount of monetary assets available in an economy at a specific time. In this unit, you will learn the meaning and functions of money. There has been a proliferation of definitions of inflation. Many of these definitions, however, embody the description of the processes by which the underlying causes of inflation–demand–pull, cost-push, etc.,–reveal themselves. Consequently, the fundamental connection between an increase in the total money supply and the rise in prices in the economy is obscured. In this unit, you will also learn about inflation, deflation and recession.
Money NOTES Self - Learning 114 Material 4.1

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this unit, you will be able to: ?Describe the meaning and functions of money ?Elaborate on stock of money

and its measures ?Analyse quantity theory of money ?Explain cash balances and cash transaction approach ?Define inflation, deflation and recession 4.2 MEANING AND FUNCTIONS OF MONEY The concept of

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money is very difficult to define. It belongs to the category of things which are not amenable to any single definition. It is partly so because money performs not one but four important functions

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money is very difficult to define. It belongs to the category of things which are not amenable to any single definition. It is partly so because money performs not one but four important functions

in the economy with each function providing a criterion of moneyness and partly because these criteria are satisfied in different degrees by different assets. Since moneyness is at best a matter of degree, it is possible to draw only an arbitrary dividing line between money and the other non-money assets. Money is only one among many kinds of financial assets which consumers, business firms, governments and other economic units hold in their asset portfolios. However, the economists' emphasis on money per se is justified because unlike the other financial assets (savings bank deposits, government and corporate bonds) money is the essential ingredient in conducting most of the economic transactions in the economy. Furthermore, the demand for money, like that for an input, is a derived demand. Money is a species of a large genus—one among the class of things which perform monetary functions in the economy. Some goods perform all the four essential monetary functions—act as the
unit of account,

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a medium of exchange, a store of value and a standard of deferred payments–

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a medium of exchange, a store of value and a standard of deferred payments–

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a medium of exchange, a store of value and a standard of deferred payments–

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a medium of exchange, a store of value and a standard of deferred payments–

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a medium of exchange, a store of value and a standard of deferred payments–

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a medium of exchange, a store of value and a standard of deferred payments–

and no other, e.g., paper currency, while other goods perform one or more monetary and non-monetary functions in the economy. The Venn diagram in Figure 4.1 clarifies the position. In the diagram, A is the class of things which perform one or more monetary functions in the economy while B is a class of things, included in A, which perform all the four monetary functions in the economy. It is easier to understand what money consists of than to give any universally acceptable definition of money. As Harry G Johnson has rightly stated, the definition of money is one of the three unresolved issues in the monetary theory. Consequently, economists have been in open disagreement on the issue of defining money.

and 4. Central Bank Approach
Money NOTES Self - Learning Material 115 Fig. 4.1 Venn Diagram of Function of Money Each

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below. 1. Conventional Approach The conventional approach to the definition of money is the oldest known approach. According to this approach, the most important function of money in society is to act as

the

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medium of exchange. Money is what money uniquely does. It pays for all the goods and services that are transacted in the community.

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medium of exchange. Money is what money uniquely does. It pays for all the goods and services that are transacted in the community.

Consequently, anything is money which functions generally as a medium of exchange in the economy. According to Ralph George Hawtrey, 'money is one of those concepts which, like a teaspoon or umbrella, but unlike an earthquake or a buttercup, are definable primarily by the use or purpose which they serve'. Following this approach, Geoffrey Crowther has stated that

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money is 'anything that is generally acceptable as a means of exchange (

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money is 'anything that is generally acceptable as a means of exchange (

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money is 'anything that is generally acceptable as a means of exchange (

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money is 'anything that is generally acceptable as a means of exchange (

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anything that is generally acceptable as a means of exchange (i.e., as a means of settling debts) and that at the same time acts as a

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anything that is generally acceptable as a means of exchange (i.e., as a means of settling debts) and that at the same time acts as a

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at the same time acts as a measure and a store of value.'

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at the same time acts as a measure and a store of value.'

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at the same time acts as a measure and a store of value.'

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at the same time acts as a measure and a store of value.'

The important words in this definition are those in italics. Thus, anything can be money if it is generally acceptable by the community in payment for anything. The only essential requirement, according to this definition of money, is the general acceptability of a thing as a means of payment. John Maynard Keynes has defined money as '

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that by delivery of which debt contracts and price contracts are discharged and in the shape of which General Purchasing Power is

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that by delivery of which debt contracts and price contracts are discharged and in the shape of which General Purchasing Power is

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that by delivery of which debt contracts and price contracts are discharged and in the shape of which General Purchasing Power is

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that by delivery of which debt contracts and price contracts are discharged and in the shape of which General Purchasing Power is

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that by delivery of which debt contracts and price contracts are discharged and in the shape of which General Purchasing Power is held.'

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that by delivery of which debt contracts and price contracts are discharged and in the shape of which General Purchasing Power is held.'

Dennis Holme Robertson has defined

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money as 'anything which is widely accepted in payment for goods, or in

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money as 'anything which is widely accepted in payment for goods, or in

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money as 'anything which is widely accepted in payment for goods, or in

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money as 'anything which is widely accepted in payment for goods, or in

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money as 'anything which is widely accepted in payment for goods, or in

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anything which is widely accepted in payment for goods, or in the discharge of other kinds of business obligations.

If things which are intended to be money—the notes of certain governments—cease to be widely accepted in discharge of obligations, they cease to function as money,' According to Raymond P Kent, '

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money is anything that is commonly used and generally accepted as a medium of exchange or as a standard of

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money is anything that is commonly used and generally accepted as a medium of exchange or as a standard of

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anything that is commonly used and generally accepted as a medium of exchange or as a standard of value.'

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anything that is commonly used and generally accepted as a medium of exchange or as a standard of value.'

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anything that is commonly used and generally accepted as a medium of exchange or as a standard of value.'

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anything that is commonly used and generally accepted as a medium of exchange or as a standard of value.'

To be
money, a thing need not itself be valuable. It must, however, be relatively scarce since it would hardly do if money could be plucked off every tree. Provided steps are taken to keep it relatively scarce and invariant in quantity, things as worthless as a scrap of paper or a tree leaf can serve as money. Historically, many thing like cigarettes, banana shells, goat, metals, stones, etc., have served as money. Animal money had, however, the disadvantage of indivisibility and it was susceptible to disease, old age and death. It was also expensive to store.
Money NOTES Self - Learning 116 Material Minted coins, on the other hand, had the advantages of durability, divisibility and cognizability. Paper money also has some of the advantages of being a good money material.

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Defined on the basis of its function as a medium of exchange, a nation's total money stock would comprise those things which are generally accepted as the means of payment. This definition of money includes only

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Defined on the basis of its function as a medium of exchange, a nation's total money stock would comprise those things which are generally accepted as the means of payment. This definition of money includes only

the currency and the

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demand deposits in commercial banks as constituting the supply of money, i.e., M = C + D.

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demand deposits in commercial banks as constituting the supply of money, i.e., M = C + D.

It excludes the time deposits in commercial banks and postal savings bank deposits. The reason for excluding the time deposits from the aggregate money supply is that such deposits must be converted into either currency or demand deposits before these can be spent. Many other assets like short-term treasury securities, prime commercial papers, savings, bonds, etc., possess high liquidity in as much as these can be converted into cash or demand deposits with little loss or risk. Thus, it is argued that if time deposits are included in the money supply there is no justification for excluding all these other near-liquid assets from the money supply, 2.

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Chicago Approach The Chicago approach to the concept of money is associated with

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Chicago Approach The Chicago approach to the concept of money is associated with

the views of Professor Milton Friedman, his students, including David Meiselman, Phillip Cagan, David Fand, Anna Jacobson Schwartz and other monetary theorists of the University of Chicago. The Chicago economists have adopted a broader definition of money by including in it, besides the currency and chequeable or demand deposits, the commercial bank time deposits—fixed interest-bearing deposits placed with the commercial banks. Obviously, the Chicago approach

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to the definition of money conflicts with the conventional approach to the definition of money since the

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to the definition of money conflicts with the conventional approach to the definition of money since the

commercial bank time deposits are not directly spendable—these do not function directly as a medium of exchange in the economy. For example, if a person owns a fixed time deposit receipt worth 2,000 in a commercial bank and wants to use it to buy a refrigerator, he must first exchange his time deposit for currency or demand deposit which can be used to make the payment for making the purchase of the refrigerator. The economists of the Chicago School have advanced two reasons for including the time or term deposits placed with the commercial banks in their definition of money. First , according to the Chicago School theorists, national income is more highly correlated with money as they have defined it than with money when it is alternatively defined. Since the Chicago monetary theorists have hypothesized that changes in the money supply bring about predictable changes in the national income, their definition of money, it is argued by these theorists, come closest to satisfying the empirical criterion of putting the monetary theory in a good light.
Secondly, the Chicago approach is based on the theoretical criterion of including in the definition of a single commodity all those things which are perfect substitutes for each other. It is argued by the supporters of the Chicago approach that the commercial bank time deposits are very close substitutes for currency and demand deposits. In practice, the time deposits are almost as readily available for spending as are the demand deposits or currency since most commercial banks make the
Money NOTES Self - Learning Material 117 time deposits available to their customers on demand, although they may require a waiting period of 30 to 60 days. In India, the time deposits are encashable when money is needed by the deposit holders provided they are willing to forgo a small percentage of interest income accrued on such deposits. Consequently, it is better to treat the time deposits in banks as if these were perfect substitutes for currency and demand deposits rather than not to treat them so. The relatively timeless and costless ease with which time deposits can be converted into currency or demand deposits together with the universally held notion that a savings deposit account is 'money in the bank' lends credibility to the close substitutability argument. However, it is still correct to say that the time deposits held with the commercial banks are not perfect substitutes for the currency and demand deposits because had it been so people would not have preferred holding the zero interest-bearing currency and/or demand deposits to holding the positive interest-bearing time deposits in the banks. 3.

was evolved through a series of articles and the book titled Money in a Theory of Finance by the two learned professors. According to the Gurley and Shaw approach, currency and demand deposits are just two among the many claims against the financial intermediaries. They emphasize the close substitution relationship between the currency, demand deposits, time deposits, savings bank deposits, credit institutions' shares, bonds, etc., all of which are regarded as alternative liquid store of value by the public. The Gurley and Shaw approach to the definition of money is akin to the Chicago approach in its objective. Both the approaches include in money the means of payment and those assets which are close substitutes for the means of payment. Despite this similarity, the Gurley and Shaw approach is, however, different from the Chicago approach in its analysis. Unlike the Chicago approach which considers only the time deposits held with the commercial banks as close substitutes for the means of payment, the Gurley and Shaw approach includes in the close substitutes for the means of payment the deposits of and the claims against all types of financial intermediaries. It is necessary for taking account of the substitution relationship to define money supply as the weighted sum of currency, demand deposits and their substitutes, with the weights being assigned to each item on the basis of the degree of substitutability.Thus a unit weight would be assigned to currency, demand deposits and their perfect substitutes, if any. Zero weight would be assigned to each one of those assets which were completely unrelated to currency and demand deposits. Weights ranging between one and zero would be assigned to those assets which were imperfect substitutes for currency and demand deposits. As an illustration of this approach we may assume that the public's total assets consist of (1) 200 crore in the form of currency; (2) 400 crore worth of bank shares; and (3) 1,000 crore worth of ceiling fans such that public's total assets are worth 1,600 crore. It may be further assumed that the asset demands for currency and for the ceiling fans are quite independent of one another while the degree of substitutability

Money NOTES Self - Learning 118 Material between the bank shares and currency is 0.50. The weighted sum of the money supply would be equal to 400 crore or 25 per cent of the total assets because currency would be assigned a weight of one, bank shares a weight of 0.5 and the ceiling fans a weight of zero. The Gurley and Shaw approach is superior to the Chicago approach because unlike the Chicago approach in which currency, demand deposits and time deposits all have been lumped together, the Gurley and Shaw approach refuses to lump the currency, bank deposits and close substitutes together; instead, it circumvents the problem of making arbitrary assumptions regarding the degree of substitutability by assigning the weights to different assets on the basis of their closeness to the means of payment. No effort has, however, been made by the authors of this approach to test the operational merit of the weighted sum definition of money. The concept has neither been used for testing the monetary theory nor for applying the monetary policy. 4. Central Bank

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Approach This approach, which has been favoured by the central banking authorities, takes the broadest possible view of money as though it was synonymous with credit- funds lent to

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Approach This approach, which has been favoured by the central banking authorities, takes the broadest possible view of money as though it was synonymous with credit- funds lent to

the borrowers. The supporters of the central bank approach have argued that similarity between money and the other means of financing the purchases justifies the use of a much broader concept of money measurable or immeasurable. As an example of the measurable concept, they

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mention the long established theory of the Federal Reserve Board according to which

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mention the long established theory of the Federal Reserve Board according to which

what matters is the total amount of credit outstanding with

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the quantity of money exercising its influence only because bank credit is a part of total credit. The example of the unmeasurable concept is the Radcliffe Committee's concept of liquidity of the economy and credit can be substituted for money without limit. Consequently, money is identified with the credit extended by a wide variety of

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the quantity of money exercising its influence only because bank credit is a part of total credit. The example of the unmeasurable concept is the Radcliffe Committee's concept of liquidity of the economy and credit can be substituted for money without limit. Consequently, money is identified with the credit extended by a wide variety of

sources. The reason for identifying money with credit used in the broadest possible sense of the term lies in the central bank's historic position that the 'total credit availability' constitutes the key variable for regulating the economy. Functions of Money It is inconceiveable to imagine a modern economy operating without the use of money. Money serves as the

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great instrument of commerce and industry in the economy by performing the four essential specific functions which have removed the

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great instrument of commerce and industry in the economy by performing the four essential specific functions which have removed the

manifold difficulties, more particularly the 'double coincidence of wants', of the pure barter system. These four functions of money emerge from its serving in the economy as: (i) a unit of value or account; (ii) a

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medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. Money

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medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. Money

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medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. Money

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medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. Money

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medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. Money

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medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. Money

NOTES Self - Learning Material 119 The first two of these functions are usually called the primary functions of money while the remaining two are called the derivative functions of money as these are derived from the primary functions. We may now discuss each one of these four basic functions of money. 1. Money as Unit of Value or Account This function of money has been variously called the 'unit of account', 'standard of value', 'common measure of value' and 'common denominator of value. The common idea present in all these terms is that money unit

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serves as a unit of measurement in terms of which the 'values' of all the goods and services

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serves as a unit of measurement in terms of which the 'values' of all the goods and services

exchanged in the economy are measured and expressed. As soon as a money unit, such as a rupee, dollar, or franc is adopted as a numeraire in the economy, the value of each commodity and service is expressed as a price which expresses the number of money units for which it will exchange or sell in the economy. The introduction of the

were to be assessed and stated was as important for the development of economic life of the community as was the invention of the wheel for the development of technology. The existence of a common unit of account is quite indispensable for the emergence of an orderly pricing system which is essential both for rational economic calculation and choice by the individuals and for transmitting the economic information between individuals. For a rational individual choice, it is essential that different goods and services not otherwise comparable should be rendered comparable. By serving as a common unit of account— numeraire— money has made such a comparison possible because prices of different goods and services expressed in terms of money as a common unit of account are comparable since the worth of different goods and services is converted into a common scale for purposes of reckoning. A common unit of account and prices stated in terms of this unit facilitates transmission of economic information between people and consequently extends the scope of specialization and division of labour beyond the narrow confines of the family or household. The prices of different goods and services stated in terms of money enable the individual to decide on what he should specialize as a seller and in what proportions he should buy and combine different goods as a buyer. The importance of money prices as the efficient means of economic communication in enabling the people in society to decide what to produce and on what to spend the proceeds of their economic efforts is realised only when these cease to fulfil this function. For example, in the German hyperinflation when money prices ceased to serve as the means of economic communication, the Germans were separated from one another living like solitary predatory beasts. Giving a graphic description of the state of Germans, Richard Hughes has stated thus: 'Money was rapidly ebbing away from between men, leaving them desperately incommunicable like men rendered voiceless by an intervening vacuum: millions still heaped on top of each other in human cities yet forced to live separate, each like some solitary predatory beast.' Money NOTES Self - Learning 120 Material No less than the households, the producers also depend on money to provide them the lines of communication. They look on the money prices of goods and services to furnish them vital information on the basis of which they make production decisions which maximize their profits. In the absence of money or when money ceases to function as a unit of account, it becomes much more difficult and costly to obtain this information. Again, the German hyperinflation can be cited as an illustration. The German hyperinflation had created an environment in which the money prices and values had become virtually meaningless. Consequently, the German firms had to expand their office staff in order to deal with the greatly expanded task of procuring and interpreting the market information. It raised greatly the ratio of the non-productive to productive workers. For example, in the famous German firm of Siemens-Schuckert producing the electric goods this ratio had increased by 43 per cent. It shows that the existence of money is a necessary condition for an efficient economic organization and development. Money prices are essential for a person to know in order to decide in which one of his many possible activities he would be most productive for the economy. He needs money prices in order to determine how best to perform this activity and how best to mix his own labour and know- how with the other factors of production. He must also know the money prices in order to choose the best form in which to consume his income and enjoy most his labour's fruits. 2. Money as Medium of Exchange The speciality which distinguishes money from other commodities and places it in a separate class inherent in its role as the means of payment. Although it has no inherent power to satisfy human wants but by acting as the medium of exchange in the economy it commands power to purchase those goods and services which satisfy human wants. By performing its role as the

economy by decomposing the single barter transaction into two separate transactions of sale and purchase eliminates the need for the double coincidence of wants. Consequently, much time and effort wasted in barter is saved. But what is more important is the fact that separation of a single barter transaction into two money exchange transactions involves more than a simple separation of sale and purchase elements which were implicit in the barter transaction. The use of money as a medium of exchange also necessarily separates the transactions both in time and place. It is no longer necessary for a seller of a commodity simultaneously to act also as a buyer of some other commodity and equal to the value of the commodity he wishes to sell. It must be remembered that money will not be required as a means of payment unless we want to sell at one time and place and buy at some different time and place. It means that there is time-lag between our buying and selling activities. In the pure barter, buying and selling had to coincide both in time and place. By serving as the means of payment, money has relieved society of the colossal waste of time and effort which double coincidence of wants necessarily

Money NOTES Self - Learning Material 121 involved under the barter system. However, in order to serve as the means of payment money has also to serve as the temporary abode or store of the purchasing power. The use of money as a medium of exchange and the consequent decomposition of every single barter transaction into two separate purchase and sale transactions allows for the use of division of labour in the decision-making process which yields returns in the form of increased rationality. It is possible for one to deal more effectively with the problem of how best to sell his services while free from the worry about how best to spend the proceeds. At the same time, however, one also needs to know generally how valuable, in terms of the spending power, the proceeds will be. Money is helpful on both these counts. Money enables one to deal with the separate problems of buying and selling one at a time. Furthermore, the use of money as a medium of exchange reduces the number of transactions required to achieve a given degree of specialization. Notwithstanding that a single barter transaction equals a sale and a purchase transaction, such persons trading who would be satisfied by a single barter transaction can very rarely be found because only in the extremely rare case would the goods and services which one person had to offer be exactly those goods and services which another person wanted to obtain. More generally, before a mutually satisfactory barter transaction became possible, a person had to engage in the whole complex chain of complementary barter transactions to acquire the bundle of goods and services that was most acceptable as a means of payment to the other party. Such chains of complementary barter transactions were often long and complex involving the huge waste of time and effort. By splitting every single barter transaction into two separate money transactions of a sale and a purchase, the use of money by greatly reducing the number of transactions has effected substantial saving of time and effort. It has enabled people to sell at one place and time and to buy at another place and time. By serving as a medium of exchange in the economy, it has relieved the community of the vast inconvenience faced by it due to the double coincidence of wants inherent in the barter system. As a medium of exchange, money has opened the floodgates of free multilateral trade and the substantial advantages that flow from it. The economy in time and effort which the use of money as the medium of exchange has made possible is quite substantial. The study of hyperinflations, when money ceases to serve as a medium of exchange because people refuse to accept money as the means of payment and the economy reverts back to barter system, provides the basis for quantitative measurement of the welfare gain enjoyed by people by having a medium of exchange which avoids the clumsiness and complexity of pure barter. According to Martin J Bailey, who estimated this gain or 'the cost to society of abandoning money entirely' for the seven different hyperinflations, ranged between 14 and 48 per cent of the national product. The use of money as the medium of exchange by increasing the number of similar transactions increases competition thereby increasing the uniformity of the terms of contract. For example, when 2,000 people buy tea in a money economy, they make similar transactions in the same one market and by the sheer largeness

Money NOTES Self - Learning 122 Material of number, create a highly competitive situation on buyers' side in the market. In a barter economy, the same 2,000 people would have formed dozens of smaller, separate and non-competing groups depending on whether they paid for their tea with bread, wine, clothes, shoes or some other commodity. Consequently, in this process, competition would have greatly diminished causing the loss of collective welfare. The above mentioned advantages of having money as a medium of exchange would be greater larger the number of people who accepted money as a medium of exchange and larger the territory in which it was accepted as the means of payment. The advantages of having a medium of exchange explain why every society sooner or later adopts a commodity particularly suitable for this purpose and uses it as money in addition to its other uses. These other uses are not essential for the moneyness of money although these facilitate its gradual adoption by the society as a medium of exchange. The value of money—its acceptance as the medium of exchange—is a matter of social convention. Each person accepts money as the means of payment because he is confident that others will also accept it in payment from him. I value money only because I know that others also do and everybody else thinks the same way. The circulatory chain involved means that in order to raise something to money's high status, it is necessary to establish a social convention requiring every member of society to accept that commodity as the means of payment. The social convention could be established through a formal pledge made by all members of the society to accept a certain agreed-upon commodity as the medium of exchange among themselves. Alternatively, such a social convention could be enforced by the legal authority of the state. This is the basis of legal tender and the courts in the country enforce the acceptance of national currency in the discharge of all present and deferred payments. A social convention giving general acceptability to money as the means of payment could also be established if some important member of the group unilaterally accepts in payment a certain form of money. If he is important enough and his money is convenient enough, the other group members will follow suit. The use of the reserve currency whereby the other countries use one important country's currency as their external reserves is an example of establishing the social convention of accepting a particular form of money—the US dollar or British pound-sterling—in the discharge of payment obligations. 3. Money as Standard of Deferred Payments As soon as money comes to be used as a unit of value and a medium of exchange, it is also inevitably used as the unit in terms of which future payments are stated. In a modern economy, a large number of transactions relate to future contractual payments which are stated in terms of money unit. Thus, by functioning as a unit in terms of which all future payments are expressed, money also serves as a unit or

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standard of deferred payments. However, money as a standard of deferred payments

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standard of deferred payments. However, money as a standard of deferred payments

is satisfactory only if its value or purchasing power remains stable over time. When the purchasing power of money either increases or decreases through time, the interests of debtors or creditors are injured and people may mention

Money NOTES Self - Learning Material 123 certain safeguard clauses in future contractual obligations. For example, in Germany during hyperinflation the creditors insisted on mentioning the amount of debt payable in equivalent dollars or francs—currencies whose values were relatively stable— to protect themselves against the injury that may be caused to the creditors by the debtors by paying their debt money and interest in the fast depreciating German mark. According to the safeguard clause included in the agreement, the payment had to be made in the currency of the country of creditor's choice. 4. Money as Store of Value It has been stated earlier that the introduction of money as a unit of account separates a single barter transaction implying simultaneous sale and purchase of equal value into two separate transactions of sale and purchase. This separation of a single barter transaction into two transactions enables one to act as a seller of one good at one place and time without being forced to act simultaneously as a buyer of another good. This separation, therefore, means separation both in time and place. Money as the medium of exchange has made it possible for people to sell goods and services at one place and time and to buy goods and services at another place and time. It is, however, not possible to do so unless it is also possible to store the means of payment, i.e., purchasing power during the intervening time. It is, therefore, obvious that money necessarily acts as a temporary store of value by virtue of its use as the medium of exchange. In other words, in order to perform the function of the medium of exchange, the value or purchasing power has to be stored in the form of money for a temporary period in order to enable people to buy and sell at different times and places. Consequently, money also has to function as the temporary abode of purchasing power in order to function efficiently as the medium of exchange in the economy. The role or function of money as the permanent store of value—permanent abode of purchasing power—was least stressed by the early classical economists. Even the neoclassical economists, to some extent Alfred Marshall excepted, ignored

It was argued by the classical economists that no one outside a lunatic asylum will hold his assets in the unproductive or barren form of money in the face of availability of alternative interest and dividend bearing assets such as riskless government bonds, corporate debentures and shares of the well-known companies. It was Keynes who first fully realized and drew attention to the significance of money's function as a permanent store of value for economic analysis and policy. The great significance of this role arises from the fact that only this function of money creates the demand for money which can be analysed in terms similar to those which are employed for analysing the demand for other goods and services. In its role as a permanent store of value, i.e., as one of the many forms in which assets may be held, money has many close substitutes in other productive assets—government bonds, quasi-government securities, shares and debentures of well-established corporations, bank deposits of various kinds, etc. Consequently, money has to compete with these assets and the proportion in which money is held together with these other assets depends on their differential advantages (such as yield) over money. The demand for holding money for asset
Money NOTES Self - Learning 124 Material purposes is, therefore, a continuous and elastic function of the yield of other assets. This fact both provides a demand curve for money and renders its supply a policy tool with which the yields on other assets can be influenced. In contrast to its function as the permanent store of value where it faces competition from other assets, it has no serious competitor in other assets in its role as a unit of account and a medium of exchange. Moreover, the use of money as a unit of account is independent of its supply. Although money's use as a medium of exchange is not independent of its supply but a shortage of supply as a medium of exchange, apart from causing inconvenience, does not cause ordinary market reactions to an excess of demand over supply such as raising the market rate of interest. As the permanent store of value or asset, money has both certain advantages and disadvantages over its other competing yield-giving assets such as bonds, fixed deposits in banks, shares, debentures, house, land, furniture, etc. As the store of value,

utility to their owners. They also sometimes yield capital gains to their owners. However, compared with money, these assets also suffer from certain disadvantages as store of value. First, their holding involves storage costs. Secondly, these may depreciate in money value. Thirdly, they are illiquid—lack in perfect liquidity or moneyness—because these are not acceptable as money. Consequently, all assets other than money lack in quick convertibility into money without involving some loss of value. In face of the above mentioned advantages possessed by the other assets, if money is demanded as a permanent store of value in the community, it must be due to the comparative advantages of holding money which other assets lack. These advantages are collectively called liquidity, The main aspect of liquidity follows from the fact that money acts as a medium of exchange in the economy. First, as an asset it commands the unique advantage of ready and immediate acceptance as the means of payment. Secondly, since it is accepted as the means of payment in the economy, as an asset its value can be easily predicted at some unspecified future period. Thirdly, as an asset its value in payment equals its value in receipt. It is so because money is perfectly liquid. In other words, as an asset money commands reversibility. All assets other than money lack perfect reversibility in the sense that their value in payment is not equal to their value in receipt. Real assets—land, consumer durables like car or television—lack reversibility the most. For example, the moment a car is driven out of the dealer's showroom, it loses in value because (abstracting from scarcity conditions) the purchaser will find it difficult to sell it at the price at which he had bought it a minute earlier. Even financial assets like the riskless government bonds do not command perfect reversibility as their purchase and sale are subject to certain brokerage cost although this may be quite small. Perfect liquidity arising from the general acceptability of a good as the means of payment in the economy gives rise to perfect reversibility. Since no asset other than money acts as the medium of exchange in the economy, it lacks in perfect reversibility. It is, however, necessary that in order to serve as the permanent store of value in the economy the purchasing power or the value of money should either remain stable or else should monotonically rise over time.

Money NOTES Self - Learning Material 125 Finally, it is necessary to emphasize that money is anything that is generally accepted in exchange. In the past, astounding variety of money—ranging from sea shells and round stones to cigarette ends—have been used. The most essential feature of money is its general acceptability in the community or society in which it circulates. Check Your Progress 1. Name the important approaches which help to define money. 2. What are the four functions of money? 3. What are the disadvantages for money being as a store of value? 4.3 STOCK OF MONEY AND ITS MEASURES In the literature on monetary theory while the analysis of the demand for money— motives for holding cash balances—has been the main focus of economists' attention, study of the supply of money has received relatively scant attention. For one thing, the factors influencing the demand for money have been assumed as not influencing the supply of money with the result that in the monetary theory, the supply of money and the demand for money have remained separate and mutually exclusive. The classical economists and the quantity theorists believed that the important factors affecting the supply of money did not affect the demand for money. In this connection, the views of Milton Friedman—one of the leading monetarists—are worth repeating. According to Milton Friedman, the quantity theorist.... holds that there are important factors affecting the supply of money that do not affect the demand for money... A stable demand function is useful precisely in order to trace out the effect of changes in supply, which means that it is useful only if supply is affected by at least some factors other than those regarded as affecting demand.' Although Milton Friedman recognizes that the conditions affecting the demand for money do influence the supply of money, all the same he states that 'it seems useful to regard the nominal quantity of money as determined primarily by conditions of supply, and the real quantity of money and the income velocity of money as determined primarily by conditions of demand.' Secondly, the supply of money has been considered as an exogenous variable, being autonomously determined by the monetary authority whose policy actions were largely non-responsive to the monetary needs of the economy. In other words, the supply of money did not change in response to changes in the demand for it, i.e., in response to changes in the economy's monetary requirements as the economy expanded or shrank. Don Patinkin has succinctly expressed it in the words mentioned in the following page. '....in most discussions of monetary theory the nominal quantity of money supplied is taken as an exogenous variable. But though we continuously shy away from this fact in our theoretical work, we do nevertheless know that in the real world this is not the case for money is largely the creature of a banking system which responds to such endogenous variables as the rate of interest, the wages of

Money NOTES Self - Learning 126 Material clerks, etc. How then can we take account of these responses? And in particular, is there a limit to the extent to which endogenous influences can be assumed to operate? Conversely, must a determinate monetary system necessarily retain some exogenous element.'In the lines above, Don Patinkin has pointed out to the tradition of treating the money supply as an exogenous variable. He, however, holds that the endogenous variables exert their influence on the supply of money no less than do the exogenous variables. In fact, Don Patinkin has praised Gurley and Shaw for their penetrating study in which the authors have focussed on the influence of the endogenous variables on the supply of money which has traditionally been treated as an exogenous variable. As a matter of fact, interest rate is a strategic endogenous variable which influences both the demand for and the supply of money in the economy. Under a full-fledged gold-coin standard, with either gold coins actually in circulation or with banks keeping 100 per cent reserves against the full-bodied representative money circulating in the economy, the banks are virtually powerless to create the credit money. Consequently, the total money supply (M) would comprise the gold coins minted by the monetary authority. However, even under these restrictive conditions the public could influence the money supply to suit the total needs of the economy by influencing–by increasing or decreasing the rate (V) per time unit each coin circulated in the economy as the medium of transactions. This naturally gives the total money supply as a product of the total high-powered money M issued by the monetary authority and its transactions velocity V, i.e., MV. However, in a monetary system operating under a fractional reserves system the banking system acquires the power to influence significantly the total money supply in the economy by creating deposit money since every rupee of legal reserve is a high-powered money in the sense that each rupee of reserves can support several rupees of the derived bank deposits. Apart from the power of banks to create credit, the public also influences the size of total bank deposits by influencing the velocity of these bank-created deposits. Consequently, the total money supply becomes the sum of the high-powered money issued by the monetary authority multiplied by its velocity, i.e., MV and the bank-created deposit money M? multiplied by its velocity V?, i.e., M?V?. In short, the total money supply in circulation in the economy equals M V + M?V?. Even if it is

authority whose actions are non- responsive to economy's needs (demand for money), the other components of the money supply being endogenously determined (V and V? are directly under public's control while the M? is responsive to the interest rate changes and other endogenous variables), the total money supply cannot be treated entirely as an exogenous variable without inviting the legitimate criticism. There is an overwhelming evidence that lends support to the hypothesis concerning the commercial banks' supply response to interest rate changes albeit the exact nature of this response is not yet fully understood. A rise (fall) in the interest rate, ceteris paribus, induces the commercial banks in the economy to increase (decrease) their total credit. Consequently, it is not correct to assume
Money NOTES Self - Learning Material 127 that the total stock of money in the economy is determined exogenously only by the monetary authority without any reference to credit creation by the commercial banking system. As opposed

monetary authority—central bank—are the views of the Keynesians who

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hold that the total money supply in the economy is largely determined endogenously in response to the economy's

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hold that the total money supply in the economy is largely determined endogenously in response to the economy's

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hold that the total money supply in the economy is largely determined endogenously in response to the economy's

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hold that the total money supply in the economy is largely determined endogenously in response to the economy's

needs. Led by Professor Nicholas Kaldor, the Keynesians have strongly asserted their point and have argued the issue ad nauseam. To cite as a case, A B Cramp hammers the point that 'it is strongly arguable that, in practice, whatever, textbook theory says,

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the quantity of money has been largely determined "endogenously" by the demands/needs of

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economy, rather than "exogenously" imposed on the economy by the Central Bank as

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economy, rather than "exogenously" imposed on the economy by the Central Bank as

the monetarist doctrine presumes.' The views of the monetarists are sharply opposed to those of the Keynesians. This divergence of the two views is due to the fact that while the monetarists stress the power of the central bank to control the issue of money to an extent that it can ignore the monetary needs of the economy (it should, however, be noted that in the final analysis, the total stock of money depends on the willingness of the central bank to acquire assets), the Keynesians believe in a responsible central bank which responds to the monetery requirements of the economy that are strictly determined by the portfolio analysis. A critical evaluation of the two approaches to the supply of money leads us to the conclusion that neither of these two approaches is entirely correct and the truth lies somewhere in between. In fact, the supply of money in the

judgement, effectiveness and scientific authority with which the central bank performs its functions. It also depends on the supply response of the commercial banks to the interest rate changes which might be initiated by the central bank itself as a necessary part of its monetary policy action in order to influence the total money supply in the economy. Position in India In India, the Reserve Bank of India (RBI) has adopted the narrow and broad concepts of the money supply. According to the narrow approach, the money supply (M 1) comprises of the, (i) currency with the public (C), and (ii) demand deposits with the banks (D) while the major components of the broad money supply (

Major sources of supply of M 3 comprise the (i) net RBI credit to government; (ii) other banks' credit to government; (iii) other banks' commercial credit; and (iv) net foreign exchange assets of the banking sector. Besides the familiar concepts of M 1 and M 3 pertaining to the supply of money, the second working group set up by the RBI in 1977 propounded the money supply concepts of M 2 and M 4 . The concept of the M 2 comprises M 1 and deposits in post office saving banks while the concept of M 4 comprises the M 3 and total deposists of post office savings organization (excluding national savings certificates).
Money NOTES Self - Learning 128 Material In other words,

M 1 = currency with public (C) + demand deposits with banks (D): M 2 = M 1 + deposits with post office savings banks; M 3 = M 1 + time deposits with

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M 1 = currency with public (C) + demand deposits with banks (D): M 2 = M 1 + deposits with post office savings banks; M 3 = M 1 + time deposits with

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deposits with banks (D): M 2 = M 1 + deposits with post office savings banks; M 3 = M 1 + time deposits with

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deposits with banks (D): M 2 = M 1 + deposits with post office savings banks; M 3 = M 1 + time deposits with

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M 2 = M 1 + deposits with post office savings banks; M 3 = M 1 + time deposits with banks:

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M 2 = M 1 + deposits with post office savings banks; M 3 = M 1 + time deposits with banks:

and M 4 = M 3 + deposits with post office savings organization. The Reserve Bank of India publishes the statistics relating to the major components and major sources of supply of the M 1 and M 3 fortnightly. Currency with the public is the most important component of money supply as it can be used directly, instantly and without any restrictions to make the payment. Its close substitutes—demand deposits in banks, traveller's cheques issued by banks and other known non-banking firms, like the American Express Company are also included in the definition of money. Included in the broad money supply are the time or fixed deposits in the banks, funds in the savings banks accounts in the banks; bank drafts, commercial papers, short-term treasury deposits credit cards issued by the banks, etc., are also included in the concept of broad money supply as these can be converted in to money proper at short notice. Determinants of Money Supply The total supply of nominal money in the economy is determined by the joint behaviour of the central bank which controls the total issue of the high-powered money, the commercial banks which by creating the credit determine the total amount of nominal demand deposits and the public which by influencing the size of the nominal currency in hand is in a position to influence the amount of the nominal demand deposits of the commercial banks through effecting their excess cash reserves. We derive here a simple accounting model in order to show how this joint behaviour of the three parties determines

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the total supply of money in the economy. Since the total supply of nominal money consists of the currency held by the public (

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the total supply of money in the economy. Since the total supply of nominal money consists of the currency held by the public (

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the total supply of money in the economy. Since the total supply of nominal money consists of the currency held by the public (

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the total supply of money in the economy. Since the total supply of nominal money consists of the currency held by the public (

C) and the demand deposits of the commercial banks (D), the total supply of money held by the public (M) may be denoted as– M =C + D ...(4.1) whereM= the nominal money supply; C= nominal currency; and D= nominal demand deposits. The total supply of nominal high-powered money (H)

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issued by the central bank consists of the nominal currency held by the public (

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issued by the central bank consists of the nominal currency held by the public (

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issued by the central bank consists of the nominal currency held by the public (

C) and the nominal

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cash reserves held by the commercial banks against their deposit liabilities (

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cash reserves held by the commercial banks against their deposit liabilities (

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cash reserves held by the commercial banks against their deposit liabilities (

R), i.e., H=C + R ...(4.2) whereH= nominal supply of the high-powered money; C= nominal currency held by the public; and R= nominal cash reserves kept by the commercial banks.

Money NOTES Self - Learning Material 129 By dividing both sides of equation (4.2) by M, we get– H M = C R M M ? ...(4.3) By simultaneously adding and subtracting the term R D , the last term of equation (4.3) can be rewritten as– R M = R R R D D M ? ? ...(4.4) In the same manner, by multiplying the second term on the right-hand side of equation (4.4) by M/M and the third term by D/D, we obtain equation (4.5) without altering the equality as follows: R M = R RM RD D DM MD ? ? ...(4.5) R M = ( ) R R M D D MD ? ? ...(4.6) Since it follows from equation (4.1) that (M – D) = C equation (4.6) can be rewritten as– R M = R CR D MD ? ...(7.7) By substituting equation (4.7) into equation (4.3), we obtain– H M = C R CR M D MD ? ? ...(4.8) or M H = 1 C R CR M D MD ? ? ...(4.9) Finally, by multiplying both sides of equation (4.9) by H, we get– M= H C R CR M D MD ? ? ...(4.10) Equation (4.9) expresses the nominal money supply held by the public in terms of the behaviour

commercial banks, the total supply of nominal money in the economy will vary directly with the supply of the nominal high-powered money issued by the central bank. The behaviour of the public is determined by the ratio of currency to the money supply C/M, designated as the currency ratio C r . As long as the total nominal money supply comprises the nominal currency and nominal demand deposits, i.e., M = C + D, the currency ratio will be less than 1.0. The behaviour of the commercial banks in the economy is reflected in the ratio of their cash reserves to deposits R/D, known as the reserves ratio and denoted by the symbol R r . We know that the central bank in the country has the statutory authority of determining

Money NOTES Self - Learning 130 Material the minimum value of this ratio which is called the minimum legal or required reserves ratio RR r = (RR/D). In actual practice, however, the commercial banks keep only a part or fraction of their total deposits in the form of cash reserves. Consequently, the value of the reserves ratio R r is less than 1.0. However, for the commercial banking system as a whole the actual reserves ratio R r is greater than the required reserves ratio RR r since the banks keep with them a higher than the statutorily required percentage of their deposits in the form of cash reserves. By substituting the term C r for the term C/M and the term R r for the term R/ D in equation (4.10) we derive the following equation (4.11) showing the total nominal money supply. M= r r r r H C R C R ? ? ...(4.11) Since the value of C r and R r is less than unity, the value of their product C r R r must be less than the vaue of either of the individual values of C r and R r It means that if either C r or R r increases and H remains constant, the nominal money supply will decrease. Consequently, the conclusion follows that the nominal money supply varies directly with the quantity of the high-powered money and inversely with the currency and reserves ratios. Although these three variables do not completely explain changes in the nominal money supply, nevertheless they serve as useful devices for analysing such changes Consequently, these variables—the high-powered money (H), the currency ratio (C r) and the reserves ratio (R r)— are designated as the proximate determinants of the nominal money supply in the economy. According to the monetarists—Milton Friedman, Anna Jacobson Schwartz, Phillip Cagan, to mention only a few—the above method of studying the variables which cause changes in the nominal money supply is very helpful because the determinants are not rigidly linked by either the accounting or the institutional arrangements. In practice, however, some interdependence undoubtedly exists. But whatever small interdependence exists between these three variables, it results from certain behaviour on the part of central bank, the commercial banks and the public. It is possible to determine the nature of this interdependence among the three proximate determinants of the nominal money supply by examining the data which measures the actions of the central bank, the commercial banks and the public in the economy. 4.4 QUANTITY THEORY OF MONEY The intermittent occurrence of wide movements in the general price level has attracted special attention ever since the economists first began to write on economic matters. These price movements have been largely ascribed to the monetary and non-monetary factors. According to the monetary explanation, changes in the general price level in the economy are caused by changes in the total quantity of money in circulation. According to the other explanation, changes in prices are caused by the non-monetary factors such as war, famine, weather
Money NOTES Self - Learning Material 131 changes or some other special circumstance. The first explanation of changes in the prices has been labelled as the quantity theory of money. According to the quantity theorists, the principal thrust of any given change in the total supply of money is to cause changes in the level of prices in the economy. The origin of

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the quantity theory of money as an explanation of changes in the

value of money (prices) as a function of changes in its quantity can be found in the writings of early mercantilist writers. In his monumentally scholarly work titled The Theory of Prices, Arthur W Marget has traced the origin of the quantity theory of money to the 15 th century. There is, however, dispute among the economists as to who was the first writer to formulate the theory. According to Angell and Monroe, eminent French philosopher John Locke was the first to formulate the theory in 1691. This view has, however, been disputed by Jacob Viner who has shown that the quantity theory of money in its several variants was stated earlier by Gerard de Malynes, Thomas Mun, Robert Bruce Cotton, Henry Robinson and others. In support of his assertion, Jacob Viner has quoted from the writings of these writers which presented in some form the quantity theory of money ante-dating John Locke by 40 to 90 years. According to Joseph A Schumpeter, Jean Bodin was the first discoverer of the quantity theory of money because Bodin had recognized the connection between an influx of the precious metals and the rising prices in France in 1568. This is not, however, to deny that the doctrine was not attacked; in fact, it was repeatedly attacked ever since Thomas Tooke criticized it in his famous work titled History of Prices. After John Locke had propounded it, the quantity theory of money, suffering additions and modifications at the hands of several writers, attained the status of an important doctrine of the classical political economy. Although Dudley North in 1661, Issac Gervaise in 1720, Richard Cantillon in 1730 and Jacob Vanderlint in 1734 had stated the quantity theory of money with varying degrees of completeness and correctness, it was David Hume who systematized and popularized the doctrine by formulating it precisely in 1752 in his well-known work titled Political Discourses. The doctrine was propounded to explain the balance of payments adjustment mechanism. David Hume's version of the pure quantity theory of money held a prominent position in the 19 th century classical economic thought and his essay entitled Of Money , can still be read for pleasure and profit by every serious student of economics. Hume introduced the notion of causality between the total money supply (M) and the general price level (P) laying down this commonly accepted version: T and V being insensitive or non-responsive to monetary changes, M and P will vary equi-proportionately. This proposition is, however, valid only so long as money in the economy is merely a standard of value and a medium of exchange. In such a situation, this proposition is a tautology. However, as soon as money is considered to be demanded as a store of value, M and P will not necessarily vary equi-proportionately. The quantity theory of money in the sense of a fairly rigid connection between M and P was considered at the time as a verifiable and indeed as an obvious statement concerning the real

Money NOTES Self - Learning 132 Material world. If nothing else, the 'price revolution' of the 16th century was regarded as a strong evidence of a direct casual relationship between the variations in M and P. In the earlier versions of the doctrine, although a positive relationship between the aggregate money supply and the general level of prices was established so that an increase in the former always led to a rise in the latter and vice versa, these versions did not assert that this positive relationship between the aggregate money supply and the general price level was one of strict proportionality. The early quantity theorists were aware of the possibility of the increase in the aggregate output over time due to the technological improvements. They also realized that the velocity of money would change due to the changing nature of the monetary institutions. Consequently, they did not assert that the general price level would change equi-proportionately to changes in the aggregate money supply. Subject to these limitations, it was, however, stated that the general price level P would change in some dependable manner in response to changes in the total quantity of money in circulation M (or MV) such that an increase (decrease) in the total money supply in the economy would cause the general price level to rise (fall). In other words, changes in the value or the general purchasing power of money (1/ P) depended on changes in its supply in such a way that an increase (decrease) in the aggregate money supply in circulation would result in the fall (rise) in the purchasing power of money. This means that the value of money was an inverse function of its total quantity or supply. The naïve quantity theory of money asserts that the money elasticity of the general price level is positive. This statement is, however, very different from the statement which asserts an equi-proportionality relationship between changes in the quantity of money and the general price level. The early quantity theory of money in its naive form can be explained with the help of Figure 4.2 showing that when the total quantity of money in circulation increases, the general price level also rises. The relationship between these two macroeconomic variables is positive. Fig. 4.2 Total Quantity of Money The curve P = f (MV) shows that initially the increase in the general price level is less than equi-proportional to the increase in the money supply. Furthermore, with progressive increase in the money supply, the increase in the general price

Money NOTES Self - Learning Material 133 level becomes higher although it still remains short of the equi-proportional increase. This is explained by the fact that initially the impact of the increase in the money supply is more on increasing the economy's aggregate output rather than on raising the general price level with the emphasis progressively shifting from the former to the latter as the economy approaches its optimum capacity output. After the full employment output is achieved in the economy, the increase in the general price level will be equi-proportional to the increase in the aggregate money supply. The later-day classical and the neoclassical economists in their vain bid to reduce the economic phenomena to a few broad principles stated the relationship between changes in the money supply and changes in its value in terms of the rigid proportionality relationship between the total money supply and the general price level. In fact, the rigid quantity theorists asserted that the demand curve for money was a rectangular hyperbola so that the purchasing power of money varied in inverse ratio to changes in

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the quantity of money. The naive quantity theory of money has been

illustrated in Figures 4.3 and 4.4. Figure 4.2 shows
that

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changes in the general price level (P) are equi- proportional to changes in the

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changes in the general price level (P) are equi- proportional to changes in the

total quantity of money (MV) in circulation. When the total quantity of money in circulation is 0 M 1 , the general price level is 0 P 1 . When the total
money supply increases from 0 M 1 to 0 M 3 , the general price level in the economy rises from 0 P 1 to 0 P 3 . The proportionate (percentage) rise in the general price level 3 1 1 0 0 0 P P P ? is equal to the proportionate increase in the total money supply 3 1 1 0 0 0 M M M ? . Similarly, when the total quantity of money in circulation falls from 0 M 1 to 0 M 2 , the general price level falls from 0 P 1 to 0 P 2 and the proportionate fall ? 1 2 1 0 0 0 P P P in the general price level is equal to the proportionate fall 1 2 1 0 0 0 M M M ? in the aggregate money supply. . Fig. 4.3 Naive Quantity Theory of Money

Money NOTES Self - Learning 134 Material Figure 4.3 is simply a transformation of Figure 4.2. It shows the relationship between changes in the aggregate money supply (MV) and resulting changes in the value (purchasing power), of money (1 /P). It is evident that when the quantity of money increases from 0 M 1 to 0 M 2 , the value or purchasing power of money falls from 1/0 P 1 to 1/0 P 2 , i.e., when the quantity of money is doubled its value is halved. Conversely, when the supply of money is halved from 0 M 1 to 0 M 3 , the value of money is doubled from l/0 P 1 to 1/0 P 3 . All this necessarily assumes that the demand for real cash balances (M/P) remains constant while changes in the nominal money supply take place. In other words, money acts only as a medium of exchange in the economy and it does not influence the given total real output. Expressed differently, the money elasticity of the aggregate real output is zero. The LL curve in Figure 4.4 can also be interpreted as a demand function for the nominal cash balances whose elasticity throughout its length is unitary or one. Such a function assumes the form of a rectangular hyperbola showing that while the demand for the nominal cash varies in the inverse proportion to changes in the value of money, the total demand for the real cash balances (M/P) remains constant. Since the demand for the real cash balances in the economy arises from the need to exchange the aggregate real output, it follows that the aggregate real output is assumed as constant in the rigid quantity theory of money model which the quantity theorists explained in the form of the quantity equations. Fig. 4.4 Changes in Aggregate Money Supply The direct mechanism of the classical monetary theory, which was expounded by Richard Cantillon and David Hume, related

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the quantity of money to the general price level by stating that an increase in the quantity of money raises prices

directly through its prior effect on the aggregate demand. Since in the economy money is demanded only as the means of payment and not per se , the increase in people's money incomes causes an increase in the aggregate money expenditure flow

Money NOTES Self - Learning Material 135 because people's existing cash holdings are in excess of their desired cash holdings. To bring the increased actual cash balances into equilibrium with their desired cash balances, people must get rid of their unwanted (excess) cash balances by spending. In the process of spending, these cash balances increases the aggregate money spending flow in the economy. The effect of this, in the absence of any corresponding increase in the aggregate real output, will be seen in the rise in the prices of goods and services. The 18th century doctrine which stated that the quantity of money was determined by the 'needs of trade' was based on the assumption that there was a stable demand for transactions cash balances. Both David Hume and Richard Cantillon had studied the manner in which a cash injection in the circular flow of money in the economy was disbursed and the various lags which were involved in the process. In fact, they showed that an increase in the quantity of money would raise the general price level equi-proportionately only if the additional money supply was neutrally distributed—if everyone's initial money balances were equi- proportionately increased. As David Hume described it: imagine everyone's money holdings doubled overnight; prices would start rising and in this special case, would continue rising until they had doubled. 4.4.1 Cash Balances and Cash Transaction Approach The quantity theory of money, which is fundamentally a theory of the demand for money, has been stated in various forms of equations of exchange. The two most well-known forms of the quantity theory equations are the cash-transactions equation of exchange of the form MV = PT and the cash-balances equation of exchange variously written as M = KPT ; M = KPO or M = KY . The cash- transactions version is associated with the name of the American economist Irving Fisher who developed it in his well-known work entitled The Purchasing Power of Money published in 1911. The cash-balances approach, also known as the Cambridge approach, is associated with the names of the Cambridge economists Alfred Marshall, Arthur Cecil Pigou, Dennis Holme Robertson and John Maynard Keynes who taught at Cambridge University. These two versions of the quantity theory equations may now be discussed in detail. (i) Cash-Transactions or Fisher's Equation The cash-transactions approach to the quantity theory of money, usually ascribed to Simon Newcomb and Irving Fisher, was stated by the early economists, including David Ricardo, John Stuart Mill and others. In his theory of the demand for money, Irving Fisher primarily emphasized the role of money as the medium of exchange– money is demanded in the economy because it serves as the means of effecting payments. In the cash transactions equation version no attention has been given to the asset demand for money. Fisher's explanation of changes in the general price level

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relate changes in the general price level P to changes in the total quantity of money in

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relate changes in the general price level P to changes in the total quantity of money in

circulation M, its velocity of circulation V and the volume of transactions T which depended on the volume of trade so that his fundamental equation of exchange is: MV = PT
Money NOTES Self - Learning 136 Material According to Fisher, the nominal quantity of money in circulation (M) is an autonomous variable determined by the central bank. The total number or volume of transactions being a function of the level of income which is assumed to be the full employment income, the value of T is fixed in the short period. The velocity of money V is also constant being determined by the institutional and technological factors of the transactions process that do not change in the short period. Under these assumptions, the above equation of exchange can be transformed

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into a theory of the determination of the general price level (value of money)

where– P = MV T which states that the general price level is determined exclusively by the nominal quantity of money and is equi-proportional to it. Later, Fisher introduced the bank deposits M? and their velocity V? in his equation so that finally his equation of exchange became MV + M?V? = PT and this yielded the quantity theory equation P = MV M V T ? ? ? According to Fisher, in virtually all cases of substantial price changes, M was the active variable in the equation of exchange while P was 'normally the one absolutely passive element in the equation of exchange'. Furthermore, V and V? reflecting the community's spending habits, were short-run constants. According to Fisher, M? cannot change autonomously since there was a stable relationship between the primary money, bank reserves and the volume of bank demand deposits. Under these assumptions,

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changes in the quantity of money were the exclusive cause of changes in the general price level

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changes in the quantity of money were the exclusive cause of changes in the general price level

in the economy. Criticism: The cash-transactions equation of exchange has been subjected to various criticisms, mostly emanating from the assumptions embodying the equation. It has been said against the equation that it says nothing about the cyclical fluctuations in prices. In depression, prices fall while the monetary authority increases the quantity of money in circulation. This paradox is explained by the steep fall in the velocity of circulation of money V which more than offsets the increase in the money supply M. It has also been argued that contrary to the assumption made in the equation, the price level P might rise without the quantity of money M having increased and at any rate P might rise more than proportionately to the increase in M as was actually witnessed during the German hyperinflation when the general price level rose incredibly high due to the rapid increase in the velocity of the fast depreciating German mark. Crowther has correctly stated that 'the quantity theory might be relegated to the position of explaining the longer secular movements in the average price level, while some other explanation was sought for the shorter and more violent swings of the trade cycle.' It has also been said in criticism of the quantity theory that it concentrates too much attention on the general

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price level as if changes in prices were the most critical and important phenomenon of the

economy. It is true that changes in prices

Money NOTES Self - Learning Material 137 induce changes in the tempo of economic activities leading to changes in the volume of production. Rising prices lead to increased economic activity resulting in the creation of wealth and vice versa. The quantity theory of money is, however, defective because taking these undeniable truths it proceeds to assume that all changes in the level of general economic activity are the result of changes in the general price level. In Marget's opinion, 'the quantity equations themselves are nothing more or less than short-hand expression designed to indicate the nature of the variables whose operations can be shown to influence prices. Each of the variables in these equations is merely a chapter heading, a rubric for detailed analysis designed to explain why the variable in question will be of a different magnitude under different circumstances, and to indicate the circumstances under which, and the sequence in which, changes in the magnitude of one variable may be expected to be associated with changes in other variables.' George N Halm has criticized the equation of exchange by pointing out certain inconsistencies. Criticizing the quantity equation he says that 'the importance of the equation of exchange must by no means be overrated. Otherwise we are bound to get into difficulties. We have to note that M refers to a point of time, whereas V refers to the turnover of money during a period of time: consequently, the expression MV would involve the inconsistency of multiplying non-comparable factors unless the assumption is made that M is an average amount of money in circulation during the period in question or is the same amount during the whole period. But these assumptions are not comparable with all possible purposes of the equation.' According to the equation of exchange, the general price level can be controlled by the monetary authority by controlling the money supply. According to the quantity theorists, monetary policy alone is sufficient to ensure price stability in the economy. The general price level is not, however, a function of money supply alone being influenced by many other monetary and non-monetary factors, which might cancel out the influence of changes in the money supply on the level of prices. Criticizing the equation of exchange Friedrich A Von Hayck has in his book Prices and Production stated that it concentrates too much attention on the general magnitudes. The equation of exchange establishes an unreal causal nexus between the total quantity of money, volume of trade and general price level without realizing that monetary factors can influence the economy's general price level through first affecting the innumerable single price-making decisions. There is no mention in the equation of exchange of the changes in the relative prices caused by the changes in the quantity of money. Geoffrey Crowther has criticized the quantity theory (both the cash- transactions and the cash-balances equation) on different grounds. According to him, the 'Quantity theory can only explain the "How it works" of fluctuations in the value of money and in the activity of industry. But it cannot explain the "Why it works", except in the long-period and in those exceptional short-period fluctuations that are manifest due to large-scale creations or contractions of money. It cannot even explain why it is that a creation of money will sometimes "take" and start off a rise in prices, while at another time an equal creation may have no effect at all.' Money NOTES Self - Learning 138 Material Again he states: '

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The quantity theory is at best an imperfect guide to the causes of the trade cycle.

Shortage of money may cause the recovery to turn into depression. But it is not the sole cause, and depressions may begin when there is no shortage of money.....the quantity of money in existence seems to be the dominant influence on the price level on the average of long periods. But in the short period of the trade cycle, it may or may not control the movements of prices. And whether it does or does not depends on whether changes in the quantity of money are offset by changes in the velocity of its circulation.' Crowther concludes that according to modern thinking,

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the quantity of money is not a determinant of the value of money. The value of money is a consequence of the total income rather than of the total quantity of money. Criticizing the quantity theory of money,

Keynes has stated that 'for the purposes of the real world it is a great fault in the quantity theory that it does not distinguish between changes in prices which are a function of changes in output, and those which are a function of changes in the wage-unit. The explanation of this omission is, perhaps, to be found in the assumptions that there is no propensity to hoard and that there is always full employment. For in this case, O being always constant and M 2 being zero, it follows, if we can take V also as constant, that both the wage-unit and the price-level will be directly proportional to the quantity of money.' Explaining the shortcoming of the quantity equations, particularly the cash- transactions approach to the quantity theory of money, Don Patinkin has very correctly stated that 'the familiar equation MV = PT can be looked upon as determining the equilibrium price level P as the resultant of forces represented by the aggregate demand for goods MV, on the one hand, and their aggregate supply T on the other. This equation, however, does little to exploit the full potentialities of the theme. It restricts monetary theory to the case of an aggregate demand function for goods which, to outward appearances, is independent of the rate of interest and directly proportionate to the quantity of money. This is as misleading as it is unrealistic, for it gives the false impression that the results obtained by analysing this equation are necessarily dependent upon these extreme assumptions.' Criticizing the quantity equation in his review of Irving Fisher's book The Purchasing Power of Money , Findlay Shirras wrote: '

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The quantity theory of money does not explain the process by which an increase in the quantity of money causes an increase in the aggregate money spending which, with the given aggregate real output, raises the general level of prices in the economy.
Money NOTES Self - Learning Material 139 The quantity theory of money emphasizes only the medium of exchange function of money. In its role as the medium of exchange, money is needed only for transactions purposes. In the classical economic theory, of which the quantity theory of money was a crucial part, the asset demand for money was not at all recognized. The quantity theory of money reflects the classical view that since money has no inherent utility, the only rational motive of holding cash balances on the part of people is to facilitate the transactions. It was argued that since money was barren, no one outside a lunatic asylum would hold his assets in the barren form of money as compared to adding interest-bearing riskless government bonds or company shares on which an individual wealth-holder would earn dividend income. The classicists assumed that the interest elasticity of the demand for money was zero. This was a serious lacuna in their analysis. One of the major contributions of the Keynesian economics is the demonstration that there are circumstances, depending on the current rate of interest, where it is rational for the wealth-holders to hold cash balances as part of their asset portfolio as well as for transactions purposes. If the quantity theorists had recognized the asset demand for money they would have integrated it with the transactions demand for money in order to obtain the total demand function for money. Consequently, they would have developed an altogether different theory of the determination of the value of money. The theory is open to further criticism for it divorces the theory of the value of money from the general theory of value causing the classical dichotomy between the real and monetary sectors of the economy. The fact is that like any other commodity,

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the value of money is also determined by the demand for and the supply of money.

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the value of money is also determined by the demand for and the supply of money.

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the value of money is also determined by the demand for and the supply of money. The

general theory of value with its supply and demand tools can explain the determination of the value of money. There is, therefore, no case for a separate theory to explain the determination of the value of money. Evaluating the traditional cash-transactions equation in 1930 in his well-known work, A Treatise on Money , John Maynard Keynes wrote the following: 'The great advantage of this formula is the fact that one side of it, namely MV, fits in better than most with the actually available banking statistics. For quantitative inquiries it is possible, therefore, to make more progress with this formula than with any other. MV corresponds, more or less, to the volume of bank clearing and M to the volume of deposits, for both of which figures are available, so that the value of V can be deduced. Its weakness, on the other hand, is to be found on the other side of it, namely PT. For neither P nor T corresponds to quantities in which we are likely to be interested for their own sake. P is not the Purchasing Power of Money and T is not the Volume of Output. Professor Fisher has not, indeed, been oblivious to those defects, but he has not, I think, rated them as high as he should. Nor do the approximations which he has employed for their evaluation command confidence....' (ii) Cash-balances or Cambridge Equation Associated with the names of the Cambridge economists Alfred Marshall, Arthur Cecil Pigou, Dennis Holme Robertson and John Maynard Keynes, the cash- balances quantity equation has 'a much longer descent, being derived from William Petty, John Locke, Richard Cantillon, and Adam Smith.' The main propelling force behind developing the cash-balances equation approach was to integrate the theory

Money NOTES Self - Learning 140 Material of money with the theory of value. This is evident from Alfred Marshall's attempt to show that the usual technique of the demand and supply curves could be utilized to determine the value of money. Keynes, who was Marshall's distinguished student, tells us that Marshall used to teach 'the quantity theory of money as a part of the general theory of value.' Following Marshall, Pigou also analysed the value of money in terms of the demand for and the supply of money. Robertson also regarded the theory of the value of money merely as a special case of the general theory of value. The cash-balances approach, representing the neoclassical quantity theory of money, has been ably summarized by Don Patinkin in the following words: 'In its cash-balances version-associated primarily with the names of Walras, Marshall, Wicksell, and Pigou—neoclassical theory assumed that for their convenience, individuals wish to hold a certain proportion, K, of the real volume of their planned transactions, T, in the form of real money balances. The demand for these balances thus equals KT. Correspondingly, the demand for nominal money balances is KPT, where P is the price level of the commodities transacted. The equating of this demand to the supply of money, M, then produced the famous Cambridge equation M = KPT.....' Alfred Marshall, who headed the Cambridge school of economists, has beautifully summarized the cash-balances version of the quantity theory of money in the following words: '

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In every state of society there is some fraction of their income which people find it worthwhile to keep in the form of currency: it may be a fifth, or a tenth or a twentieth.

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In every state of society there is some fraction of their income which people find it worthwhile to keep in the form of currency: it may be a fifth, or a tenth or a twentieth.

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keep in the form of currency: it may be a fifth, or a tenth or a twentieth.

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keep in the form of currency: it may be a fifth, or a tenth or a twentieth.

A large command of resources in the form of currency renders their business easy and smooth, and puts them at an advantage in bargaining, but on the other hand it locks up in a barren form resources that might yield an income or gratification if invested, say in extra furniture; or a money income; if invested, in extra machinery or cattle.' A man fixes the appropriate fraction 'after balancing one against another, the advantage of a further ready command and the disadvantages of putting more of his resources into a form in which they yield him no direct income or other benefit.'..... '

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Let us suppose that the inhabitants of a country, taken one with another (and including, therefore, all varieties of character and of occupation), find it just worth their while to keep by them on the average ready purchasing power to the extent of a tenth part of their annual income, together with a fifteenth part of their

property; then the aggregate volume of the currency of the country will tend to be equal to the sum of these amounts.' According to Alfred Marshall, people in a country hold in the form of currency or 'ready purchasing power' a certain fraction of their annual money income and a certain fraction of their property or wealth. The total amount of money demanded by the people is, therefore, functionally related to their annual money income and to the amount of their property, i.e., M= f (Y, A) where Y represents the community's annual aggregate money income and A is the money value of its total wealth or assets. Treating the demand for money as a stable function of the money income and property, Alfred Marshall has expressed it in terms of the following equation: M = KY + K?A
Money NOTES Self - Learning Material 141 where K is the fraction of their total money income and K? is the fraction of their total assets expressed in terms of the money value

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which people find it worthwhile to keep in the form of currency.

Both K and K? are short-run constants determined by the institutional factors such as the payments and transactions patterns and procedures, (e.g., K would be larger if the wage and salary payments are less frequently received; it would be smaller if most expenditures are made immediately following the income receipts rather than being spread out over time; again it would be smaller the greater is the extent of the vertical integration between the business units.) The asset or wealth component of the equation was ignored by Marshall's followers. Consequently, the demand for money was functionally related only to the money income reducing the above equation to the following simple equation: M= KPO or P= M KO Referring to the quantity theory of money, Pigou has stated that, 'an increase in the supply of legal tender ought always, since the elasticity of demand for legal tender is equal to unity, to raise prices in the proportion in which the supply is increased.' The unit elasticity of demand for money simply means that if the purchasing power of money (1/ P) is doubled, its demand is halved and vice versa. In other words, any given proportionate change in money's purchasing power causes an equi- proportionate change in the opposite direction in the total amount of money demanded. In other words, the product of the purchasing power of money (1 /P) and the amount of money demanded (M) is always constant, i.e., the demand for real cash balances M/P = KO = constant. This is the equation of a rectangular hyperbola demand curve for money. Pigou has stated the cash-balances equation in the following form: M= KR P or P= KR M where R is the total real income in terms of wheat, K

legal tender (money) and P is the value of money in terms of wheat. It is, therefore, obvious that P in Pigou's equation is the inverse of P in Marshall's and Robertson's equations. There is, however, no basic difference between Pigou's and the other Cambridge economists' equations. According to Pigou's equation 1 P is the general price level which equals M KR . This is the same thing as M KO in Marshall's equation or M KT in Robertson's equation. The above equation was modified to make it applicable to those situations

its modified form, the equation was:

Money NOTES Self - Learning 142 Material M= KR P [c + h (1 – c)] or P= KR M [c + h (1 – c)] where c is the proportion of K which the community holds in the form of actual legal tender so that 1 – c is the proportion of K kept in the form of bank deposits and h is the proportion or ratio of their total deposits which the banks hold in the form of cash reserves. Dennis Holme Robertson, another leading member of the Cambridge school of economists, gave the following equation: M = KPT or P= M KT where M, P, T and K denote the total quantity of money, the general price level, the amount of goods and services purchased during one year and the fraction of T which people hold in the form of cash balances. Stating the quantity theory of money John Maynard Keynes wrote: 'The quantity theory of money states that the amount of cash, which the community requires, assuming certain habits of business and of banking to be established, and assuming also a given level and distribution of wealth, depends on the level of prices. If the consumption and production of actual goods are unaltered but prices and wages are doubled, then twice as much cash as before is required to do the business. The truth of this, properly explained and qualified, it is foolish to deny. The theory infers from this that the aggregate real value of all the paper money in circulation remains more or less the same irrespective of the number of units of it in circulation, provided the habits and propensity of the people are not changed.' Thus, according to Keynes, the correspondence of the quantity theory of money with the facts of life was not assailable. He explained the quantity theory of money in the form of the following two equations: n= pK; and n= p (K + rK?) where n is the total quantity of money in circulation, p is the price of consumption units, K is the amount of consumption units which the public holds in the form of money, K? is the amount of consumption units which the public holds in the form of bank deposits and r is the ratio of cash reserves of banks to their deposit liabilities K?. With K, K ? and r remaining constant, the quantity theory conclusion that n and p rise and fall together equi-proportionately follows. This equation has some resemblance with the quantity theory equations of Marshall, Pigou and Robertson. Criticism: Although an improvement over the cash-transactions equation of Fisher, the cash-balances equation is not unassailable. As the monetary theory, the cash- balances equation is inadequate in explaining the dynamic price behaviour in the economy. The equation is merely an exercise in comparative statics and is much too simple to deal with the dynamic economic system. Consequently, it cannot explain the cyclical changes in prices.
Money NOTES Self - Learning Material 143 Secondly, the cash-balances equation is defective since it does not analyse the total demand for cash balances, it neglects the asset or speculative demand for cash-balances which frequently causes sudden and violent changes in the community's liquidity preference schedule. By neglecting the important role of the speculative motive in determining the total demand for money, the cash-balances equation does not explain the behaviour of all the forces influencing the total demand for money and consequently the value of money. According to this approach, money serves only as a medium of exchange in the economy. In the equation, the precautionary motive for holding money has been treated only slightly and incidentally while the asset motive for holding money involving the speculative decisions has not been mentioned at all. Notwithstanding that Marshall conceived of an asset demand for money, i.e., the demand for money to satisfy the speculative acquisition for cash assets he made virtually nothing of it and it was practically forgotten by his followers. By not paying sufficient attention to the asset or speculative demand for money, the cash-balances equation did not recognize the role of interest rate in determining the demand for cash balances. Consequently, the equation remains separate from the whole corpus of the monetary theory dealing with the rate of interest. 'The omission of the rate of interest from the cash-balance equation creates the misleading impression that the classical invariance of this rate holds only in the special case where it does not affect the demand for money... no such restriction is necessary. This is not to deny that in other contexts neoclassical economists did recognize the influence of the rate of interest on the demand for money and did make other significant extensions of classical interest theory. But it is to stress that these contributions found no place in those fundamental equations which, more than anything else, are the hallmark of the neoclassical monetary theory.' The neglect in treating

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the demand for money as a function of the rate of interest

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demand for money as a function of the rate of interest explains the

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demand for money as a function of the rate of interest explains the

failure of the quantity theorists to integrate the monetary theory with the theory of income and output, a task which was successfully achieved by Keynes. Thirdly, like the cash-transactions equation the cash-balances equation assumes K and T or Y as given. In the equation, K is determined by the institutional factors which are assumed constant in the short period while the aggregate output Y is also assumed as given. Fourthly, in the equation the cash balances of all groups of people have been lumped together. In fact, different people's cash balances are subject to different behaviour patterns showing the influence of substantially different sets of underlying determinants. Furthermore, even the changes in the proportions in which the cash balances are held between the different groups of cash balances holders may be of great significance, apart from changes in the total cash balances held by the entire community. Cash-transactions and Cash-balances Equations Compared According to some economists, the two quantity equations are fundamentally the same. While the cash-transactions equation of the quantity theory of money emphasizes the value of money over a period of time by incorporating the velocity of money, the cash-balances equation explains the value of money at a point of time by including the concept of the demand for cash balances K. Mathematically,
Money NOTES Self - Learning 144 Material the two equations can be reconciled by substituting 1/ K for V in the cash-transactions equation and 1/ V for K in the cash-balances equation. Marshall thought that the essential reason why people demand cash or, in modem lingo, have preference for liquidity, is to bridge the time gap between the discrete receipt of money income and its continuous or, at any rate, less discrete spending. If the transactions demand for money is such that the total money stock turns over, say, at the rate of six times a year, then an equivalent of one-sixth of the annual money value of output will be kept in cash balances at any given point of time. Thus, the demand for the cash balances represented by K is the reciprocal of V, the velocity of money in circulation, i.e., V = 1/ K. By substituting 1/ K for V in the cash- transactions equation MV = PT, we get M = KPT which is simply the cash- balances equation. Similarly, by substituting 1/ V for K in the cash-balances equation M = KPT, we get MV = PT which is simply the cash-transactions equation. According to Robertson, the two equations are different observations of the same pehnomenon. The cash-balances equation emphasizes the 'money sitting' while the cash-transactions equation looks at the 'money on the wings'. The cash- transactions equation is concerned with money as a flow while the cash-balances equation is concerned with money as a stock. While the cash-transactions equation stresses the transactions velocity of money V, the cash-balances approach emphasizes the demand for cash balances K. Both the equations, however, regard money as serving only as the medium of exchange in the economy. The cash- balances approach stresses the role of money as a temporary abode of generalized purchasing power. According to Alvin H Hansen, the Marshallian cash-balances quantity equation is superior to Fisher's cash-transactions equation. Stressing this point Hansen has stated: '

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The Marshallian version of the quantity theory i.e., M = KY represents a fundamentally new approach to the problem of money and prices. It is not true, as is often alleged, that the 'cash-balances' equation is merely the quantity theory in a new algebraic dress. Substituting PO (price level times output) for Y, the Marshallian equation becomes M = KPO. Arithmetically K is, therefore, simply the reciprocal of V in the equation MV = PO. But it does not follow from the mere fact that V = 1/ K as an arithmetical identity that, therefore, the Marshallian analysis is in fact the same thing as the Hume-Fisher analysis. To assert this is to miss entirely the significance of K in the Marshallian equation.' The crucial difference

between the two quantity equation approaches and the superiority of the cash-balances approach as compared with the cash- transactions approach can be stated in these words: ‘

Money NOTES Self - Learning Material 145 Although formally the cash-balances equation M = KPO is simply a transformation of the cash-transactions equation MV = PT and most writers who have used one of the two approaches have regarded them so, yet the two approaches are very different. The cash-balances equation is not simply a transformation of the cash-transactions equation. The two approaches stress different aspects of money, make different definitions of money seem natural and emphasize the different variables and analytical techniques. The cash-transactions approach defines money in terms of anything which serves as the medium of exchange in discharging obligations. On the other hand, the cash-balances approach lays stress on money’s function as the temporary abode of purchasing power. Consequently, according to the cash-balances approach, it is quite appropriate to include in money such stores of value as the demand and time deposits in the banks which are not transferable by cheques although it clearly does not require their inclusion. In short, while the cash-transactions approach confines itself to the narrow definition of money, the cash-balances approach looks at money in a broader perspective. Moreover, the cash-transactions equation stresses such variables as the payment practices, financial and economic arrangements for effecting the transactions, and the speed of communication and means of transportation as it affects the time required to make the payment, i.e., it essentially emphasizes the mechanical aspects of the payments process. On the other hand, the cash-balances approach emphasizes those variables which affect the usefulness of money as an asset—the cost of and the income received from holding money instead of holding the other alternative assets, uncertainty in future and other such variables. Analytically, the cash-balances approach fits in more readily with the general Marshallian demand-supply apparatus than does the cash-transactions approach. The equation M = KPO can be regarded as a demand function for money, with P and O on the right-hand side being two of the variables on which the demand for money depends and with K representing all the other variables so that K is to be regarded not as a numerical constant but itself a function of still other variables. To complete the analysis, we require another equation showing the supply of money as a function of other variables. The general price level then becomes the consequence of the interaction of the demand and supply functions. Thus treated, the quantity theory of money as embodied in the cash-balances equations M = KPO or M = KPy is a theory of the demand for money, not a theory of the general price level or of the money income. Marshall’s introduction of the cash balances into the equation of exchange has the obvious advantage of facilitating the examination of those changes in the price level which are brought about by shifts in the liquidity preference of the public as well as those changes which are initiated by changes in the quantity of money. The importance given to K in the cash-balances equation approach emphasizes the human motives for holding the cash balances which cannot be analysed in money terms in sharp contrast to the highly mechanical nature of the concept of velocity V in the cash-transactipns approach. This important fact–the analysis of human motives for holding the cash balances–led the Cambridge economists to study those factors which constituted the foundation for the

Money NOTES Self - Learning 146 Material development of the monetary theory during the past six decades. Marshall's introduction of the concept of the demand for cash balances was a step forward towards the Keynesian concept of the liquidity preference in which the primary emphasis was given to the speculative motive for holding the cash balances. Keynes made the demand for money a function of the interest rate (bond prices) and by showing the relationship between the rate of interest and investment demand, he integrated the monetary theory with the general theory of income and output. The cash-balances equation M = KPT or M = KPO is a more useful tool than the cash-transactions equation MV = PT for explaining the value of money because it is easier to know the cash-balances relative to the money income which are held by the individuals than to know how much they spend on all the transactions. The cash-balances approach is superior to the cash-transactions approach because by focussing attention on the cash balances which people like to hold—by comparing at the margin the relative advantage of holding money as against spending or investing—the approach focusses attention on the discussion of the 'velocity' of money. This shift in the viewpoint led the economists subsequently to remove many confusions which were still latent in the analysis and to the identification of qualitatively distinct motive for holding the cash balances as well as to synthesize the 'monetary' and 'price' theories. Although mathematically identical with the cash-transactions equation, the development of the cash-balances equation was a break with the earlier approach. In the cash-balances equation, the emphasis shifted from the institutional and technological factors to the psychological factors as the main determinants of the demand for money. The demand to hold money became formally identical to the demand to hold any asset in which the principal determinants are, in addition to preferences, the individual's total wealth, the yield of the asset and the yields of the relevant alternatives. In the cash-balances equation, the transactions demand for money has been relegated to secondary importance. The relationship between the amount of money held and the volume of transactions conducted during any given time period is a very loose one as these can be carried with the help of other devices such as by increasing the velocity of money in circulation or through the resort to barter as certainly happens during hyperinflations. According to Alfred Marshall, the chief merit of the cash-balances equation of the quantity theory of money is that it removes the serious complications which arise when we establish a relationship between the velocity of money in circulation and the value of money as has been done in the cash-transactions equation. The cash-balances equation explains that the value of money is a function of its supply and its demand as measured by 'the average stock of command over commodities which persons care to keep in a ready form.' The emphasis placed on K in the cash-balances equation is more significant for understanding the phenomenon of cyclical fluctuations than is V in the cash-transactions equation. The cash-balances equation focusses attention on how changes in the value of real cash balances cause cyclical changes in the level of prices. A distrust of the people in the money unit in the country by diminishing their willingness to hold it increases prices and vice versa. Money NOTES Self - Learning Material 147 In the cash-balances approach, the demand to hold money is formally identical to holding any asset in which the main determinants, apart from wealth- holders' preferences, are their total wealth and the yields made available on the alternative forms of assets. The cash-balances equation is the forerunner of the modern liquidity preference theory which is significant in the explanation of the determination of equilibrium income and employment and also in explaining the limitations of the monetary policy in controlling the slumps and booms in the economy. Moreover, the cash-balances approach with its emphasis on the demand for money is more realistic than the cash-transactions approach because the fundamental truth about money is that someone must always hold it in the economy. Check Your Progress 4. Who is the authority for controlling money supply in India? 5. What is the definition of broad money? 6. What is high powered money? 7. How do you decide on the liquidity level and price level in the economy? 8. How do you show the mechanism by which reserve money creates money supply in the economy? 4.5 INFLATION, DEFLATION AND RECESSION: DEFINITION, CAUSES AND EFFECTS Let us study the definition, causes and effects of inflation, deflation and recession. 4.5.1

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Inflation Inflation means generally a considerable and persistent rise in the general level of prices. However, a precise meaning of 'inflation'

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has been a matter of economists' opinion. There is no universally acceptable definition of inflation. The definition of inflation has been changing over time depending on the perception of the economists. For example, Pigou defined inflation in the following words: "

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Inflation exists when money income is expanding more than in proportion to increase in earning activity."

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To Coulborn, inflation is a situation of "too much money chasing too few goods".

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To Coulborn, inflation is a situation of "too much money chasing too few goods".

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To Coulborn, inflation is a situation of "too much money chasing too few goods".

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To Coulborn, inflation is a situation of "too much money chasing too few goods".

Modern economist have tried to define inflation more meaningfully.

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According to Ackley, "Inflation is a persistent and appreciable rise in the general level or average of prices."

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a persistent and appreciable rise in the general level or average of prices."

Harry G. Johnson defines inflation as "a sustained rise in

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prices." According to Samuelson, "Inflation denotes a rise in the general level of prices."

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prices." According to Samuelson, "Inflation denotes a rise in the general level of prices."

Bronfenbrenner and Holzman have suggested a number of alternative definitions of inflation which are mostly modified versions of earlier definitions. Their alternative definitions make things more fuzzy rather than adding clarity to inflation. However, economists seem to agree that

terms like 'persistent, 'appreciable' "sustained", "considerable", "continuing" and "prolonged" are not precisely defined. In practice, however, the term 'persistent' implies that the price rise exhibits a secular trend or continues to rise over a period

Money NOTES Self - Learning 148 Material of one to two years, and does not respond to anti-inflationary policies. The term 'appreciable' is more ambiguous because it does not specify as to what rate of increase in the price level is to be considered as 'appreciable' or 'considerable'. Desirable Limits of Inflation A moderate rate of inflation is considered to be desirable for the economy. The limit of desirable inflation varies from country to country and from time to time. The moderate rate of inflation can be determined on the basis of the rise in price that contributes in following ways. (i) Keeping economic outlook optimistic and helping production and employment; and (ii) Promoting mobilization of resources (savings and investment) by what is called inflationary method of financing. The desirable limit of inflation depends on the need and the absorption capacity of a country. This limit is determined for an economy on certain symptoms: (i) inflation makes economy overheated; (ii) real macro variables like savings, investment and growth of output declines in spite of inflation, and (iii) BOP position turns adverse, and (iv) employment get adversely affected. These symptoms and the absorption capacity, so defined, varies from country to country and from time to time depending on their growth potentials. Therefore, the desirable limit or the moderate limit of inflation has to be determined for each country. There is no definite rule in this regard. However, based on the past experience, it is sometimes suggested that 1–2% inflation in developed countries and 4–6% inflation in less developed countries is the appropriate and desirable limit of moderate inflation. Some consider a lower rate to be desirable. "Some people who regard inflation as an economic evil believe that a price level rising at around 1.5% ... assists in achieving and maintaining full employment and a satisfactory rate of growth. What is the Desirable Rate of Inflation? There is no precise or unique answer to this question. However, a price rise in excess of 2 –3% per annum in the developed and 4 –5% per annum in developing economies is considered to be undesirable inflation. These rates of desirable inflation have no theoretical basis. However, these rates have great policy implications. So long as (i) the general level of price rises at an annual average rate of 2 –3% in developed countries and 4 –5% in less developed countries, and (ii) macro-variables are not adversely affected by the price rise, policy measures to control inflation are not required because controlling inflation under these conditions may distort the price system and disturb employment and growth process. Every Price Rise is Not Inflation One may think that any price rise in excess of 2 –3% in the developed and 4 –5% in the developing economies can be called inflation. However, a price rise even in excess of these rates on account of the following factors is not inflationary.

Money NOTES Self - Learning Material 149 (i)When prices tend to rise due to change in the composition of GDP, it is not inflationary. During the period of economic growth, the proportion of low-price goods, e.g., agriculture product, decreases and that of high-price goods, e.g., cars, TV sets, computers, superior housing, increases causing a high rise in price index number. This rise in price is not inflation. (ii) Price rise due to qualitative change in products is not inflation. For example, in case of colour TV sets, qualitative improvements have been made in the form of multi-channel and remote control facilities. In case of cars, to consider another example, the brand of car may have qualitative improvement in the form of AC facility, automatic gear system and power brake, etc. Such qualitative changes involve increase in cost of production and therefore cause a rise in the price. (iii) Short-run rise in price due to sudden increase in demand and/or decrease in supply is not inflation. Sometimes prices rise because of sudden increase in market demand and/or sudden decrease in supply for such reasons as crop failure, strikes and lockouts, pre-budget speculations, disruption of foreign supply due to war, etc. The price rise under such conditions are not supposed to be a persistent increase in the price level. (iv) Price rise after depression or recession is not inflationary. Prices tend to rise during the phase of recovery after a short-run depression or recession to reach their normal level. Such a price rise is not inflation, even if it is 'persistent' and 'appreciable'. Measures of Inflation There are two common methods of measuring inflation: (i) by computing change in Price Index Numbers (PIN), and (ii) by comparing the change in GNP Deflator. Measuring Inflation through Wholesale PINs The following formula is used for measuring the rate of inflation through the changes in the PINs. Rate of inflation = ? ? where PIN t is the wholesale price index number for the year selected for measuring inflation and PIN t–1 is the PIN in the preceding year. For example, consider some hypothetical price index number in India. The WPI (2009–10 = 100) for 'all commodities' increased from 150.9 in fiscal year 2017–2018 to 159.2 in 2018–19. The rate of inflation between 2017–18 and 2018–19 can be obtained by using the above formula as follows. Rate of inflation = ? ? = 5.5%

Money NOTES Self - Learning 150 Material Measuring Inflation by GNP Deflator The GNP deflator is the ratio of nominal GNP in a year to the real GNP of that year. It is also defined as follows. GNP Daflator = where Nominal GNP is GNP at current prices and Real GNP is GNP at constant prices. That percentage change in GNP deflator between any two continuous years gives the rate of inflation. For example, suppose we want to know inflation rate between 2017–2018 and 2018–2019 by using GNP deflator method. For example, Let's suppose India's nominal GNP (i.e., GNP at current prices) in 2017–2018 was 1740.2 (P) thousand crores and her real GNP (i.e., GNP at constant prices of 2009-10) in this year was 1136.9 thousand crores. Now, India's GNP deflator for 2017–2018 can be obtained as follows. GNP deflator (1999–2000) = = 1.53 In terms of percentage, India's GNP deflator in 2018–2018 equals 1.53 × 100 = 153. Similarly, GNP deflator for 2018–19 (Q) is worked out at 1.60 and at percentage rate of 160. The percentage change in GNP deflator between any two years gives a measure of inflation. For example, the rate of inflation in India between 2017– 2018 and 2018–19 can be obtained as follows. Rate of inflation = × 100 = 4.6% It is important to note here that GNP takes into account all the goods and services and all the prices in the economy. Therefore, GNP deflator method takes into account all the final prices. In contrast, WPI takes into account prices only at the wholesale level. Therefore, economists consider GNP deflator as a better measure of inflation than WPI. Kinds of Inflation Inflation is generally classified on the basis of its rate and causes. The types of inflation on basis of its cause will be discussed under the causes of inflation. Here, we take a look at the kinds of inflation based on the rate of inflation. Inflation on the basis of rate is classified as (i) moderate inflation, (ii) galloping inflation, and (iii) hyper inflation. (i)Moderate Inflation: 'A single digit' rate of annual inflation is called 'moderate inflation' or 'creeping inflation'. During the period of moderate inflation, prices increase but at a moderate rate. The 'moderate rate' may vary from country to country. However, important feature of moderate

Money NOTES Self - Learning Material 151 inflation is that it is 'predictable' and people hold money as a store of value. By this definition, India has had a moderate of inflation during the post- independence period, except in few years. (ii) Galloping Inflation: A very high rate of inflation is called "galloping inflation'. How high should be the rate of inflation to be called galloping inflation is not defined precisely. According to Baumol and Blinder, "Galloping inflation refers to an inflation that proceeds at an exceptionally high rate." They do not specify what rate of inflation is 'exceptionally high'. Samuelson and Nordhaus define 'galloping inflation' more precisely. According to them, "Inflation in the double or triple-digit range of 20, 100 or 200 percent a year is labeled "galloping inflation". This definition is not less imprecise because the double-triple-digit inflation varies from 10% to 999%. A country with 900 percent inflation will have devastating effects whereas a country with 20–30 per cent inflation can manage without pressing the alarm bell. The post-War I inflation in Germany is an example of galloping inflation. The wholesale prices in Germany increased 140 per cent in 1921 and a colossal 4100 per cent in 1922. Some examples of galloping inflation, i.e., the annual average rate of inflation during 1980–91 are as follows: Argentina - 416.9%; Brazil - 327.6%; Mexico - 66.5 %; Peru - 287.3% and former Yugoslavia - 123.0%. These cases are often quoted as the example of hyper inflation also. (iii) Hyper Inflation: Hyper inflation takes place when prices shoot up at more than three-digit rate per annum. During the period of hyper inflation, paper currency becomes worthless. Germany had hyper inflation in 1922 and 1923 when wholesale price index shot up by '100 million per cent between December 1922 and November 1923.' November 1923 was the worst period of hyper inflation in Germany—"from January 1922 to November 1923, the price index rose from 1 to 10,000,000,000." Hungarian inflation of 1945–46 is another example of hyper inflation, the worst case of hyper inflation ever recorded. In Hungary, "rate of inflation averaged about 20,000 per cent per month for a year and in the last month prices skyrocketed 42 quadrillion per cent." In recent times, Argentina, Brazil, and Peru had hyper inflation in 1989 and 1991, as shown below. Country 1989 1990 Argentina 3079.8% 2314.0% Brazil 1287.0% 2937.8% Peru 3398.6%; 7481.7% Source : CMIE, World Economy & India's Place In It, October 1993, Table 11.6. (iv) Suppressed Inflation: Another category of inflation often come across in the contemporary writings on the subject is suppressed inflation. In contrast to open inflation (i.e., price rise without any control and regulation), when price rise is prevented from rising at its potential rate, there exists suppressed

Money NOTES Self - Learning 152 Material inflation. Price control through various direct or indirect price control measure has become a common feature of economic policy of most developed and developing economies. Price controls take the form of statutory fixation of the price or fixation of a price ceiling; rationing the consumption of scarce goods, controlled distribution of goods through public distribution system; subsidization of commodities with high inflation potentials. In spite of these control measures, prices do rise and inflation does take place but at a rate lower than the potential rate in the open system. This kind of inflation is called suppressed inflation. Effects of Inflation The economic effects of inflation is all pervasive. It affects all those who depend on the market for their supplies. Its effects may be lower or high depending on the rate of inflation. A high rate of inflation is called 'economic evil' because it affects economy in many adverse ways. It affects different sections of the society in different ways and to different extent. The effects of inflation may be favourable or unfavourable. Besides, galloping and hyper-inflation have social and political implications too. In this section, however, we will discuss only economic effects of inflation on the economy as a whole and on the different sections of the people. We will discuss here the effects of inflation on (i) production and economic growth, (ii) employment of labour, (iii) distribution of income, and (iv) distribution of wealth. Effect of Inflation on Production and Growth Theoretically, the rate of economic growth depends primarily on the rate of capital formation and the rate of capital formation depends on the rate of saving and investment. Therefore, whether inflation affects economic growth depends on how it affects savings and investment. Many economists hold the view that inflation is conducive to economic growth and that there is positive relationship between inflation and economic growth. For example, Harry G. Johnson says, "...some degree of inflation— but a moderate degree only—is the logical concomitant of efficient economic mobilization." Apart from helping growth through redistribution of income, he argues, a moderate rate of inflation breaks the characteristic "rigidities and immobilities" of the underdeveloped economies and can "draw labour and resources out of traditional or subsistence sectors into the developing sectors of the economy" and can help efficient re-allocation of resources. Johnson puts forward two arguments in support of his view. First, during the period of inflation, output prices rise first and input prices follow. This is called time-lag between the rise in output prices and rise in input prices, especially the wage rate. In fact, output prices increase first and wages increase after a time-lag. This time-lag between the rise in output prices and the wage rate is called wage- lag. If wage-lag persists over time, it enhances the profit margin which provides incentive for investment and investible funds to the firms. This results in increase in investment, production capacity and a higher level of output.

Money NOTES Self - Learning Material 153 Second, inflation redistributes incomes in favour of higher income-groups which have higher propensity to save. Inflation-induced redistribution of incomes increases total savings because upper-income classes have a higher propensity to save . As a result, the level of savings increases which lowers the rate of interest. Lower interest rate induces new investment. Increase in investment enhances production capacity of the economy leading to increase in the total output which means economic growth. Empirically , there does not seem to be a clear evidence of positive relationship between inflation and economic growth, at least in the long run. "Looking back to the record of the eighteenth and the nineteenth centuries, some economists find a positive relationship between inflation and economic growth in various countries." Samuelson and Nordhaus recount the US experience: "Until the 1970s, high inflation usually went hand in hand with high employment and output. Rising inflation occurred when investment was brisk and jobs were plentiful...But a more careful examination of the historical record has revealed an interesting fact: The positive association between output and inflation appears to be only a temporary relationship. Over the longer run, there seems to be no sustained relation between a country's inflation rate and its level or growth of output or employment. Different kinds of relations between inflation and growth have been observed during the post-War II period: (i) low rate of inflation and high rate of growth (West Germany); (ii) high rate of inflation and high rate of growth (Japan); (iii) high rate of inflation and low rate of growth (United Kingdom); and (iv) low rate of inflation and low rate of growth (India). To conclude, economists generally agree that a moderate rate of inflation is conducive to economic growth. In the words of Samuelson and Nordhaus, "While economists may disagree on the exact target for inflation, most agree that a predictable and stable or gently rising price level provides the best climate for healthy economic growth. In the long run, economic growth of a country is affected by many other factors and therefore the relation between inflation and growth loses its distinctiveness. Furthermore, a very high rate of inflation of galloping and hyper type cause erosion in real savings and investment and thereby in real savings and investment. Besides, when price rise is uncertain or unanticipated, people find it very difficult to determine their course of response to the price changes. This upsets the price system which causes inefficient allocation of resources and a lower output. Dornbusch and Fisher quote evidence from Jorret and Selody that the output growth in Canada declined by 0.3 per cent for each 1 per cent increase in the inflation rate. In their opinion, "... there is no doubt that high inflation is bad for growth." Effect of Inflation on Employment The rate of employment depends generally on the rate of economic growth. The factors that accelerate the pace of economic growth determine also the course of

Money NOTES Self - Learning 154 Material employment. If inflation rate is such that it affects growth variables—savings, investment and profits—favourably then it affects employment favourably too. However, growth rate and employment come in conflict at a high rate of inflation. A high rate of inflation increases employment but it affects growth adversely. Besides, inflation as a means to growth and employment involves severe economic and social costs. Evidence shows that a high rate of inflation causes distortions in relative prices, malallocation of resources, and social and political unrest. Policy- makers are therefore often faced with a situation of dilemma: whether are or not to control inflation. If inflation is allowed to go on a high rate, it will affect growth adversely, and if it is controlled, it will affect employment adversely: there may be a high rate of unemployment The policy-makers are therefore required to find a trade-off between inflation and unemployment. Since inflation and unemployment have persisted side by side in many countries, this issue has received a great deal of attention in recent times. We give a brief review of the developments in this area. The Phillips Curve The relationship between inflation and employment was first studied systematically way back in 1958 by A.W. Phillips, a New Zealander, who taught economics in England in the 1950s. He studied the relationship between unemployment and the change in money

unemployment. He presented this relationship by a curve called Phillips curve as shown in Fig. 4.5. The Phillips curve in Fig. 4.5 shows the inverse relationship between the rate of change in money wage rate and the rate of unemployment. The general conclusion drawn from this empirical finding is that rise in money wage rate reduces the rate of unemployment and fall in money wages increases the rate of unemployment. From policy point of view, the Phillips curve implies that there is

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a trade-off between the rate of unemployment and the rate of change in money

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wage
rates, i.e., unemployment can be reduced by lowering the money wage rate. Fig. 4.5 The Phillips Curve: Inflation and Unemployment
Money NOTES Self - Learning Material 155 Although Phillips had traced the

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relation between the rate of change in money wages and the rate of

unemployment, it was later extended to examine

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the relationship between the rate of inflation and the rate of unemployment.

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between the rate of inflation and the rate of unemployment.

Dernburg studied this phenomenon for the period 1951–61, Dornbusch and Fisher for 1961– 69, Ackley for 1955–69, and Glahe for 1961–70. They all find Phillips curve to be consistent with the US data in the short-run, i.e., in the US,

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there existed an inverse relationship between the rate of inflation and rate of

at least in the short run. The Phillips curve implies that there is a positive or direct

inverse relationship between the wage rates and the unemployment rates can be explained by both demand-pull and wage-push factors. The demand- pull factor works through demand-pull inflation. Increase in product prices increases the demand for labour and when demand for labour increases and unemployed labour is drawn into employment. Therefore, with the increase in the money wage rates, the rate of unemployment decreases. The wage-push factor works through autonomous demand by the labour unions for wages in excess of increase in labour productivity. The extent to which labour unions can push wages up depends, among other things, on the rate of unemployment. The lower the rate of unemployment, the greater the union's power to push the wages up. The period of low unemployment is generally the sign of 'buoyant' product market and high profits. Therefore, employers are willing to pay higher wages. There is, therefore, fast upward movement in wages and decrease in employment. Phillips curve created a flutter and generated a long debate on the relationship between inflation and unemployment and its policy implications. In the course of the debate, several economists commented on and contributed to the relationship between the rate of employment (or unemployment) and inflation, and made several modifications to the Phillips curve hypothesis. Effect of Inflation and Income Distribution Whether inflation affects income distribution depends on how it affects price received and price paid. Prices received are the same as incomes defined crudely. Incomes are received, for example, in the form of wages and salaries, rents and royalties, dividend, interest, profits and self-employment earnings. Incomes are also received in the form of old age pensions, unemployment allowances, etc. On the other hand, prices paid represent expenditures. Also, prices paid by one person are the prices received by another person and all prices do not change simultaneously and proportionately. Inflation changes income-distribution- pattern only when it creates a divergence between the total price received and the total prices paid by different sections of the society. Effects of Inflation on Some Sections of Society We have noted above that the overall impact of inflation is unpredictable. However, inflation has certain definite and predictable effect on the incomes of some sections of society. These are briefly discussed below.

Money NOTES Self - Learning 156 Material (i)Wage Earners: It is a common belief that wage earners are hurt by inflation more than other sections of the society. For, in general, wage rise lags behind the rise in consumer prices. Some authors consider this belief as a myth. In fact, whether wage earners lose or gain by inflation is again a matter of labour market conditions. In developed countries, labour is, by and large, organized and labour market is competitive. According to Baumol and Blinder 'the average wage typically rises more or less in step with prices'. This contradicts the 'popular myth' that wage earners are, in general, losers during the period of inflation. Baumol and Blinder have used US data to show that real wage "is not systematically eroded by inflation". They add, "The fact is that in the long run wages tend to outstrip prices as new capital equipment and innovation increase output per worker". The Baumol-Blinder conclusion holds for at least the organized sector in India. In the organized sector, labour is unionized. The organized labour uses its union power to get compensatory increase in their wages. The labour in the organized sector is, therefore, often adequately compensated for the loss of purchasing power due to inflation. According to the official data, the public sector employees—a part of the organized sector—are more than doubly compensated. The per capita annual emoluments have increases by 1326.17 per cent between 1971–72 and 1994–95 whereas the consumer price index (1960 = 100) has gone up by only 630.21 per cent during this period.The annual emoluments in the private organized sector has increased at a faster rate. It may thus be concluded that the wage earners in the organized sector have gained during the period of inflation. The above conclusion can however be hardly accepted as a universal phenomenon. For, labour market conditions and price variations vary from country to country and from time to time. The labour market in the less developed countries, mostly faced with large scale open and disguised unemployment, is generally divided between organized and unorganized labour markets. In India, for example, the employment share of unorganized sector is much larger, nearly 5 times bigger... than that of the organized sector. The wage in the unorganized labour market have not increased in proportion to the rate of inflation. Therefore, the labour in the unorganized sector has been a net loser during the period of inflation because their wages lag far behind the price rise. (ii) Producers: Whether producers gain or lose due to inflation depends, theoretically, on the rate of increase in prices they receive (the sale price) and the prices they pay (input prices or the cost of production) including wages and salaries, interest, rent and other input prices like cost of raw material, transportation and communication, and electricity. In general, product prices rise first and faster than the cost of production. The product prices rise first due to demand-pull factor, rise in money supply, supply bottlenecks, or a sudden rise in certain input prices (e.g., oil price). The input prices remaining the same, profit margin increases. This creates

Money NOTES Self - Learning Material 157 additional demand for inputs pushing the input prices up though at different rates and with different time lags. However, it must be brone in mind that wages and salaries do not increase automatically and simultaneously during the period of inflation. There is always a time-lag between the rise in commodity price and wages. The producers gain during the period of inflation due to wage-lag. (iii) Fixed Income Class: The fixed income class which consists of house- owners getting fixed rent on their property; some category of wage-earners getting fixed wages, and artisans make a limited fixed income during the period of industria-lization. The people of the fixed-income category are the net losers during the period of inflation. The reason is, their income does not increase—it remains constant—but the prices of goods and services they consume increase. As a result, the purchasing power of their income is eroded in proportion to the rate of inflation. (iv) Borrowers and Lenders: In general, borrowers gain and lenders lose during the period of inflation. During the period of inflation, borrowers gain because when they pay off their debts, they pay a lower real value. Lenders lose for the same reason. For example, suppose a person borrows Rs 5 million at 12 per cent simple rate of interest for a period of five years to buy a house. Suppose also that escalation in property prices is such that property prices double every 5 years. After 5 years, the borrower would pay a total sum of Rs 8 million whereas the price of house rises to Rs 10 million. The borrower thus gains by Rs 2 million. The lender loses by the same amount in the sense that had he bought the house himself, the worth of his money would have risen to Rs 10 million. (v)The Government: The government is a net gainer during the period of inflation. It gains because inflation increases tax yields from personal income tax because (i) inflation redistributes income in favour of higher income groups taxable at higher rates of income tax, and (ii) inflation increases the nominal income at the rate of inflation, real income remaining the same. As a consequence, an income which was non-taxable prior to inflation becomes taxable after inflation. Inflation enhances also the tax base and, therefore, tax revenue increases. In case of corporate income tax, tax-yield increases during the period of inflation on account of (i) increase in corporate profits, and (ii) increase in depreciation allowance due increase in the nominal value of firm's assets. Inflation enhances also the revenue from indirect taxes because tax yield increases in case commodities are taxed at ad valorem rates. Finally, the government gains as a net borrower. Effect of Inflation on Distribution of Wealth Here, the term 'wealth' means net worth defined as assets minus liabilities or debts. For our purpose here, net worth means the net worth of variable price assets comprising physical and financial assets. The effect of inflation on the distribution of wealth depends on how inflation affects the net worth of the different classes of the wealth holders. In general, the value of variable price assists increases

Money NOTES Self - Learning 158 Material at the rate higher than the cost of maintenance. Therefore, sections of the society holding large price-variable assets gain. This increases their returns on wealth and ability to accumulate more assets. Therefore, wealthy people gain more wealth. The result is redistribution of wealth in favour of rich section of the society, even if low asset holder maintain their assets. However, if low asset holders sell their property under the pressure of inflation, wealth distribution get more accentuated in favour of rich. However, the voluminous literature available on the subject and various empirical studies do not produce conclusive evidence on the effect of inflation on the distribution of income and wealth. To quote Samuelson and Nordhaus. "The summary wisdom of these studies indicates that the overall impact is highly unpredictable". 4.5.2 Deflation Deflation basically means a decrease in the general price level of goods and services. It occurs when the inflation rate falls below 0%. Deflation is caused essentially for two reasons: (i) fall in the aggregate demand; (ii) increase in the aggregate supply. Let us see some of the reasons why there is a fall in the aggregate demand and increase in aggregate supply in the economy: ?Fall in the money supply in the economy: When the central bank of an economy increases interest rate, people begin to save their money. This may lead to a fall in the money circulating in the economy. ?Decline in confidence: When there are negative events associated with the economy, it may cause a decline in confidence among people about the future of the economy. This may lead to decline in demand. ?Lower production costs: A lowering of production costs may lead to oversupply in the economy, which will lead to lowering of prices. ?Technological advances: Improvements in technology may lead to oversupply in the economy, which will lead to lowering of prices. Deflation can have dramatic effects on the economy of the country. It may lead to mass unemployment and increase the real value of debt. 4.5.3 Recession The prosperity phase is characterized by a rise in the national output, rise in consumer and capital expenditure, rise in the prices of raw materials and finished goods, and rise in the level of employment. Inventories of both input and output increase. Debtors find it more and more convenient to pay off debts. Bank advances grow rapidly even though bank rate increases. There is general expansion of credit. Idle funds find their way to productive investment since stock prices increase due to increase in profitability and dividend. Purchasing power continues to flow in and out of all kinds of economic activities. So long as the conditions permit, the expansion continues, following the multiplier process. In the later stages of prosperity, however, inputs start falling short of their demand. Additional workers are hard to find. Hence additional workers can be obtained by bidding a wage rate higher than the prevailing rates. Labour market

Money NOTES Self - Learning Material 159 becomes a seller's market. A similar situation also appears in other input markets. Consequently, input prices increase rapidly leading to increase in output and employment. Cost of living increases at a rate relatively higher than the increase in household incomes. Hence consumers, particularly wage earners and households of fixed income class, review their consumption expenditure. Consumers' resistance gets momentum. Actual demand stagnates or even decreases. The first and most pronounced impact falls on the demand for new houses, flats and apartments. Following this, demand for cement, iron and steel, and construction labour tends to halt. This trend subsequently appears in other durable goods industries like automobiles, refrigerators, furniture, etc. This marks reaching the peak. Turning-Point and Recession: As already mentioned, once the economy reaches the peak, increase in demand is halted. The demand even starts decreasing in some sectors, for the reason stated above. Producers, on the other hand, unaware of this fact continue to maintain their existing levels of production and investment. As a result, a discrepancy arises between output supply and demand: supply exceeds demand. The growth of this discrepancy between supply and demand is so slow that it goes unnoticed for some time. However, producers realize over time that their inventories are piling up. This situation might appear in a few industries at the first instance, but later it spreads to other industries also. Initially, it might be taken as a problem arisen out of minor maladjustment. But, the persistence of the problem makes the producers believe that they have indulged in 'over-investment' and over-production. Consequently, future investment plans are given up; orders placed for new equipments, raw materials and other inputs are cancelled. Replacement of worn-out capital is postponed. Demand for labour ceases to increase; rather, temporary and casual workers are laid off in a bid to bring demand and supply in balance. The cancellation of orders for inputs by the producers of consumer goods creates a chain-reaction in the input market. Producers of capital goods and raw materials cancel their orders for their input. This is the turning point and the beginning of recession . Since demand for inputs has decreased, input prices, e.g., wages, interest, etc., show a gradual decline leading to a simultaneous decrease in the incomes of wage and interest earners. This ultimately causes demand recession . On the other hand, producers lower their price in order to get rid of their inventories and also to meet their financial obligations. Consumers, is their turn, expect a further decrease in price, and hence, postpone their purchases. As a result, the discrepancy between demand and supply continues to grow. When this process gathers speed, it takes the form of irreversible recession . Investments start declining. The decline in investment leads to decline in income and consumption. The process is exactly reverse of the process of expansion. When investments are curtailed, production and employment decline resulting in further decline in demand for both consumer and capital goods. Borrowings for investment decreases; bank credit shrinks; stock prices decrease; unemployment increases even though there is a fall in wage rates. At this stage, the process of recession is complete. When growth rate falls below the steady growth line, the economy enters the phase of depression . Depression and Trough: During the phase of depression , economic activities slide down their normal level. The growth rate becomes negative. The

Money NOTES Self - Learning 160 Material level of national income and expenditure declines rapidly. Prices of consumer and capital goods decline steadily. Workers lose their jobs. Debtors find it difficult to pay off their debts. Demand for bank credit reaches a low ebb and banks experience mounting of their cash balances. Investment in stock becomes less profitable and less attractive. At the depth of depression , all economic activities touch the bottom and the phase of trough is reached. Even the expenditure on maintenance is deferred in view of excess production capacity. Weaker firms are eliminated from the industries. At this point, the process of depression is complete. How is the Process Reversed?: The factors that reverse the downswing vary from cycle to cycle like factors responsible for business cycle vary from cycle to cycle. The basic thing is that there is a limit to point to which an economy can sink. When the economy hits the bottom and stays there for some time, it marks the end of pessimism and beginning of optimism. This reverses the process. The process of reversal generally begins in the labour market. The widespread unemployment forces workers to work at wages less than the prevailing rates. The producers anticipating better future try to maintain their capital stock and offer jobs to some workers here and there. They do so also because they begin to take an optimistic view of the situation due to the halt in decrease in price in the trough phase. Consumers on their part expecting no further decline in price begin to resume their postponed consumption and hence demand picks up, though gradually. Bankers having accumulated excess liquidity (idle cash reserve) try to salvage their financial position by lowering the lending rate and by investing their funds in securities and bonds, even if rate of return is very low. Similar action is taken by the private investors. Consequently, security prices move up and interest rates move downward. On the other hand, stock prices begin to rise for the simple reason that fall in stock prices comes to an end and an optimism is underway in the stock market. Besides, there is a self-correcting process in a free economic system through the price mechanism. When prices fall during recession, the prices of raw materials and those of other inputs fall faster than the prices of finished products. Therefore, some profitability always remains there, which tends to increase after the trough . Hence the optimism generated in the input market gets strengthened in the commodity market. Producers start replacing the worn-out capital and making-up the depleted capital stock, though cautiously and slowly. Consequently, investment picks up and employment gradually increases. Following this recovery in production and wage income, demand for both consumer and capital goods starts picking up. Since banks have accumulated excess cash reserves, bank credit becomes easily available and at a lower rate. Speculative increase in prices give indication of continued rise in the price level. For all these reasons economic activities get accelerated. Due to increase in income and consumption, the process of multiplier gives further impetus to the economic activities, and the phase of recovery gets underway, depending on the speed of recovery.
Money NOTES Self - Learning Material 161 Check Your Progress 9. What is inflation? 10. What is Pigou's theory of inflation? 11. What is inflation according to quantity theorists? 12. What are the two main aspects of the cost-push inflation? 13. Define Phillips curve. 14. Why after the critical rate of unemployment there is no trade-off between unemployment and inflation? 15. Why is modern theory of inflation called an extension of the classical and Keynesian theories of inflation? 16. What are the factors of increase in the aggregate demand during demand-pull inflation? 17. What are the real factors for demand-pull inflation? 4.6 ANSWERS TO 'CHECK YOUR PROGRESS' 1. The following are the four important approaches to the definition of money: (a) Conventional Approach (b) Chicago Approach (c) Gurley and Shaw Approach; and (d) Central Bank Approach. 2. These four functions of money emerge from its serving in the economy as: (i) a unit of value or account; (ii) a

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medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. 3. Disadvantages of money

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medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. 3. Disadvantages of money

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medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. 3. Disadvantages of money

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medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. 3. Disadvantages of money

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medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. 3. Disadvantages of money

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medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. 3. Disadvantages of money

being a store of value are the following: First, their holding involves storage costs. Secondly, these may depreciate in money value. Thirdly, they are illiquid—lack in perfect liquidity or moneyness— because these are not acceptable as money. 4. In India, Reserve bank of India (the central bank) controls the supply of money in the market. 5. The major components of the broad money supply (

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M3) comprise the (I) currency with the public, (ii) demand, deposits with the banks, and (iii) time deposits with the banks.

Major sources of supply of M3 comprise the (i) net RBI credit to government; (ii) other banks' credit to government; (iii) other banks' commercial credit; and (iv) net foreign exchange assets of the banking sector
Money NOTES Self - Learning 162 Material 6. There are various forms of money supply – narrow money, reserve money and broad money. However, the most important indicator of all these is reserve money. It is also known as high-powered money. 7. Reserve or high-powered money holds the highest position in the RBI's monetary policy. It is the sum of all currency in circulation with the people of country, cash kept with the commercial banks and reserves with the RBI, reserve money decides the level of liquidity and price level in the economy. 8. Money multiplier shows the mechanism by which reserve money creates money supply in the economy. It is again dependent on two variables, namely reserve deposit ratio and currency deposit ratio. 9. The fundamental connection between an increase in the total money supply and the rise in prices in the economy is called

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inflation. 10. According to Pigou, inflation exists 'when money income is expanding

relatively to the output of work done by the productive agents for which it is the payment.' 11. Inflation was synonymous with an increase in the quantity of money which, on the assumption of given velocity and transactions, caused a rise in the general price level. This means that a rise in prices was the effect of inflation and not inflation itself. 12. Two main aspects of the cost- push inflation are as follows: First, it deals with the question of demand which the cost-push inflationary pressures themselves generate through the needed increase in the money supply. Secondly, it strives to seriously analyse the motivations of the 'pushers' instead of resorting to name-calling as the crude version does. 13. an inverse relationship between the rate of change in the money wage rate and the rate of unemployment is called Phillips curve. 14. According to Tobin, beyond the critical level of unemployment in the vertical portion of the curve will not increase the demand for more wages. At this level, it is not possible to provide more employment because those seeking jobs have wrong skills or wrong age or gender or are in the wrong place but emerges from imperfections of the labour market. 15.

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The modern approach to inflation follows the theory of price determination. That is, the general price is determined by aggregate demand for and aggregate supply

of goods and services and the variation in the aggregate

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price level is caused by the shift in the aggregate demand and aggregate supply

curves. The modern theory of inflation is, in fact, a synthesis of classical and Keynesian theories of inflation. 16. Increase in aggregate demand may be caused by (a) monetary factors, i.e., increase in money supply, and/or (b) real factors, i.e., increase in demand for real output.
Money NOTES Self - Learning Material 163 17. Demand-pull inflation can be caused by any or many of the following real factors. (a) Increase in the government expenditure without change in tax revenue; (b) Cut in tax rates without change in the government expenditure; (c) Upward shift in the investment function; (d) Downward shift in the saving function; (e) Upward shift in export function; and (f) Downward shift in the import function. 4.7 SUMMARY ?The classical economists and the quantity theorists believed that the important factors affecting the supply of money did not affect the demand for money. ?The supply of money has been considered as an exogenous variable, being autonomously determined by the monetary authority. ?

84% **MATCHING BLOCK 587/683** W

The supply of money in the economy depends on the degree of responsibility of the central bank; and the

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The supply of money in the economy depends on the degree of responsibility of the central bank; and the

84% **MATCHING BLOCK 589/683** W

The supply of money in the economy depends on the degree of responsibility of the central bank; and the

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The supply of money in the economy depends on the degree of responsibility of the central bank; and the

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of money in the economy depends on the degree of responsibility of the central bank; and the

judgement, effectiveness and scientific authority with which the central bank performs its functions the

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most important function of money in society is to act as

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most important function of money in society is to act as

the medium of exchange. ?It is necessary to emphasize that money is anything that is generally accepted in exchange ? The most essential feature of money is its general acceptability in the community or society in which it circulates. ?A stable demand function is useful precisely in order to trace out the effect of changes in supply ?The supply of money in the

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economy depends on (a) the degree of responsibility of the central bank; and (b) the

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economy depends on (a) the degree of responsibility of the central bank; and (b) the

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economy depends on (a) the degree of responsibility of the central bank; and (b) the

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economy depends on (a) the degree of responsibility of the central bank; and (b) the

judgement, effectiveness and scientific authority with which the central bank performs its functions. ?The classical economists and the quantity theorists believed that the important factors affecting the supply of money did not affect the demand for money. ?The supply

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of money in the economy depends on the degree of responsibility of the central bank; and the

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economy depends on the degree of responsibility of the central bank; and the

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economy depends on the degree of responsibility of the central bank; and the

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economy depends on the degree of responsibility of the central bank; and the

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economy depends on the degree of responsibility of the central bank; and the

judgement, effectiveness and scientific authority with which the central bank performs its functions. ?In India, the Reserve Bank of India (RBI) has adopted the narrow and broad concepts

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of the money supply ?The theoretical analysis of the demand for money is a function of the

real income, general price level and interest rate ?Components of reserve/ high-powered money are Currency in Circulation, Bankers' Deposits with RBI and 'Other' Deposits with RBI.
Money NOTES Self - Learning 164 Material ?

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The use of high-powered money consists of the demand of commercial banks for the legal limit or required reserves

with the central bank and excess reserves and the demand of the public for currency. ?High-powered money also known as reserve money, central bank money, base money plays a critical role in the determination of monetary aggregates. ?

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Inflation means generally a considerable and persistent rise in the general level of prices. However, a precise meaning of 'inflation'

67% **MATCHING BLOCK 605/683** W

Inflation means generally a considerable and persistent rise in the general level of prices. However, a precise meaning of 'inflation'

67% **MATCHING BLOCK 606/683** W

Inflation means generally a considerable and persistent rise in the general level of prices. However, a precise meaning of 'inflation'

67% **MATCHING BLOCK 607/683** W

Inflation means generally a considerable and persistent rise in the general level of prices. However, a precise meaning of 'inflation'

has been a matter of economists' opinion. There is no universally acceptable definition of inflation. The definition of inflation has been changing over time depending on the perception of the economists. ?There are two common methods of measuring inflation: (i) by computing change in Price Index Numbers (PIN), and (ii) by comparing the change in GNP Deflator. ?Inflation on the basis of rate is classified as (i) moderate inflation, (ii) galloping inflation, and (iii) hyper inflation. 4.8 KEY TERMS ?High Powered Money: It is the base level for money supply available in an economy or it is the high-powered component of money supply. ?Liquidity: It is the amount of cash in circulation in an economy. ? Suppressed Inflation: Inflation may be present in the economy if there is sustained price rise, which would have otherwise occurred, is prevented from occurring by imposing the price and physical controls in the economy. ? Inflationary Gap: It is the positive difference between the actual level of aggregate demand which exists in the economy at the full employment level of income and the amount of aggregate demand which is required to attain full employment. ?Demand pull inflation: The net excess of the aggregate demand created over the constant aggregate supply is known as demand pull inflation. ?Cost Push Inflation: It is the inflation that occurs due to the increase in the costs or supply prices of goods caused by an increase in the cost of inputs. 4.9 SELF-ASSESSMENT QUESTIONS AND EXERCISES Short-Answers Questions 1. Why is money considered the perfect medium of exchange? 2. Differentiate between the monetarist and Keynesian views on money. 3. Write short notes on Narrow Money and Broad Money. 4. What is the significance of high-powered money?
Money NOTES Self - Learning Material 165 5. Write a short note on effectiveness of monetary policy. 6.

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Write a short note on the methods of measuring inflation. 7. Write a short note on

deflation. Long-Answer Question 1. Describe the approaches to money. 2. Examine the functions of money. 3. Explain the various components of high-powered money. How do you use it to determine the money supply in the economy? 4. Explain kinds of inflation. 5. Discuss the effects of inflation. 6. Explain the concept of recession. 4.10 FURTHER READING Mankiw, N Gregory. 2010. Macroeconomics . New York: Worth Publishers. Shapiro, Edward. 1996. Macroeconomic Analysis . New Delhi: Galgotia Publication. Jha, R. 1999. Contemporary Macroeconomic Theory and Policy . New Delhi: New Age International. Gupta, SB. 2011. Monetary Economics: Instruments and Policy . New Delhi: S Chand & Co.
Banking and Credit Control NOTES Self - Learning Material 167 UNIT 5 BANKING AND CREDIT CONTROL Structure 5.0 Introduction 5.1 Objectives 5.2 Meaning and Types of Banks 5.3 Central Bank and its Functions 5.3.1 The Reserve Bank of India 5.4 Credit Control: Qualitative and Quantitative Methods 5.4.1 Credit Control by RBI 5.5 Objectives and Limitations of Monetary Policy 5.6 Functions of Commercial Banks 5.7 Process of Credit Creation 5.8 MUDRA 5.8.1 Jan Dhan Yojana 5.9 Answers to 'Check Your Progress' 5.10 Summary 5.11 Key Terms 5.12 Self-Assessment Questions and Exercises 5.13 Further Reading 5.0 INTRODUCTION A bank is an institution that sell its services and earn money. The Central Bank is primarily meant to promote the financial and economic stability of the country. "The guiding principle of a central bank is that it should act only in the public interest and for the welfare of the country and without regard to profit as primary consideration". Earning of profit for a central bank is thus a secondary consideration. The central bank is thus not a profit hunting institution. It does not act as rival of other banks. In fact, it is a monetary authority of the country and must function in a manner so as to promote economic stability and development. In this unit, you will study about the types of banks, the major functions of a central bank with special reference to the Reserve Bank of India (RBI), qualitative and quantitative methods of credit control, objectives and limitation of monetary policy, functions of commercial bank, process of credit creation, and schemes of MUDRA and Jan Dhan Yojana. 5.1

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OBJECTIVES After going through this unit, you will be able to: ?Elaborate the

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this unit, you will be able to: ?Elaborate the types of Banks ?Describe the functions of

the Central Bank

Banking and Credit Control NOTES Self - Learning 168 Material ?Prepare an overview of the Reserve Bank of India ? Discuss the aualitative and quantitative methods of credit control ?Analyse objectives and limitations of monetary policy ?Describe the functions of commercial banks ?Explain the process of credit creation ?State the main objectives of MUDRA and Jan Dhan Yojana 5.2 MEANING AND TYPES OF BANKS Banks play an inevitable role in a country's economy. The demographics of a country is majorly dependent on the banking structure for saving and loans. The fact that banks play the dual role of accepting deposits and issuing loans prove the mettle and importance of banks in a society. The present banking structure of our country is coherent and constantly evolving to meet the immediate needs of the population. Despite the fact that there is a lot of pressure on the banks in the present scenario, one cannot do away with the efficiency with which banks have been delivering their services to the people. Definition of Bank Banking plays a pivotal role in modern trade and commerce. Banks perform the twin functions of accepting deposits from the public and making loans to needy and deserving people in society. Deposits become liabilities and loans appear on the assets side of their balance sheets. Banks lend money to different categories of borrowers. The interest received on those loans becomes their primary source of income and the interest on deposits constitutes the main item of expenditure for a bank. Banks in India are regulated by the Banking Regulation Act, 1949. The repayment of deposit on demand is a necessary requirement to qualify to become a bank. According to the Banking Regulation Act, 1949, banking means 'the

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accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise.'

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accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise.'

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accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise.'

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accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise.'

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accepting, for the purpose of lending or investment, of deposits of money from

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accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise.'

Kinds of Banks Banks in India are classified into the following categories in accordance to their functions, which include the following: ?Central Bank ?Commercial Banks ?Development Banks ?Cooperative Banks ?Specialized Banks

Banking and Credit Control NOTES Self - Learning Material 169 Fig. 5.1 Classification of Banks in India Credit Creation and Balance Sheet Commercial banks always try to maintain their holdings of idle cash to the lowest extent possible. In their attempt to achieve this end, they unwittingly increase the total amount of money in circulation in the community. It, however, does not mean that they increase the total amount of legal tender currency which is an exclusive prerogative of the central bank. When it is said that a banker is lending money, he is actually lending money in the deposit credit with a right to the borrower to draw cheques against it. For instance, let us take the case of a loan granted to a customer. Instead of paying away the whole loan in the form of liquid cash, the bank will place the amount to the credit of the borrower. Thus, the borrower acquires a claim against the bank, just as a sum of money deposited by him with the bank creates a claim against the bank. Assuming the borrower draws cheques in favour of other people, they pay these cheques into their own banks for collection, and their deposits go up. Here one may agree with Hartley Withers in that ' every loan creates a deposit '. Again, by purchasing securities or any other banking assets also a bank is adding to the total supply of money. When the bank buys securities, it pays for them by its own cheque. This cheque, like a currency note issued by the central bank, is an IOU (I Owe You) of the bank issuing it. And this is accepted by the seller of the securities because of his faith in the ability of the bank to produce cash on demand. The seller deposits this cheque in the very same bank or with any other bank where he has an account, thereby creating additional deposit money. Thus, the commercial banks as a system can and do increase the total amount of money in circulation by increasing the purchasing power of the people through the deposit money created by them. A close analytical study of the mechanism of banking will simplify matters more. Let us take the case of a community where there is only one bank and where the people are highly banking minded so that all transactions are settled by means of cheques. Further, let us assume that total amount of legal tender currency in circulation is 10,000 and the bank knows by experience that 10 per cent of its deposits as cash reserves is sufficient to meet the demands of its customers. Since there is only one bank in the community, people will deposit all their money in this particular bank.
Banking and Credit Control NOTES Self - Learning 170 Material The balance sheet of the bank would then be: Liabilities Assets Deposits 10,000 Cash in Hand 10,000 According to our assumption, the bank would need to maintain a cash reserve of only 10 per cent of the deposits and can safely lend the balance amount of 9,000 to those who are in need of funds. The bank will place this amount to the credit of the borrowers, giving them the right to operate their accounts with cheques. Their deposits will consequently go up by this amount. The balance sheet of the bank, then, would be: Liabilities Assets Deposits (original) 10,000 Cash in Hand 10,000 Deposits (i.e. credit Balance of borrowers) 9,000 Loans to clients 9,000 19,000 19,000 These deposits, now standing to the credit of the borrowers are, as we know, claims against the bank. As such they command a purchasing power and hence they may be considered as good as money. Suppose the borrowers draw cheques in favour of their creditors. The payees of these cheques will not require liquid cash over the counter since they are highly banking minded, according to our supposition. On the other hand, they will deposit these cheques with our supposed single bank for collection. Here what happens is merely a transfer of the credit balance of the borrowers to the credit of the accounts of the payees of their cheques. In short, although the total amount of legal tender currency in circulation is only to the order of 10,000, our bank, through the process of creating additional deposit money, has brought into effective circulation an additional amount of 9,000, thereby raising the total supply of money from 10,000–19,000. The power of the bank to increase the amount of money in circulation does not come to an end here. It can further increase the supply of money. As shown in the above balance sheet, the amount of the deposits of the bank is now 19,000. The assumption is that the bank should maintain a cash reserve ratio of only 10 per cent. To maintain this, the bank only needs to provide an additional amount of 900 over and above the amount of 1,000 which it already maintains. Even then there is a balance of 8,100 in the vaults of the bank which it can lend without undergoing any risk. Now the balance sheet position would be: Liabilities Assets Deposits (original) 10,000 Cash in Hand 10,000 Deposits (deposited by the Payees of the cheques issued by the first borrowers 9,000 Loans to Clients. Deposits (credit balance of 9,000 Subsequent borrowers) 8,100 8,100 17,100 27,100 27,100

Banking and Credit Control NOTES Self - Learning Material 171 Here the bank has to keep an additional cash reserve of 810. The total cash reserves increase to 2,710. Still there is a balance of loanable funds with the bank, amounting to 7,290. Thus, the bank can go on increasing the creation of additional money. However, there are questions that crop up. Is it possible for the bank to increase credit without any limit? Is the power of the bank to increase the supply of deposit money unlimited? The answer is definitely in the negative. Limitations on the Creation of Credit The power of commercial banks to create credit is limited mainly by the cash reserves which they have to hold against their deposits and the total amount of legal tender currency issued by the central bank. Every bank has to meet the demands of its customers to pay cash over the counter. So a working reserve of liquid cash is always necessary for a bank. Of course, if the people are highly banking minded, a lower cash reserve will be sufficient. But in the case of a community where the habits are not well developed, a higher cash reserve will be essential. In either case, a cash reserve is necessary. This acts as a brake on the power of the banks to create credit. To revert to the previous illustration, our supposed bank can go on creating further and further credit money till it finds that it has no more liquid cash to maintain the 10 per cent cash reserve ratio. In other words, it is in a position to supply more and more credit up to an additional amount of 90,000. If it wants to expand credit still further, either there should be an additional supply of liquid cash, which entirely is the sole prerogative of the central bank, or the cash ratio should be lowered which can be done only at its own peril. Moreover, a minimum cash reserve ratio is prescribed by law in most countries. Thus, a bank's power to create credit is limited by two factors, viz., the cash reserve ratio and the total amount of legal tender currency. So far the analysis was confined to a community where there is only one bank. This is not a realistic assumption. But admittedly, the multiplicity of banks will not make any material alteration in the mechanism of credit creation and the limitations on it. The banking system, taken as a whole, will be conducting its operations on the very same lines. The only difference is that if any bank tries in an isolated manner to expand credit more than the other banks, it will lose cash to other banks. So in the case of a network of branches, each bank will have to keep in step with the others whenever it is creating credit. In conclusion, commercial banks can increase the total amount of money in circulation through the process of credit creation. In the words of Sayers, 'Bankers

CENTRAL BANK AND ITS FUNCTIONS The central bank is an important financial institution in every sovereign independent state in modern times. It is the apex of an economy's monetary and banking system. It plays an active role in implementing the government's economic policy in the

Banking and Credit Control NOTES Self - Learning 172 Material country. According to Will Rogers, the central bank occupies the coveted position of being one of the three great inventions that have taken place since the beginning of the times, the other two being the fire and the wheel. Although some people may seriously doubt if the central bank could belong to such an exalted company, they, however, agree that the central bank is one of the most useful financial institutions which have been developed to help society manage its collective financial affairs. Today, the central bank is the central arch-pillar of the monetary and fiscal framework in every country of the world and its activities are essential for the proper functioning of the economy and are indispensable for the fiscal operations of the government. Although some central banks were established more than two centuries ago, central banking is mostly a recent development being essentially a product of the 19 th century. Although the Riksbank in Sweden was established in 1668, the Bank of England was established only in 1694. It was the first to function as a true central bank in 1844. Central banking originated in England almost by chance as commercial banks found it convenient to settle their clearing balances by cheques drawn on the Bank of England. The history of the Bank of England represents the history of the evolution of the principles and techniques of central banking. The Bank of France which was organized in 1800 was closely connected with the state ever since its establishment. The Reichsbank in Germany was established in 1876 after the formation of the Empire. The Bank of Netherlands was founded in 1814 on the ruins of the old Bank of Amsterdam. The National Bank of Austria, which was reorganized as the Bank ofAustria-Hungary in 1877, was established in 1817 to restore order in the national monetary system which had deteriorated due to the over-issue of paper currency. The Bank of Norway, the National Bank of Denmark, the National Bank of Belgium and the Bank of Spain were established in 1817, 1818, 1850 and 1856 respectively. The Bank of Russia was established in 1860 to consolidate the circulation of money and to float debt for the Russian Empire. The Bank of Japan was established in 1882 to restore order in the currency system of the country; the Bank of Italy was established in 1893 while the Swiss National Bank was established at the turn of the century in 1907. In the 19 th century, central banks were also established in Portugal, Rumania, Bulgaria, Servia, Turkey, Java, Egypt and Algeria. These banks possessed the monopoly of note-issue. Thus 19 th century was the century par excellance of the establishment of central banks in many countries of the world, particularly in Europe where almost every country had established a central bank empowered to issue notes and vested with the special privileges and powers. In due course of time, these banks became the bankers and advisers to their respective governments. Although by the end of the 19 th century almost every country in Europe had a central bank but the concept of the central bank was not, of course, too clearly articulated or understood before the turn of the century and some of these banks were not always fully aware of their special functions and responsibilities. For example, the Swedish Riksbank and the Bank of Italy did not become 'real' central banks until about the turn of the century. Moreover, the countries of the Orient—barring a few like Japan, Java and Egypt—and of the new world did not have

Banking and Credit Control NOTES Self - Learning Material 173 central banks. In 1900, there was no central bank in the western hemisphere. The Federal Reserve System in America was established in 1913 while the Bank of Canada was established in 1934. Important countries of the east such as India and China had no central banks. Consequently, in the 20 th century the work of establishing the central banks continued. In the post-war period, characterized by a strong wave of nationalism and state control over the economic life of the community, extensive additions to the list of central banks were witnessed and there took place a general enlargement of the authority of the older central banks. The great fillip to the establishment of the central banks was provided by the International Financial Conference held at Brussels in 1920. This Conference resolved that 'all those countries which had not yet established a central bank should proceed to do so as soon as possible, not only with a view to facilitating the restoration and maintenance of stability in their monetary and banking systems but also in the interest of world cooperation.' The period of more than three decades immediately following the Conference resolution saw a rapid growth of central banks in different countries of the world. From 1921 to 1937, barring 1929 and 1990, every year one or more bank was added to the list of central banks. Just as the Brussel Conference of 1920 accelerated the pace of growth of the central banks after World War I, in the same way the birth of the IMF further facilitated the development of central banks in the new Afro-Asian and Latin American countries. The governments of these countries found that the central bank could deal more effectively with the IMF and other matters relating to foreign exchange. Consequently, today every independent country has a central bank. The number of these central banks now stands well over 150 and of these more than half have been established after 1940.

What is a Central Bank? A modern central bank performs so many functions of different nature that it is difficult to give any brief and accurate definition of a central bank. Any definition of a central bank is derived from its functions and these functions have varied from time to time and from country to country. Like the topsies, the functions of central banks have grown over time making it more difficult to give any brief and unchanging definition of a central bank. Nevertheless, a central bank may be defined as that central monetary institution which is charged with performing the duties of banker's bank, fiscal agent for the government and managing the monetary system of the country. It must also be stated that barring rare exceptions, a central bank should not conduct commercial banking business. Economists have defined the central bank differently, emphasizing its one function or the other. According to Vera Smith, '

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the primary definition of central banking is a banking system in which a single bank has either complete or

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the primary definition of central banking is a banking system in which a single bank has either complete or

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the primary definition of central banking is a banking system in which a single bank has either complete or

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the primary definition of central banking is a banking system in which a single bank has either complete or

a residuary monopoly of note-issue.' In Shaw's opinion, the central bank is a bank which controls credit. Thus, the one true, but at the same time all sufficing function of a central bank is control of credit.' According to Hawtrey, a central bank is the lender of last resort. According to the Statutes of the Bank for International Settlements, a central bank is 'the bank in any country to which has been entrusted the duty of regulating the volume of currency and credit in the country.' According to Kisch and Elkin, a central bank is a bank
Banking and Credit Control NOTES Self - Learning 174 Material whose essential duty is to maintain stability of the monetary standard. In short, while Vera Smith's definition of the central bank stresses the note-issue function of the central bank, the definitions of Shaw, Hawtrey, the Bank for International Settlements and Kisch and Elkin emphasize credit control, lender of the last resort, regulation of currency and credit and maintenance of stability of the value of the money unit functions of the central bank. M H De Kock's concept of a central bank is superior to that of others as it is more inclusive. His long definition of central bank includes many of the important functions performed by the central bank. His definition, however, lacks brevity, which is an essential quality of any definition. According to De Kock, a central bank is '

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a bank which constitutes the apex of the monetary and banking structure of its country

and which performs, as best as it can in the national economic interest, the following functions: 1. The regulation of currency in accordance with the requirements of business and the general public, for which purpose it is granted either the sole right of note issue or at least a partial monopoly thereof. 2. The performance of general banking and agency services for the state. 3. The custody of the cash reserves of commercial banks. 4. The custody and management of the nation's reserves of international currency. 5. The granting of accommodation, in the form of rediscounts or collateral advances, to commercial banks, bill brokers and dealers, or other financial institutions, and the general acceptance of the responsibility of lender of last resort. 6. The settlement of clearance balances between the banks; and 7. The control of credit in accordance with the needs of business; and with a view to carrying out the broad monetary policy adopted by the State. A further requisite of a real central bank is that it should not, to any great extent, perform such banking transactions as accepting deposits from the general public and accommodating regular commercial customers with discounts or advances. It is now almost generally accepted that a central bank should conduct direct dealings with the public only in such forms and to such extent as, in the circumstances of the particular country, it considers absolutely necessary for the purpose of carrying out its monetary and banking policy.' Functions of a Central Bank Economists and financial experts lack unanimity about the functions of a central bank. According to Kisch and Elin, 'the essential function of a central bank is the maintenance of the stability of the monetary standard.' While for Shaw it consists in the control of credit, De Kock has removed the confusion by mentioning the following seven functions of a central bank in his well-known book titled Central Banking. According to him, a central bank is a 1.Bank of issue; 2. Banker, agent and financial adviser to the government;

Banking and Credit Control NOTES Self - Learning Material 175 3. Custodian of member banks' cash reserves; 4. Custodian of the nation's foreign exchange reserves; 5. Lender of the last resort; 6. Bank of central settlement and transfer acting as a clearing house; and 7. Controller of credit. The functions of a central bank are different from those of commercial banks. First , a central bank is established for public service rather than for private profit. Unlike commercial banks, its operations are not basically guided by profit motive. Secondly , a central bank has a special relationship with the government of the country. Since the central bank acts as the banker to the government, the latter informally influences its activities. Thirdly , a central bank generally does not deal directly with the public; it deals with the public only indirectly through commercial banks and the money market. It does not accept deposits from the public as doing so would amount to usurping the usual banking functions of commercial banks. This is not, however, to deny that many central banks conducted commercial banking business in the beginning of their career. In fact, almost without exception, central banks before 1914 engaged in the regular commercial banking business with the general public and in some cases on a very substantial scale. With a wide network of branches throughout the country, this brought these banks into some measure of direct competition with commercial banks. Concern for earnings, moreover, all too often coloured their operations and policies to the detriment of their central banking responsibilities, the Bank of England being a good case in point. In this connection, it is pertinent to note that virtually all the central banks before 1914 were privately owned. Bank of Issue The central bank enjoys the monopoly of bank note-issue, i.e., no bank other than the central bank is authorized by law to print currency notes. Printing of paper currency is one of the most important functions of a modern central bank. 'The privilege of note issue was almost everywhere associated with the origin and development of central banks. In fact, until the beginning of the 20 th century they were generally known as banks of issue.' So important is this function that in the opinion of Vera Smith, it is the essence of a central bank's definition. The main reasons for granting the exclusive monopoly of note-issue to the central bank are listed below: 1. As the use of deposit money created by the commercial banks increased, a growing need for credit control by a central bank was felt. It was realized that a monopoly of note-issue allowed to the central bank made its control over excessive credit expansion by commercial banks more effective as it was essential. 2. The inherence of the right of note-issue in one single bank, particularly when the payment of notes is guaranteed by the government, imparts the notes a distinctive prestige which is absent if the notes are issued by the commercial banks.

Banking and Credit Control NOTES Self - Learning 176 Material 3. When the notes are issued by the central bank, they carry with them the advantage of uniformity. Although uniformity can also be achieved by means of direct state issue of notes, many examples of depreciation of government notes in the past, by shaking the public confidence, have caused the state to vest the right of note-issue in the central bank. 4. If the right of note-issue is exclusively granted to the central bank, it is easier for the state to supervise and control the irregularities and malpractices committed by the central bank in issuing the notes. 5. Since the central bank handles complicated matters relating to monetary management, it is better equipped to solve effectively the problems related to the issuing of notes. Government Banker, Fiscal Agent and Adviser Central banks in all countries act as the fiscal agent, banker and adviser on all important financial matters to governments of their countries. In fact, the older banks performed these functions even before they assumed the name and role of central bank. Bank charters were granted in exchange for loans. We are told by Adam Smith that the earliest banks of Italy, where the name 'bank' began, were finance companies. These were established to make loans to and float loans for the governments of the cities in which they were established. Alfred Marshall also writes that the famous early banks, such as the Bank of Amsterdam, acted as fiscal agents for the government. As government banker, the central bank conducts the banking accounts of government departments and enterprises. It gives short- term loans to the government in anticipation of the collection of taxes or raising of loans from the public. For example, in Germany the Reichsbank made three- month loans to the government by discounting treasury bills in anticipation of the public loans to be floated every six months to finance the war of 1914–18. The central bank also makes extraordinary advances to the government during depression, war or other national emergencies. It conducts transactions on behalf of the government involving purchases or sales of foreign currencies. Besides providing these services, the central bank also performs various other services such as to act as the financial agent of the government. It generally acts as the financial adviser to the government. It manages the national debt and gives the much sought after advice to the government on important matters of economic policy, such as the extent to which deficit financing may be resorted to by the government for accelerating planned economic development without inflation, devaluation of the currency, foreign trade policy, etc. In India, the Reserve Bank of India has advised the government of India on various important economic policy matters including the stability of prices, funding of the national debt, amount of deficit financing which the economy can absorb, etc., during the past seven decades. Custodian of Member Banks' Cash Reserves As a bankers' bank, the central bank preforms several functions. It keeps the cash reserves of commercial banks in the economy and thus acts as the custodian of the ultimate reserves of the country which support our credit and banking system. The other banks keep their deposits with the central bank. The central bank discounts

Banking and Credit Control NOTES Self - Learning Material 177 the bills of commercial banks making available to them credit based on these ultimate reserves. It provides able and effective leadership to the banking system in the country. Other banks look to it for guidance and direction in shaping their policies in accordance with its directions. It effects centralization of the cash reserves of member banks in the country. 'The centralization of cash reserves in the central bank is a source of great strength to the banking system of any country. Centralized cash reserves can at least serve as the basis of a large and more elastic credit structure than if the same amount were scattered among the individual banks. It is obvious that, when bank reserves are pooled in one institution which is, moreover, charged with the responsibility of safeguarding the national economic interest, such reserves can be employed to the fullest extent possible and in the most effective manner during periods of seasonal strain and in financial crises or general emergencies.' Custodian of Nation's Foreign Exchange Reserves This function of the central bank has been derived from its function as the bank of issue and the custodian of member banks' cash reserves. The essential purpose behind entrusting the custody of the nation's foreign exchange reserves to the central bank is the meeting of adversity at any time in the country's external balance of payments and the maintenance of foreign exchange rate stability. To the extent, however, a central bank is required by law to maintain minimum gold and foreign exchange reserves against both its note and deposit liabilities, its holdings of these reserves are immobilised and are not available for maintaining equilibrium in the international balance of payments. Lender of the Last Resort The central bank also acts as lender of the last resort. Historically, this function developed out of the special position of the central bank. The central bank was granted monopoly of note-issue in the country and its notes were unlimited legal tender. The centralization of the metallic reserves further added strength to the capacity of the central bank to perform its functions as lender of the last resort. In its capacity of lender of the last resort, the central bank meets directly or indirectly all reasonable demands for financial accommodation from the commercial banks, discount houses and other credit institutions subject to certain terms and conditions which constitute its discount rate policy. Today, this function is regarded as the sine qua non of central banking. The great importance of a central bank's function as lender of the last resort was stressed by Walter Bagehot in 1873 in his well-known book Lombard Street wherein he drew the attention of the Bank of England to act as lender of the last resort by providing the rediscount facilities to the banking system in times of financial crises if it had to be called a true central bank. The classic statement of Bagehot runs thus: 'Theory suggests, and experience proves, that in a panic the holders of the ultimate Bank reserve (whether one bank or many) should lend to all, that bring good securities quickly, freely, and readily. By that policy they allay a panic; by every other policy they intensify it. The public have a right to know whether the Bank of England—the holders of our ultimate bank reserve—acknowledge this duty, and are ready to perform it. But this is now very uncertain.'

Banking and Credit Control NOTES Self - Learning 178 Material 'Nothing, therefore, can be more certain than that the Bank of England has in this respect no peculiar privilege; that it is simply in the position of a Bank keeping the Banking reserve of the country; that it must in time of panic do what all other similar banks must do; that in time of panic it must advance freely and vigorously to the public out of the reserve. And with the Bank of England, as with other banks in the same case, these advances, if they are to be made at all, should be made so as if possible to obtain the object for which they are made. The end is to stay the panic; and the advances should, if possible, stay the panic. And for this purpose there are two rules: First , that these loans should only be made at a very high rate of interest. This will operate as a very heavy fine on unreasonable timidity, and will prevent the greatest number of applications by persons who do not require it. The rate should be raised early in the panic, so that the fine may be paid early; that no one may borrow out of idle precaution without paying well for it; that the Banking reserve may be protected as far as possible. Second , that at this rate these advances should be made on all good banking securities, and as largely as the public ask for them. The reason is plain. The object is to stay alarm, and nothing therefore should be done to cause alarm. But the way to cause alarm is to refuse some one who has good security to offer.' After the publication of Bagehot's Lombard Street, the Bank of England's responsibility as lender of the last resort was unequivocally recognized. The term 'lender of the last resort' was coined by Walter Bagehot. After the assumption of the role of 'lender of the last resort' by the Bank of England, other central banks took it as a matter of fact and routine. Nowadays, central banks perform this function ungrudgingly. Bank of Central Clearance, Settlement and Transfer This function was first developed by the Bank of England towards the middle of the 19 th century. In 1854, a scheme was adopted to settle differences between various banks at the end of daily clearing through the book transfer entries between the accounts of different banks kept at the Bank of England. This function of clearance, settlement and transfer of mutual claims, which evolved as a method of practice, became, in due course of time, an accepted normal function of the central bank as bankers' bank. Some central banks performed this function because it found place in their laws or articles of association and memoranda. For instance, the Central Bank of Chile was required to act statutorily as a 'clearing house for member banks in Santiago and other cities of the republic in which it has branches'. The Bank of Columbia was also similarly enjoined. One of the purposes of the reconstituted Reichsbank and of the National Bank of Austria and Hungary, as mentioned in their laws, was 'to facilitate the clearance of payments'. Today, the clearing function is an essential function of a central bank. Stressing this function of the central bank, Shaw asserts that 'a central bank will operate as the clearing house for all its member banks as a mere matter of mechanism or book-keeping.' According to Kisch and Elkin, it is necessary for the central bank 'to set up an expeditious and economical machinery for the clearance of drafts and settlement of internal accounts because in its capacity 'as holder of the balances of the

Banking and Credit Control NOTES Self - Learning Material 179 commercial banks a central bank is specially qualified for this duty.' According to Jauncey, 'clearing is the main operation of central banking.' Willis also holds that the 'clearing function with its ancillary element...is among the most significant of central banking function and is one for which only a very incomplete substitute may be found through resort to other expedients.' Since commercial banks keep their surplus cash reserves in deposits with the central bank it is far easier to clear and settle claims between them by making transfer entries in their accounts maintained with the central bank than if each commercial bank entered into separate clearance and settlement transactions with every other bank. Labour and inconvenience experienced in the individual system of clearance and settlement is avoided when the central bank enters the picture as a central clearing agency. The process of effecting settlement between the banks in the books of central bank while comparatively simple to operate is of great convenience to the banking community as it economizes the use of money in the banking operations. Willis has very ably highlighted the significance of clearing and settlement function performed by the central bank in these words: '

a matter which is essential for the central bank to know from day to day.' He goes to the exlent of stating that 'the attitude adopted has been that of treating clearance as a test of liquidity' and that 'the bank performs its characteristic function by determining what classes of goods are to be admitted to the field of exchange and the process of clearing indicates the extent to which the judgements which have thus been registered by the bank, have been sound or at least in accordance with the judgements of other elements in the productive process of the community.' Controller of Credit The principles of credit control by the central bank were discovered and enunciated after the publication of Bagehot's Lombard Street in 1873. Even after 1873 the criteria by which the central bank acted were almost entirely rules of thumb and little or no attempt was made at any conscious control in pursuit of a consistent policy before World War I. Today, however, control of credit is the most important function of a central bank and it embraces the most important aspect of the central banking policy. It is through this function that all the other functions are united and serve a common purpose. So important is this function that it finds place in the laws of all central banks. For example, the Reserve Bank of India Act, 1934 states that the Bank is '

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generally to operate the currency and credit system of the country to its advantage.'

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generally to operate the currency and credit system of the country to its advantage.'

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generally to operate the currency and credit system of the country to its advantage.'

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generally to operate the currency and credit system of the country to its advantage.'

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generally to operate the currency and credit system of the country to its advantage.' The

need for controlling credit is obvious. Credit has become more important than money although the latter is the basis of the former. Unwarranted fluctuations in the volume of credit by causing wide fluctuations in the value of money cause great social and economic unrest in the country. The experience of the last one hundred years is a testimony to the need for controlling credit in order to maintain economic and political stability in the economy. 5.3.1 The Reserve Bank of India The preamble to the Reserve Bank of India Act, 1934, lays down the object of

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the RBI to be 'to regulate the issue of bank notes and the keeping of reserve with a view

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to regulate the issue of bank notes and the keeping of reserve with a view

Banking and Credit Control NOTES Self - Learning 180 Material to securing monetary stability in British

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India and generally to operate the currency and credit system of the country to its advantage’. The

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and generally to operate the currency and credit system of the country to its advantage’.

financial system of India, before the establishment of the RBI, had been utterly inadequate mainly because of the dual control of currency by the government and of credit by the Imperial Bank. The Hilton Young Commission pointed out the inherent weakness of a system in which the control of currency and credit is in the hands of two distinct authorities, whose policies may be widely divergent and in which the currency and banking services are controlled and managed separately from one another. Under the circumstances, the necessity of a single institution regulating the financial policy from the point of view of the economic development of the nation as a whole was keenly felt, and the RBI was constituted mainly with this object in view. Secondly, according to Paragraph 32 of the introduction to White Paper on Indian Constitutional Reforms, the proposal for transfer of responsibility at the Centre from British to Indian hands was made dependent on the condition that a Reserve Bank, free from political influence, be established and be in successful operations. It was a 'fundamental condition of the success of the constitution that no room should be left for doubts as to the ability of India to maintain her financial stability and credit, both at home and abroad'. Thirdly, the inadequacy of the Imperial Bank of India in controlling the money market was patent, because of the lack of confidence of other joint-stock banks on the Imperial Bank. The success of a central banking institution depends on the confidence which it inspires on the member banks and the influence which it exercises on them. But the Imperial Bank, which was acting as the central bank, was for all practical purposes a commercial bank competing with other joint- stock banks. Under these circumstances, it was decided to establish a Reserve Bank with the object of discharging purely central banking functions and thereby initiating a fresh start in the field of Indian central banking. Functions The RBI performs all the typical functions of a central bank. Its main function is to regulate the monetary mechanism comprising of the currency, banking and credit systems of the country. For this, the Bank is given the monopoly of note issue and has wide powers over the banking system. Another important function of the Bank is to conduct the banking and financial operations of the government. The Bank discharges certain other functions like maintaining the external value of the rupee, collection and publication of monetary and financial information, etc. The range of functions of the Bank has come to be steadily enlarged with the task of economic development assuming new urgency and dimensions. Implementation of appropriate monetary policies, no doubt, remains its most important function. At the same time, the Bank is taking an active part in fostering an adequate banking structure capable of meeting the needs of trade, industry, agriculture and commerce. Check Your Progress 1. How are the powers of commercial banks to create credit limited? 2. Who discovered the principles of credit control by the central bank?

Banking and Credit Control NOTES Self - Learning Material 181 5.4 CREDIT CONTROL: QUALITATIVE AND QUANTITATIVE METHODS The old objective of controlling credit creation by the commercial banks in the country was dictated by considerations of maintaining stability in the rate of foreign exchange. The international gold standard was maintained for this purpose from 1875 to 1914. During the war period of 1914–1918, although it was temporarily suspended, it was restored in the post-war period from 1925 to 1934 in different forms and degrees. However, exchange rate stability was incompatible with domestic price stability. Foreign exchange rate stability was possible at the heavy cost of causing fluctuations in the domestic and international prices. Consequently, such exchange rate stability was followed by fluctuations in the level of economic activity. Naturally, with the passage of time, thought was given to the maintenance of price stability instead of exchange rate stability as the main objective of credit policy of the central bank. The reason for emphasizing the foreign exchange rate stability as the goal of the central bank's credit control policy before the breakdown of the international gold standard in 1934 rested on the universal belief that exchange rate stability was essential for the international prestige of a country and for the smooth flow of international trade and lending. After the breakdown of the international gold standard in the 30s, price stability as the goal of economic policy attracted more attention. The economic rot brought by the great depression of the 30s convinced the economists and financial experts of the futility of achieving foreign exchange rate stability in the face of fluctuating domestic prices that did irreparable harm to the stability of the domestic economy. The opinion that price stability should be preferred to exchange rate stability if the former was incompatible with the latter gained support on the plea that stabilization of domestic prices was more conducive to national economic welfare. Apart from those who support either the exchange rate stability or the domestic price stability as the goal of the central bank's monetary policy, there are those who argue that the fundamental objective of central bank's monetary policy should be to promote accelerated growth in the economy by preventing frequent occurrence of booms, slumps and unemployment. These economists consider economic growth with stability, as against either mere price or exchange rate stability, as the sine qua non of maximization of national welfare. In recent times, the emphasis has shifted from mere economic stability to economic stability compatible with full employment and high per capita income in the economy. So important have the achievement of the goals of full employment and growth become for the central bank's monetary policy that many countries have officially declared that the basic objective of their economic policy is to achieve full employment and accelerated growth of the economy. Consequently, the central bank's monetary policy is directed towards the achievement of these twin objectives. In the context of rapid economic growth, following are the special functions of the central bank in a free enterprise economy:

1. To improve the existing system of financial intermediaries in order to ensure the maximum productive investment of the community savings.

Banking and Credit Control NOTES Self - Learning 182 Material 2. To provide direct loans to those areas where the commercial banks do not find it profitable to operate. 3. To conduct its policy of credit control in a manner so as to promote maximum economic growth rate without causing runaway inflation or unmanageable deficit in the country's external balance of payments. Instruments of Credit Control The central bank employs several monetary instruments to control aggregate credit in the country. While some of these instruments like the open market operations, minimum legal cash reserve ratio and the bank rate, are indirect and traditional, others like the rationing of credit and direct credit control are relatively new having been evolved recently. According to De Kock, the following are the nine principal instruments which are generally employed by the central banks to control credit in the economy: 1. 'The lowering or raising of their discount and interest rates with a view to lowering or raising money rates generally and encouraging the expansion or contraction of credit. 2. The buying or selling of securities or bills of exchange in the open market with a view to putting additional funds into the market or withdrawing funds therefrom and thus expanding or contracting credit. 3. The rationing of credit as an alternative or an addition to raising discount and interest rates. 4. The taking of 'direct action' either in the form of coercive measures against any offending bank or other financial institution or in the form of directives to banks generally concerning their lending and investment operations, in order to assist the central bank in controlling the quantity of credit as well as securing a better qualitative distribution of credit. 5. The lowering or raising of the minimum cash reserves to be maintained by the commercial banks, as an additional means of enabling the central bank to expand or contract their capacity to create credit. 6. The imposition of minimum secondary reserves requirements to be maintained by the commercial banks in the form of Government securities and other specified assets, in order to restrict their capacity to extend credit for general business purposes. 7. The regulation of the terms and conditions under which credit repayable in instalments may be granted for purchasing or carrying consumers' durable goods, as a means of exercising some direct control over the volume of outstanding consumer credit. 8. The regulation of margin requirements in connection with purchases of Stock Exchange securities, as an instrument for exercising some direct control over the volume of credit used in the security markets; and 9. The use of moral suasion and publicity to achieve the desired objectives.' According to De Kock, in addition to the above methods of credit control, the regulation or management of exchange rates and varying forms or degrees

Banking and Credit Control NOTES Self - Learning Material 183 of exchange control have also been resorted to by many countries as the instruments of monetary or general economic control. These instruments of credit control may now be studied in greater detail. 1. Bank or Discount

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Rate Bank rate is the rate at which the central bank gives loans to commercial banks against the

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Rate Bank rate is the rate at which the central bank gives loans to commercial banks against the

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Rate Bank rate is the rate at which the central bank gives loans to commercial banks against the

security of government and other approved first class securities. In modern times, the central banks have been armed with the weapon of bank rate which they employ for the purpose of credit control in the economy. By making appropriate changes in the bank rate, the central bank controls the volume of total credit indirectly by influencing the lending rates of commercial banks as a determinant of the total loans and investment in the country. This principle on which the regulation of total credit should be based was stated in 1802 by Henry Thornton in these words: 'In order to ascertain how far the desire of obtaining loans at the bank may be expected at any time to be carried, we must enquire into the subject of the quantum of profit likely to be derived from borrowing there under existing circumstances. This is to be judged by considering two points; the amount, first of interest to be paid on the sum borrowed, and secondly, on the mercantile or other gain to be obtained by the employment of borrowed capital.... We may, therefore, consider this question as turning principally on a comparison of the rate of interest taken at the bank with the current rate of mercantile profit.' Under its bank rate policy, the central bank controls credit by changing its bank rate. The central bank rediscounts the approved securities either directly or indirectly through the money market and makes money available to the commercial banks. By raising the bank rate, the central bank makes the obtaining of funds from the central bank costlier for the commercial banks. The central bank may also refuse to rediscount certain bills it was hitherto rediscounting. In this way, it makes credit scarce. Thus through the restricted and dear rediscount policy the central bank restricts credit creation by the commercial banks in the economy. Similarly, in depression when it is necessary to encourage the commercial banks to create more credit the central bank may discount the approved securities of the commercial banks on liberal terms encouraging them to avail of the borrowing facility more frequently. Thus, the significance of the central bank's bank rate policy is the following: 1. The bank rate indicates the rate at which the public should be able to obtain financial accommodation against the security of approved securities from the commercial banks. 2. The bank rate indicates the rate of interest at which the commercial banks can borrow funds from the central bank against the security of government and other approved securities. 3. The bank rate acts as a barometer of the economic situation in the country. If the central bank raises its bank rate, it is a danger signal while a fall in the bank rate shows a clear path. A rise in the bank rate can be compared to the 'amber coloured light of warning to a robot system of finance and economics or as the danger signal of a red light warning for the business community of rocks ahead on the way in which they are engaged.' On the

 contrary, a fall in the bank rate shows 'the green light indicating that the course is clear and the ship of commerce may proceed on the way with caution.' In India, the Reserve Bank of India had first raised the bank rate in November 1951. Since then it has been frequently raised. During the period of over five and half decades upto June 2010, the bank rate has been raised 13 times and reduced 15 times. During the post reforms period of two decades it has been raised only four times and reduced 14 times. Limitations The degree or success with which the central bank can use its bank rate policy to control the total credit in the economy depends upon the interest elasticity of investment demand. During a boom, the demand for bank credit by the business community may be highly interest-inelastic. When the entrepreneurs are over- optimistic and consequently the marginal productivity of investment is high, the demand for bank credit cannot be curtailed merely by raising the bank rate by the central bank. If the investors expect that the value of their investment will appreciate, say by 10 per cent per annum, then even a rise of as high as 10 per cent per annum in the interest rate will not deter them from borrowing funds from the commercial banks. Moreover, in many business enterprises, interest rate constitutes a negligible proportion of the total unit cost of production. As a result, for such businesses the demand for bank credit is highly interest-inelastic. Although in the long period the bank rate is bound to influence the stock market and the business yield expectations but it may be too late to check the evil when the seeds of destruction have already been sown. The bank rate policy proves more ineffective during depression than during a boom. Any depression involves tedious readjustments of one type or the other. Severe depression gives a sharp blow to 'business confidence' which only a considerable time factor can revive. Consequently, at this time the demand for bank credit becomes highly interest-inelastic. Businessmen do not borrow even maximum facilities are provided by the commercial banks. When the sales are falling off quickly and the idle plant capacity is increasing over the entire economy, the investors cannot be easily persuaded to increase or even to continue the flow of their borrowings. Nobody will install any new plant for a remote and uncertain demand. Even if the interest rate falls to zero or even becomes negative (which is not possible) no inducement to invest may be caused,. If the fall in prices is expected to continue, no conceivable fall in the bank rate by the central bank and through it in the lending rates of the commercial banks will initiate recovery in the economy. Thus, the bank rate policy suffers from serious limitations and the central bank cannot eliminate the occurrence of booms and slumps in the economy merely by raising or lowering the bank rate. 2. Open Market Operations 'Open market operations' is another traditional or quantitative instrument at the disposal of the central bank to control the volume of aggregate bank credit in the economy. The commercial banks create or squeeze credit and enable businessmen

 to increase or decrease their total borrowings from them. Thus the banks have the power to expand or contract the economy of a country.

creating capacity of banks and through it to exercise control over the economic fluctuations in the country. Open market operations enable the central bank to perform this essential function. Open market operations refer to the bulk buying and selling of government and other approved securities by the central bank in the money and capital markets. Transactions in the money market are confined to those who deal in negotiable instruments falling due for payment within one year. Participants in transactions include the commercial banks, business corporations, various public agencies, central bank and other specialized financial intermediaries which deal both on their own and on their clients' behalf. The instruments traded in the money market are discountable at the central bank and as such are partial substitutes for the high- powered money. The transactions in the capital market are confined to negotiable instruments falling due in a period of one year or more; indeed, some such instruments—fixed interest perpetuities and equities—have no fixed maturity date. The principal participants in the capital market are the commercial banks, insurance companies, industrial finance corporations, development banks, investment trusts, provident funds and other specialized financial intermediaries who deal both on their own and on their clients' behalf. The instruments traded in this market are not generally regarded as substitutes for the high-powered money although long-term government securities may become fairly acceptable as such if the central bank decides to peg their prices so that these will not fall below some known level. The theory of open market operations is simple. During a boom which is considered dangerous for economic stability, the central bank sells government and other approved securities from its securities portfolio in the market to reduce the aggregate supply of money in the economy. Buyers of these securities pay the central bank by drawing on their cash deposits in banks. Since the commercial banks hold deposits with the central bank, payment by the former to the latter means a reduction in the size of the member banks' deposits held with the central bank. Reduction in their cash reserves forces the banks to reduce their advances and they refuse further loans. This reduces investment based on bank credit. Consequently, the boom in the economy is checked. To fight slump in the economy, the central bank buys the government and other approved securities in the securities market. It pays for these securities by issuing cheques drawn on itself to individuals and institutional sellers of securities. The individuals deposit these cheques in their deposit accounts in the commercial banks. The commercial banks realize the proceeds of these cheques from the central bank. Thus, their cash reserves increase. The banks use these additional cash reserves to support additional loans. Consequently, the aggregate commercial bank credit expands leading to greater investment, more employment and higher prices in the economy. Thus, by bulk buying and selling of securities in the money and capital markets, the central bank influences the credit-creating operations of the commercial banks and through these operations it influences the economic conditions in the country.

Banking and Credit Control NOTES Self - Learning 186 Material Limitations For their success, central bank's open market operations assume that the commercial banks in the country will expand their credit portfolio when they get additional cash and contract it when their cash reserves fall as a consequence of central bank's open market operations. But this may not happen because expansion and contraction of credit to a great extent reflects the prevailing business mood or psychology of the investors. During boom the businessmen are over-optimistic about the future and commercial banks will not readily restrict their loans even though their cash reserves with the central bank are reduced by the latter's open market operations. Either the commercial banks may work with low cash reserves or they may replenish their cash reserves by discounting securities (part of which they may have bought from the central bank) at the central bank. Consequently, what the central bank does on one side as the controller of credit may be nullified on the other by the action of commercial banks who may approach the central bank as lender of the last resort. During depression, the act of buying the securities from the commercial banks on the part of the central bank may not induce the banks to expand credit despite their high cash reserves. Since in a depression lending becomes more risky on account of the growing failure of firms, the commercial banks adopt the policy of 'wait and see' and work with higher reserves rather than expanding credit on the basis of their surplus cash reserves. As the ultimate custodian of public deposits kept with the commercial banks, the central bank cannot force the commercial banks to lend when the latter are not inclined to lend. Moreover, during depression, it is not merely that the commercial banks are reluctant to lend, it is also difficult to find such borrowers in enough number who are willing to launch new ventures and enterprises. Even if the banks shake away their pessimism and show readiness to lend, it may not bear any fruit in practice. The pumping in of additional money by the central bank through its open market operations (purchases of securities) may only result in expanding the surplus cash reserves of the banks without causing an increase in bank credit due to investors' reluctance to borrow from the banks even at the most liberal terms. This was witnessed in 1932–33 in England when the total deposits of the London clearing banks rose by £214 million while their loans and advances fell by £77 million. While the central bank can increase the amount of money in the system by purchasing securities in the open market in order to fight depression, there is no method by which it can force the investors to invest this additional cash into productive enterprise. Moreover, the ability of the central bank to influence the money market through its open market operations is limited by the total supply of suitable securities which it can unload in the market to check inflation and also by its own preparedness to purchase securities at high prices to check slump and incur losses by selling them at low prices to check a boom. Even if the central bank is ready to suffer losses to establish stability in the economy, it is likely that the total amount of securities which it may have in its portfolio may prove inadequate to achieve the much-needed economic stability. Pointing out to this limitation of the central bank's open market operations, Keynes stated that 'the Reserve Banks can only fire off against an incipient boom only such ammunition as they have been able to pick-up

Banking and Credit Control NOTES Self - Learning Material 187 while resisting a slump.' The inadequacy of this ammunition was experienced in the unhappy situation of the Federal Reserve Banks during the recovery of 1935– 37 when the excess cash reserves of the commercial banks reached 3,300 million dollars as against the total holdings of US government's securities held by the Federal Reserve Banks of only 2,400 million dollars. In such a situation, even the sale of all the securities by the Federal Reserve Banks would have proved inadequate to absorb the total excess cash reserves of the member banks. Consequently, even the ammunition which the central bank may possess with it cannot always be fired off. Thus, the open market operations policy of the central bank is like a blunt-edged weapon. The extent of success of central bank's open market operations mainly depends on (i) the stage of development of the money and capital markets in the economy, and (ii) the extent to which the central bank is prepared to indulge in the buying and selling operations. In the underdeveloped economies where the money and capital markets are undeveloped, where the central banks lack enough experience in the use of the technique of open market operations, where the central banks do not possess the portfolio of securities of the size and maturity composition such that they may sell the securities in the prescribed volume in the market and where the absorbing capacity of the money and capital markets is low restricting the scope of operations for the central bank, the scope for the open market operations is severely restricted. Thus, despite the theoretical excellence of the open market operations as an important instrument of central bank's credit control policy, in practice it is of little use. Researches made in the study of the business cycles reveal that credit expansion or contraction is not the primary cause of the occurrence of business cycles in the economy. It is only a secondary cause which at best accelerates the process of expansion or contraction. The open market operations are, however, employed to influence the rate of interest and the prices of government securities in the money market. In spite of the difficulties in conducting open market operations, in the countries having well developed and highly active money and capital markets, open market operations are one of the principal instruments used for monetary regulation by the authorities, as is illustrated by the experience of the United States of America and the United Kingdom. In other countries, however, where the capital and the money markets are not so well developed, open market operations as an instrument of monetary regulation are relatively unimportant. 3. Rationing of Credit As an instrument of credit control, credit rationing was first employed by the Bank of England towards the end of the 18 th century when it imposed a ceiling upon its discounts for any one bank or rejected a proportion of each discount application whenever the total demand for loans exceeded the total amount it was prepared to discount on any one day. The bank employed its discount rate policy for the first time in 1839. Subsequently, this policy was employed in the economic crises of 1847, 1857 and 1866. However, the wide use of credit rationing as a method of controlling credit was made only in recent times, particularly after World War I

Banking and Credit Control NOTES Self - Learning 188 Material to control the exceptionally difficult conditions resulting from war and post-war inflations. In Germany, the Reichsbank employed the method of credit rationing in 1924 'when the currency which was stabilized by the introduction of Rentanmark was endangered' and in 1931 when 'the Reichsbank used the credit quotas to prevent the collapse of the large banks.' In 1929 too 'when the Paris negotiations in connection with the Young Plan led to the withdrawal of foreign money from Germany and to attacks on the German currency and when the Reichsbank wanted by means of credit restriction to force the banks to do everything in their power to counteract this manoeuvre, the useful method of credit rationing was employed.' There is no doubt about the efficacy of credit rationing as a sound method of credit control. Credit rationing by the central bank became a very important factor in general economic policy execution. At times when the demand for credit exceeds the total available resources of the State Bank of Russia, it is obliged to divide the available funds in some definite way among those who need them. 'Rationing of credit and capital is a logical concomitant of the intensive and extensive planning adopted in regimented economies.' Not only is this method resorted to in the authoritarian economies but even 'in more primitive economic conditions the setting of credit quotas is the only decisive method which the central bank has in order to prevent credit demands on the part of business.' In Mexico, the central bank has consistently employed credit rationing as a principal weapon of credit regulation. In India too, the Reserve Bank of India on several occasions has made an effective use of this instrument. 4. Direct Action Direct action in more than one form has been employed by the central banks either as an alternative to their discount rate policy or open market operations or together with both these methods. In the wider sense, direct action includes moral suasion and there are many economists who do not make a distinction between these two. However, it is desirable to make a clear-cut distinction between moral suasion and direct action, the latter term indicating only such coercive measures as the refusal to rediscount or grant further rediscount facilities to the defaulting banks. Direct action in the sense of refusing rediscount facilities on the part of the central bank to those banks whose credit policy was not conducive to the maintenance of sound credit conditions was given great prominence in America by the Federal Reserve System during the 1928-29 slump. The Reserve Bank of India has recently used direct action in the form of selective credit control. For the first time, the Bank issued a directive to banks on 17 May 1956 asking them to refrain from excessive lending against commodities in general or forbidding the banks to grant credit in excess of 50,000 to individual parties against paddy and rice. This was done to check speculation and stockpiling of essential goods to bring down their prices and to prevent these from rising further. As a result of this directive, advances against paddy and rice fell from 26 crore in April 1956 to 4 crore in October 1956. By another directive issued in September 1956, the scheme of selective credit control was extended to apply to wheat and other foodgrains. In June 1958 by another directive the commercial banks were further instructed to bring down the amount of their advances against

Banking and Credit Control NOTES Self - Learning Material 189 foodgrains. Subsequently, a spate of directives has been issued from time to time by the Reserve Bank of India to the commercial banks forbidding them to grant credit or to grant credit in a prescribed manner and for prescribed purposes. The selective credit control has now been abolished. Direct action as a method of credit control suffers, however, from certain drawbacks. Dwelling upon the difficulties of success of direct control as a method of credit regulation De Kock has stated: 'There are, however, several limitations to be reckoned with, namely, the difficulty for both central and commercial banks to make clear-cut distinctions at all times and in all cases between essential and non-essential industries, productive and unproductive activities, investment and speculation, or between legitimate and excessive speculation or consumption; the further difficulty of controlling the ultimate use of credit by second, third or fourth parties; the dangers involved in the division of responsibility between the central bank and the commercial banks for the soundness of the lending operations of the latter; and the possibility of forfeiting the wholehearted and active cooperation of the commercial banks as a result of undue control and intervention.' 5. Minimum Statutory Cash Reserve Ratio The instrument of statutory cash reserve ratio is very effective in reinforcing the bank rate policy and open market operations. At present, banks are compelled either by law or by custom to keep a certain percentage of their total deposits with the central bank in the form of minimum legal cash reserves. The importance of this instrument in controlling credit in the economy follows from the fact that an increase or decrease in the minimum legal cash reserve ratio by decreasing or increasing the excess cash reserves of the banks decreases or increases their optimum credit-creating capacity. For example, if the bank deposits in the country have exceeded the desired limit and the central bank wants to bring these in line with this limit, it can do so by raising the minimum legal cash reserve ratio for the member banks in the system. The result of raising the statutory reserve ratio will be reflected in the depleted surplus cash reserves with the member banks. To maintain the same amount of deposits, now they will have to either deposit additional cash with the central bank or they will have to reduce their total deposits by calling back part of their loans. This will contract credit in the system. The reverse will be the effect of reduction in the statutory cash reserve ratio reflected in the expansion of bank credit. Generally, the instrument of minimum statutory cash reserve ratio is employed together with the instruments of bank rate and open market operations. The instrument of minimum legal cash reserve ratio for banks was first introduced in America in 1933 when the Board for Governors of the Federal Reserve System was empowered through legislation to alter the member banks' cash reserves requirements by regulation 'in order to prevent injurious credit expansion or contraction.' This power given to the Federal Reserve System to change the minimum legal cash reserve ratio to be maintained by the member banks with the Reserve Banks was meant to serve as an additional means to enable the Reserve Banks to control the money market through contracting or expanding the credit-creating capacity of the member banks. In America, the power was first used in August 1936 when the cash reserve ratio requirement was raised

Banking and Credit Control NOTES Self - Learning 190 Material by 50 per cent in order to check the possibility of excess credit creation by the member banks consequent upon the heavy inflow of gold in the country. The result of this action was as expected. Consequent upon a 50 per cent increase in the cash reserve ratio requirement, the excess cash reserves of the member banks fell from $3,100 million to $1,800 million. This substantial fall in the cash reserves of the member banks brought about by raising the minimum statutory cash reserve ratio brought the cash reserves of commercial banks within the scope of control through the system's open market portfolio which consisted of $2,430 million of US Government securities. This method of statutory cash reserve ratio was subsequently employed in May 1937 to curb the excess cash reserves of the member banks. The use of the minimum legal cash reserve ratio in America was again made in January 1951 when the reserve ratio was raised to check the inflationary pressures consequent upon the outbreak of the Korean War. In July 1953, the Federal Reserve Board lowered the reserve ratio to curb the severe monetary stringency in the country. This shows that the Federal Reserve Authorities have successfully employed the instrument of statutory cash reserve ratio in conjunction with other instruments of credit control not only to counter the cyclical fluctuations in economic activity but also as an emergency measure to deal with war or other abnormal situations. Today, central banks in every country are armoured with the necessary powers to change the minimum statutory cash reserves ratio requirement for

very frequently made changes in the minimum legal cash reserve ratio to restrict or to expand bank credit as an important instrument of its monetary policy. The instrument of statutory cash reserve ratio, however, is not without limits. In many cases the cash reserve ratio cannot be altered except by law. Besides, there is no reason why the member banks will always care about such a ratio particularly if their cash reserves are swollen they will not at all care for the increase in the minimum legal cash reserve ratio requirement unless the increase is very high. They may also conduct their operations with a lower cash reserve ratio if they are optimistic about the future while a fall in the minimum legal cash reserve ratio may fail to induce them to lend in depression. Apart from these considerations, a counteracting force may arise from a change in banking practices. It is particularly true in America where the percentage of minimum legal cash reserve ratio required to be kept with the Reserve Banks differs for different kinds of deposits held by the banks. Thus with a minimum legal cash reserve ratio of 10 per cent required against the demand deposits and of 3 per cent required against the time deposits, a shift of funds from the former to the latter would enable the member banks to expand credit and consequently to disregard the policy of the central bank. 6. Minimum Secondary Cash Reserves Requirements The principle of requiring the commercial banks to maintain the minimum secondary or supplementary cash reserves in excess of the minimum legal cash reserves was devised in 1954

in its annual report. The underlying idea behind the principle of minimum secondary
Banking and Credit Control NOTES Self - Learning Material 191 cash reserves is to curtail the capacity of the commercial banks to expand credit by limiting their capacity to convert government securities and surplus cash assets into business loans. This method has been successfully employed by the central banks in Belgium, Mexico, India, Sweden, Norway, Holland and the Philippines to fight inflation by curbing the lending capacity of member banks. According to De Kock, the method of secondary reserves requirements 'can be made to play a valuable part in any positive disinflationary monetary policy under conditions of exceptional inflationary pressures caused by war, rearmament or other abnormal circumstances.' 7. Regulation of Consumer Credit As an instrument of credit control, the regulation of consumer credit was employed in America in August 1941 by an executive order issued by the United States President authorizing the Board of Governors of the Federal Reserve System to regulate the terms and conditions under which bank credit repayable in instalments could be extended for purchasing or carrying consumer durable goods. 'The purpose of instalment credit regulation is to help dampen the demand for goods, the civilian supply of which has already been reduced because of defence needs. Demand for these goods tends to cause inflationary price rise as to absorb material increasingly needed for defence. The regulation of consumer credit is a supplementary instrument to be used in conjunction with the broader, more basic fiscal and other government powers in combating inflation.' The regulation of consumer credit is quite important in combating inflation by restricting the aggregate consumer demand for those goods which are in short supply in the industrially advanced countries like America where consumer credit is largely used to finance domestic purchases. However, in the context of underdeveloped countries where consumer credit is conspicuous by its absence and the banks do not participate in financing the purchases of consumer durables to any significant degree, this method cannot be effective in curbing the inflationary pressures in the economy. 8. Regulation of Margin Requirements The regulation of margin requirements on security loans was first introduced in America in 1934 when under the Securities Exchange Act, the Federal Reserve System was empowered to practice selective credit control. The instrument of selective credit control was designed to assist the Federal Reserve System in controlling the volume of credit used for speculation in securities. In 1936, the Board of Governors employed this method to restrain the activities of the bears by fixing the margin requirements of 50 per cent for short sales. This method is quite effective in controlling the volume of credit in a speculation-minded country like America. According to Goldenweiser, 'margin requirements have served a useful purpose, and some light has been thrown upon their possibilities and their limitations as an instrument of policy.' Although theoretically the method of regulation of margin requirements is quite capable of being used as a prompt and effective means of checking speculation in securities, in practice, however, it throws an enormous responsibility on the central bank and causes the latter to be singled out, more than ever, for the role of

Banking and Credit Control NOTES Self - Learning 192 Material arch-scapegoat. Explaining the shortcoming of this method, Burgess has stated that 'the legislation has placed upon the Reserve System a responsibility which is likely to prove onerous, for the System will find itself at times required by circumstances to take action which will directly and immediately influence the profits and even solvency of considerable groups of people.' 9. Moral Suasion As a method of credit control, moral suasion has been used by central banks in many countries. In England, France, Sweden and Holland where the central bank exercises great moral influence in the financial circles and is accepted as the financial leader by the banking community, it successfully exerts its sobering influence on the member banks through moral suasion. Even several new central banks, particularly those in Canada, Australia, India and New Zealand, have successfully established their moral influence on the commercial banks. Having faith in the efficacy of moral suasion as an instrument of credit control, Burgess has expressed the view that 'the Reserve Banks may at times exercise an important influence on the general credit situation through the informal suggestions which they may make to bankers and the informal influence which they may exercise in this way, may at times prove more important than their formal action under the law.' However, to be effective, this method of credit control should be exercised with utmost care as its influence is likely to vanish with its excessive use. In America, moral suasion has not been very successful because there are over 14,600 commercial banks with most banks commanding large cash reserves and not being subject to the restrictions of the Federal Reserve System as they are not members of it. The Federal Reserve Bank of New York before the Senate Committee on Banking and Currency in 1931 stated that 'it is impracticable to use moral suasion as an effective part of a programme designed generally to restrict or control expansion or use of Federal Reserve credit. It is not possible for Federal Reserve Banks by moral suasion or other means to prevent credit from being used for speculative or investment purpose as distinguished from other purpose.' Clark also thinks about the effectiveness of moral suasion as an instrument of credit control in similar negative terms. In Germany, the Reichsbank has, however, successfully employed the instrument of moral suasion on several occasions, e.g., in the spring of the 1927 in the form of issuing warnings to banks backed up solely by publicity. In India, the use of moral suasion by the Reserve Bank of India as an instrument of credit control has proved quite successful. For the first time, following the devaluation of the rupee in September 1949, the Governor of the Reserve Bank convened a meeting of the leading commercial banks and requested them to cooperate with the bank in its efforts to achieve stability by refraining from lending for speculative purposes. The 'big brother' appeal had the desired effect and the banks followed the restrictive credit policy regarding lending for speculative purposes. Since then the Reserve Bank of India has made frequent successful use of this method in making the member banks rally round its policies.

Banking and Credit Control NOTES Self - Learning Material 193 Moral suasion which implies the persuading of the commercial banks by the central bank to cooperate with it in pursuing a proper monetary and credit policy, can be successful only if the commercial banks accept the leadership of the central bank. This depends on the strength of the central bank and the prestige it commands among the member banks in the economy. In countries with highly liquid monetary conditions and where the central bank cannot undertake open market operations on a massive scale to counteract high bank liquidity, it is advisable for the central bank to use moral suasion although its success would largely depend upon the prestige enjoyed; the personal authority commanded and the moral influence exercised by the central bank; the technical means and the statutory powers at the disposal of the central bank; the cooperation between the central bank and the commercial banks and the nature of the country's banking and credit structure. Moreover, although moral suasion may succeed in a greater measure in curbing expansion, it may fail to expand business activity in a slump since this would depend on the attitude of businessmen who borrow funds from the banks and in depression they may be reluctant to borrow any funds even on the most liberal terms offered by the banks. 10. Publicity Apart from moral suasion, the central banks employ the instrument of publicity in order to publicize economic facts in the weekly statements of their assets and liabilities, money bulletins containing reviews of credit and business conditions, and detailed annual reports stating their operations and activities, the state of affairs of the money market and the banking system and general review of the trade, industry, agriculture, etc., in the country. By resorting to publicity, the central bank enlists public opinion in favour of its monetary policy and thereby combats opposition to its policies among political, financial and business interests. Warnings addressed to the public or to the banks supplemented by the publication of statistical data and statements made through 'respected' intermediaries are the frequently used media. The Federal Reserve System has made the most extensive use of publicity through the publishing of a weekly statement of conditions of the Federal Reserve System and monthly bulletins providing information about the economic conditions in its district. The Reichsbank has also made extensive use of publicity. In Sweden, the Riksbank of Sweden has regularly given publicity to its monetary policy and public announcements of its policy have been one of the techniques employed by the Riksbank. However, the publicity technique of the Federal Reserve System has not always been successful in achieving its purpose in the United States of America and in 1920 and 1929 the Board's pronouncements fell on deaf ears. There is no doubt that the method of publicity has the scope of useful application in industrially advanced countries where public opinion is enlightened. However, in the underdeveloped countries where people are mostly uneducated and even those who are educated are not acquainted with the technique of banking statistics, the method of publicity is relatively of little use in controlling credit. In addition to the above stated methods, central banks have fruitfully used the method of regulation or management of the foreign exchange rate and the various forms of foreign exchange control as the effective means of credit control.

Banking and Credit Control NOTES Self - Learning 194 Material 5.4.1 Credit Control by RBI Besides quantitative controls discussed above, the RBI may resort to qualitative restrictions to make effective its monetary policy measures. Under the Banking Regulation Act, 1949, the RBI is vested with powers to control the entire banking system. In pursuance of Section 21 of the Act, the RBI may give directions to banking companies with regard to their lending policies, which they are bound to comply with. The section runs as follows: 1. Where the Reserve Bank is satisfied that it is necessary or expedient in the public interest so to do, it may determine the policy in relation to advances to be followed by banking companies generally or by any banking company in particular and when the policy has been so determined, all banking companies or the particular company concerned, as the case may be, shall be bound to follow the policy so determined. 2. Without prejudice to the generality of the power vested in the Reserve Bank under sub section (1), the Reserve Bank may give directions to banking companies, either generally or to any banking company or group of banking companies in particular, as to the purpose for which advances may or may not be made, the margins to be maintained in respect of secured advances and the rates of interest to be charged on advances, and each banking company shall be bound to comply with any directions as so given. Again, 1. Where the Reserve Bank is satisfied that: (a) in the national interest or (b) to prevent the affairs of any banking company being conducted in a manner detrimental to the interests of depositors or in a manner prejudicial to the interests of the banking company or (c) to secure the proper management of any banking company generally. It is necessary to issue directions to banking companies generally or to any banking company in particular, it may, from time to time, issue such directions as it deems fit, and the banking companies or the banking company, as the case may be, shall be bound to comply with such directions. 2. The Reserve Bank may, on representation made to it or on its own motion, Modify or cancel any directive issued under sub section (1), and in so modifying or cancelling any directive may impose such conditions as it thinks fit, subject to which the modification or cancellation shall have effect. Further, under Section 36 (1) (a) of the RBI Act, the RBI is empowered to caution or prohibit banking companies generally, or any banking company in particular against entering into any particular transaction or class of transactions. It may call for periodical as well as ad hoc returns and in the public interest may also publish such information as it deems fit.

Banking and Credit Control NOTES Self - Learning Material 195 Implementation of Selective Credit Controls In order to enforce the policy of selective credit controls, the RBI used to issue directives to scheduled banks since the beginning of the Second Five Year Plan. The first such directive was issued on 17 May 1956, to all scheduled banks not to increase any credit limit they had already sanctioned and not to issue any fresh credit limit against rice and paddy in excess of 50,000 to any party. In September, this control was further extended to cover bank advances against other foodgrains, gram and other pulses, and cotton manufactures. Since then, the Bank continued to issue directives; some were by way of replacement or modification of previous ones and dome by way of extension of control measures to new sectors. Objective of Selective Credit Controls By and large, selective credit controls are employed for the purpose of controlling inflationary tendencies which appear owing to an increase in the total amount of money in circulation through an over expansion of bank credit. But in a developing country like India, they are primarily intended to prevent the anti-social use of credit, which is associated with the speculative hoarding of stocks of strategic commodities like foodgrains, and to push down prices or at least to check an unwarranted increase in their prices. The Bank Rate policy, open market operations and variable reserve ratio system, which are employed in controlling the quantity of credit, are not effective in controlling the quality of credit and canalizing its flow into those lines where they are most called for and most needed, whereas selective credit controls are effective in controlling the quality of lending and investment operations of the banks and in restricting credit against particular commodities. Salient Features of Selective Credit Controls The policy of the RBI, while instituting selective credit controls, had been one of flexibility. In other words, the directives were promptly withdrawn when circumstances no longer needed their continuance. For instance, the Bank, while maintaining the broad framework of controls regulating advances against foodgrains by banks, had made from time to time suitable modifications to the structure of control to meet the needs of the changing situations. In other words, there was no rigid formula for the Bank while instituting selective credit controls. On the other hand, the measures had been essentially flexible so that they were modified according to the developing circumstances. Another salient feature of the control technique had been the endeavour of the Bank to ensure that the measures did not hamper production. The Bank had also been careful to make the necessary modifications in the controls according to the circumstances prevailing in different areas. Limitations of Selective Controls The success of selective controls in arresting upward trends in prices does not depend on the availability of bank credit alone, but also on a variety of other factors including aggregate and individual demand and supply. It is unequivocally admitted that monetary techniques are no panacea for curing all ills in the economy

Banking and Credit Control NOTES Self - Learning 196 Material caused by the scarcity of particular commodities in relation to their demand. In India, shortage of supply has always been one of the important factors contributing to hectic movements in prices. Another limitation of this monetary technique arises from the fact that in so far as stocks of commodities are self-financed or privately financed, the role of bank finance is negligible. Above all, it is a necessary pre-requisite for successful employment of the control measures that there should be an effective machinery for the preparation of the directives according to the peculiar circumstances of each commodity and for the monitoring of these measures. Moral Suasion and Credit Rationing 'Moral Suasion' implies persuasion of banks to follow certain lines of policies, impressing upon them the necessity to do so. There is no element of compulsion in this persuasion and as such the efficacy of this measure depends on the active cooperation of banks and their goodwill to fall in line with the advices of the RBI. That is why certain quarters have expressed doubts about the success of this instrument of monetary policy. However, the success which the RBI could achieve has been somewhat encouraging. A brief discussion of the activities of the Bank in this direction is, it is hoped, not out of place in this context. After the devaluation of the rupee, as speculative activities were feared, the banks were advised to restrict their advances to genuine trade requirements and not to grant accommodation for any speculative purposes. During the recent years, the Governor of the RBI advises informally the commercial banks to follow the policy measures generally. The effect which these advices invoked has been, by and large, satisfactory; if not spectacular. The Bank's activities in this direction are facilitated by the concentration of resources in the hands of a few big banks which enables the Bank officials to have frequent informal consultations with the officials of these big banks and achieve satisfactory results. 'Direct Action' implies the refusal of the RBI to extend rediscounting facilities and other financial accommodation to banks following unsound banking principles, or to grant further accommodation to banks whose capital and reserves are considered inadequate. The Bank is not resorting to this weapon very often but cases of wilful and persistent violations of the rules could be met with the sharp blades of direct action with which the Bank is armoured. Check Your Progress 3. What are the factors which determine the extent of success of a central bank's open market operations? 4. Define moral suasion.

Banking and Credit Control NOTES Self - Learning Material 197 5.5 OBJECTIVES AND LIMITATIONS OF MONETARY POLICY Different monetary economists have defined monetary policy in their own ways. For example, Harry Johnson defines it as a "

of

Note that Johnson emphasizes only the control of money supply as the objective of monetary policy, Shaw emphasizes both supply of and demand for money. Monetary policy is essentially a programme of action undertaken by the monetary authorities, generally the central bank, to control and regulate the demand for and supply of money with the public and the flow of credit with a view to achieving predetermined macroeconomic goals . The objectives of monetary policy are the same as the objectives of fiscal policy, viz., growth, employment, stability of price and also foreign exchange and balance-of- payment equilibrium . Scope of Monetary Policy: The scope of monetary policy spans the area of economic transactions and the macroeconomic variables that monetary authorities can influence and alter through the monetary policy. From monetary instruments point of view, the scope of monetary policy includes (i) bank rate, (ii) cash reserve ratio, (iii) open market operations by the central bank and (iv) also the direct control measures as deemed fit by the central bank. From the view point of effectiveness, the scope of monetary policy depends, by and large, on two factors. (i) The level of monetized economy and (ii) The level of development of the capital market. In a fully monetized economy , the scope of monetary policy encompasses the entire gamut of economic activities. For, in such an economy, all economic trans-actions are carried out with money as a medium of exchange. In that case, monetary policy works by changing the general price level. It is, therefore capable of affecting all economic activities— production, consumption, savings, investment and foreign trade. The monetary policy can influence all major macroeconomic variables— GDP, savings and investment, employment, the general price level and the foreign exchange. The other contributory factor is the level of capital market development. While the change in the supply of money affects the level of economic activities through the price level, the other instruments of monetary control (bank rate and cash reserve ratio) work through the capital market. Where the capital market is fairly developed, monetary policy affects the level of economic activities through the changes in the capital market. It works faster and more effectively. Incidentally, a developed capital market is one which has the following features: (i) a large number of financially strong commercial banks, financial institutions, credit organizations and short-term bill market, (ii) a major part of financial transactions

Banking and Credit Control NOTES Self - Learning 198 Material are routed through the capital markets, (iii) the working of the various capital sub- markets is inter-linked and inter-dependent and (iv) the commodity sector is highly sensitive to the changes in the capital market. It is important to note that the changes in the bank rate and cash reserve ratio work through the commercial banks. Therefore, for the monetary policy to have a widespread impact on the economy, it is necessary that the capital sub-markets have strong financial links with the commercial banks. Repo and Reverse Repo Rates In addition to traditional monetary control measures, RBI uses repo rate (repurchase operation rate) and reverse repo rate under its Liquidity Adjustment Facility (LAF) programme. Repo rate is the rate that RBI charges the banks when they borrow from the RBI. Reverse repo rate is the rate that it offers the banks willing to keep their money with it. Depending on the need of the country, the RBI keeps changing these rates. Repo operation increases liquidity and reverse repo rate reduces the liquidity (or money supply) in the country. The Limitations of Monetary Policy The effectiveness of monetary policy, or any policy for that matter, depends on a number of factors. 1.The time-lag :The first and the most important limitation in the effective working of monetary policy is the time-lag , i.e., time taken in chalking out the policy action, its implementation and working time. The time-lag is divided in two parts: (i) 'inside lag' or preparatory lag and (ii) 'outside lag' or response lag. The 'inside lag' refers to the time lost in (a) identifying the nature of the problem, (b) identifying the sources of the problem, (c) assessing the magnitude of the problem, (d) choice of appropriate policy action and (e) implementation of policy actions. The 'outside lag' or the response lag refers to the time taken by the households and the firms to react in response to the policy action taken by the monetary authorities. If inside and outside lags are long, not only the nature and the magnitude of the problem may change rendering the policy ineffective, but it may also worsen the situation. It has been the experience of many countries including developed ones that 'time-lag' has been unduly long making monetary policy less effective than expected. The time-lag of monetary policy, particularly its response lag, has been found to be generally longer than the time lag of fiscal policy. However, the issue of time-lag of monetary policy is controversial. Friedman and Schwartz find an average time-lag of 18 months between peaks (troughs) of money supply and peaks (troughs) of business cycle. Their findings have, however, been questioned by the findings of other economists. However, 'the evidence from several sources suggests that the lag associated with monetary policy is long and possibly variable' and 'the consensus seems to be that the lag is about 12 to 16 months long'. 2.Problem in forecasting: The formulation of an appropriate monetary policy requires a reliable assessment of the nature and magnitude of the problem— recession or inflation. More important is to forecast the effects of monetary

Banking and Credit Control NOTES Self - Learning Material 199 actions. Despite advancement in forecasting techniques, reliable forecasting of macroeconomic variables remains an enigma. To quote Stephen McNees. "How can forecasters go wrong? They may not predict disturbances (the Gulf War, for example); they may misread the current state of the economy and hence base their forecasts on a wrong picture of the present situation; and they may misjudge the timings and the vigour of the government's monetary and fiscal responses to booms or recessions. The fact is that forecasting has not reached perfection, particularly at major turning points in the economy ...." With this status of forecasting and prediction of the outcome of a policy action, formulation of an appropriate monetary policy has remained an extremely difficult task. An inappropriate policy based on guesswork is bound to be unsatisfactorily effective. The empirical evidence proves the point. 3.Non-banking financial intermediaries: The structural change in the financial market has also reduced the scope of effectiveness of monetary policy. The proliferation of non-banking financial intermediaries including industrial finance corporations, industrial development banks, mutual saving funds, insurance companies, chits and funds, etc., has reduced the share of the commercial banks in the total credit. Although financial intermediaries cannot create credit through the process of credit multiplier, their huge share in the financial operations reduces the effectiveness of monetary policy. 4.Underdevelopment of money and capital markets: In addition, the effectiveness of monetary policy in less developed countries is reduced considerably because of the underdeveloped character of their money and capital markets. Their money and capital markets are fragmented while effective working of monetary policy requires that money market and the sub-markets of the capital market work interdependently. For this reason, the effects of change in money supply and particularly the changes in the interest rate remain confined to the banking sector. Check Your Progress 5. What is monetary policy? 6. Mention the two factors which govern the scope of monetary policy. 7. What are repo and reverse repo rates? 5.6 FUNCTIONS OF COMMERCIAL BANKS A commercial bank is a type of financial intermediary. Commercial banking is also known as business banking. Evolution of Commercial Banks The ancient Hindu scriptures refer to the money lending activities in the Vedic period. in India, during the Ramayana and the Mahabharata eras banking has become a full-

Banking and Credit Control NOTES Self - Learning 200 Material fledged business activity. During the smiriti period which followed the Vedic period and the Epic age, the business of banking was carried on by the members of the vaish community. Manu, the great law-giver of that time, speaks of the earning of interest as the business of vaishyas. The banker in the smiriti period performed most of those functions which commercial banks perform in modern times such as accepting deposits, granting secured and unsecured loans, acting as his costumer's bailee, granting loans to kings in times of grave crises, acting as the treasurer and banker of the state, issuing and managing the currency of the country. Commercial banks do the business of money; they borrow and lend the money. Now a question arises why they do it? They earn profit in borrowing and lending of the money. Again a question can be asked, than what is the difference between a money lender and a commercial bank. Commercial bank deals with the both, borrowing and lending of the money. It gives some rate of interest on the borrowings and they also charge some rate of interest on lending of the money. And because of the difference between both the rates of interest, commercial banks earn profit. In simple words, if a commercial bank is borrowing the money at 5 per cent Per Year, and on the other hand it lending the money at 8 per cent per year, it means the commercial bank is making the profit of 3 per cent per year. On the other hand the money lender lends his own money. Normally he does not borrow the money from the public. This is the difference between a commercial bank and a money lender. A very famous financial expert, Walter Bagehot has discussed the evolution of modern banking system in a very lucid manner according to him, The earliest banks of Italy, where the name began, were finance companies. The bank of St. George, at Geneva, and other banks founded in imitation of it were at first only companies to make loans to, and float loans for, the governments of the cities in which they are formed. The want of money is an urgent want of governments at most periods and seldom more urgent than it was in the tumultuous Italian republics of the middle ages. After these banks had been long established, they began to do what he call banking business, but at first they never thought of it. The great banks of the North of Europe had their origin in a want still more curious. The notion of its being a prime business of a bank to give good coin has passed out of men's memories; but whenever it is felt, there is no want of business more keen and urgent. In his world famous book, Wealth of Nations , the father of economics, Prof. Adam Smith has also discussed the evolution of the commercial banks, through discussing the main function of the bank of Amsterdam. In his words, 'this bank received both foreign coin, and the light and worn coin of the country at its intrinsic value in the good standard money of the country, deducting only so much as was necessary for defraying the expense of coinage, and the other necessary expense of management. For the value which remained, after this deduction was made, it gave a credit in its books. This credit was called bank money, which, as it represented money exactly according to the standards of mint, was always of the same real value, and intrinsically worth more than current money... it can be paid away by a simple transfer, without the trouble of counting, or the risk of transporting it from one place to another.'

Banking and Credit Control NOTES Self - Learning Material 201 Prof. Crowther has also discussed the evolution of the commercial banks, in a historical manner. According to him, the present day banker has three ancestors of particular note. One you have already met: the merchant, whose high and widespread reputation of credit enables him to issue documents that will be taken all over the known world as title to money. To this day the title of 'merchant banker' is reserved by usage to the older, cosmopolitan and more exclusive private banking firms, nearly everyone of which can trace its ancestors to trader in commodities, more tangible than money. The banker's two other ancestors are the money-lender and the gold smith. Lending and borrowing are almost as old as money itself, and the village money lender is found even in quite primitive communities. He is not usually regarded as a very lovely object; usurer is one of the very oldest terms of abuse. But the services he performs are undoubtedly useful and necessary, even though the reward he exacts in return may usually be rapacious.... The money lender works, of course, with his own capital. But if there are any other members of the community with money to spare, it will be quite natural for them to entrust it to the money lender for investment, in view of his skill and experience in the technique of exaction. As soon as the money lender reaches this stage, he is an embryonic banker. Banks are said to be departmental stores of financial services as they render a wide variety of such services to their customers. The range of these services differs from bank to bank, depending mainly size and the types of banks. They are also the most important function of a bank. The two essential functions of a commercial bank may best be summarized as the borrowing and the lending of money. They borrow money by taking all kinds of deposits. Deposits may be received on current account whereby the banker incurs the obligation to repay the money on demand. Interest is not payable on current account deposits. When deposits are received on savings bank account as well, the bank undertakes the obligation to repay them on demand. Interest is usually allowed on savings bank deposits although there are usually restrictions on the total amount that can be withdrawn and/or the number of times withdrawals are allowed during a defined period. When deposits are received on fixed deposit accounts, the banker incurs the obligation to repay the money together with an agreed rate of interest after the expiry of a fixed period. When deposits are received on deposit accounts, the banker undertakes to repay the customer together with an agreed rate of interest in return for the right to demand from him an agreed period of notice for withdrawals. Thus, a commercial bank mobilizes the savings of the society. This money is then provided to those who are in need of it by granting overdrafts or fixed loans or by discounting bills of exchange or promissory notes. In short, the primary function of a commercial bank is that of a broker and a dealer in money. By discharging this function efficiently and effectively, a commercial bank renders a very valuable service to the community by increasing the productive capacity of the country and thereby accelerating the pace of economic development. It gathers the small savings of the people, thus reducing the quantity of idle money to the lowest limits. Then, it combines these small holdings in amounts large enough to be profitably employed in those enterprises where they are most called for and Banking and Credit Control NOTES Self - Learning 202 Material most needed. Here it makes capital effective and gives industry the benefits of capital, both of which otherwise would have remained idle. For instance, take the practice of discounting bills of exchange. By converting future claims into present money, the commercial bank bridges the time element between the sale and the actual payment of money. This will enable the seller to carry on his business without any hindrance; and the buyer will get enough time to realize the money. Thus, a commercial bank receives deposits which it has to repay according to its promise and makes them available to those who are really in need of them. The bank is actually distributing its deposits between the borrowers and its own vaults. Herein, lies the most delicate of the functions of a commercial bank. Besides these two main functions, a commercial bank performs a variety of other functions which may broadly be grouped under two main heads, viz., the agency services and the general utility services. Agency Services A commercial bank provides a range of investment services. Customers can arrange for dividends to be sent to their bank and paid directly into their bank accounts, or for the bank to detach coupons from bearer bonds and present them for payment and to act upon announcements in the press of drawn bonds, coupons payable, etc. Orders for the purchase or sale of stock exchange securities are executed through the banks' brokers who will also give their opinions on securities or lists of securities. Similarly, banks will make applications on behalf of their customers for allotments arising from new capital issues, pay calls as they fall due and ultimately obtain share certificates or other documents of title. On certain agreed terms, the banks will allow their names to appear on approved prospectuses or other documents as bankers for the issue of new capital; they will receive applications and carry out other instructions. A commercial bank undertakes the payment of subscriptions, premia, rent, etc., on behalf of its customers. Similarly, it collects

It also acts as a correspondent or representative of its customers, other banks and financial corporations. Most of the commercial banks have an 'Executor and Trustee Department'. Some may have affiliated companies to deal with this branch of business. They aim to provide a complete range of trustee, executor or advisory services for a small charge. The business of banks acting as trustees, executors, administrators, etc., has continuously expanded with considerable usefulness to their customers. By appointing a bank as an executor or trustee of his/her will, the customer secures the advantage of continuity, avoiding to have made changes, impartiality in dealing with beneficiaries and in the exercise of discretions and the legal and specialized knowledge pertaining to executor and trustee services. When a person dies without making a will, the next-of-kin can employ the bank to act as administrator and to deal with the estate in accordance with the rules relating to intestacies. Alternatively, if a testator makes a will but fails to appoint an executor, or if an executor is unable or unwilling to act, the bank can usually undertake the administration with the consent of the persons who are immediately concerned. Banks will act solely or
Banking and Credit Control NOTES Self - Learning Material 203 jointly with others in these matters, as also in the case of trustee for stocks, shares, funds, properties or other investments. Under a declaration of trust, a bank undertakes the supervision of investments and distribution of income; a customer's investments can be transferred into the bank's name or control, thus enabling it to act immediately upon a notice of rights issue, allotment letters, etc. Alternatively, where it is not desired to appoint the bank as nominee, these services may still be carried out by appointing the bank as attorney. Where business is included in an estate or trust, a bank will provide for its management for a limited period, pending its sale to the best advantage as a going concern or transfer to a beneficiary. Private companies wishing to set up pension funds may appoint a bank as custodian, trustee and investment advisor, while retaining the administration of the scheme in the hands of the management of the fund. Most banks will undertake the preparation of income tax returns on behalf of their customers and claim for the recovery of overpaid tax. They also assist the customers in checking the assessments. In addition to the usual claims involving personal allowances and reliefs, claims are prepared on behalf of residents abroad, minors, charities, etc. General Utility Services These services are those in which the bank's position is not that of an agent for his customer. They include the issue of credit instruments like letters of credit and travellers' cheques, the acceptance of bills of exchange, the safe custody of valuables and documents, the transaction of foreign exchange business, acting as a referee as to the respectability and financial standing of customers, providing specialized advisory service to customers, etc. Banker's Drafts and Letters of Credit By selling drafts or orders and by issuing letters of credit, circular notes, travellers' cheques, etc., a commercial bank is discharging a very important function. A banker's draft is an order, addressed by one office of a bank to any other of its branches or by any one bank to another, to pay a specified sum to the person concerned. A 'letter of credit' is a document issued by a banker, authorizing some other bank to whom it is addressed, to honour the cheques of a person named in the document, to the extent of a stated amount in the letter and charge the same to the account of the grantor of the letter of credit. A letter of credit includes a promise by the issuing banker to accept all bills of exchange to the limit of credit. When the promise to accept is conditional on the receipt of documents of title to goods, it is called a 'documentary letter of credit'. When the promise is unconditional, it is called a 'clean letter of credit'. Letters of credit may again be classified as revocable and irrevocable. A 'revocable letter of credit' is one which can be cancelled at any time by the issuing banker. But the banker will still be liable for bills negotiated before cancellation. An 'irrevocable letter of credit' is one which cannot be cancelled before the expiry of the period of its currency. 'Circular letters of credit' are generally intended for travellers who may require money in different countries. They may be divided into 'travellers letter of credit' and 'guarantee letters of credit'. A 'travellers letter of credit' carries the instruction of the issuing bank to its foreign agents to

Banking and Credit Control NOTES Self - Learning 204 Material honour the beneficiary's drafts, cheques, etc., to a stated amount which it undertakes to meet on presentation. While issuing a 'guarantee letter of credit', the bank secures a guarantee for reimbursement at an agreed rate of interest, or it may insist on sufficient security for the grant of credit. There is yet another type which is known as 'revolving credit'. Here the letter is so worded that the amount of credit available automatically reverts to the original amount after the bills negotiated under them are duly honoured. Circular Notes, Travellers Cheques, Circular Cheques Circular notes are cheques on the issuing banker for certain round sums in his own currency. On the reverse side of the circular note is a letter addressed to the agents specifying the name of the holder and referring to a letter of indication in his hands, containing the specimen signature of the holder. The note will not be honoured unless the letter of indication is presented. Travellers' cheques are documents similar to circular notes with the exception that they are not accompanied by any letter of indication. Circular cheques are issued by banks in certain countries to their agents abroad. These agents sell them to intending visitors to the country of the issuing bank. Safe Custody of Valuables Another important service rendered by a modern commercial bank is that of keeping in safe custody valuables such as negotiable securities, jewellery, documents of title, wills, deed-boxes, etc. Some branches are also equipped with specially constructed strong rooms, each containing a large number of private steel safes of various sizes. These may be used for a small fee. Each user is provided with the key of an individual safe and thus not only obtains protection of his/her valuables but also retains full personal control over them. The safes are accessible at any time during banking hours, and often longer. Night Safes For shopkeepers and other customers who handle large sums of money after banking hours, 'night safes' are available at many banks. Night safe takes the form of a small metal door on the outside wall of the bank, accessible from the street, behind which there is a chute connecting with the bank's strong room. Customers who require this service are provided with a leather wallet, which they lock before placing in the chute. The wallet is opened by the customer when he calls at the bank the next day to get the contents credited to his account. Referee as to the Respectability and Financial Status of the Customer Another function of great value, both to banks and businessmen, is that of the bank acting as a referee as to the respectability and financial status of the customer. Bank Giro Among the services introduced by a modern commercial bank during the last quarter of a century or so, the 'bank giro' and 'credit cards' deserve special mention. The 'bank giro' is a system by which a bank customer with many payments to make, instead of drawing a cheque for each item, may simply instruct his bank
Banking and Credit Control NOTES Self - Learning Material 205 to transfer to the bank accounts of his creditors the amount due from him. He writes one cheque debiting his account with the total amount. Credit advices containing the name of each creditor with the name of his bank and branch will be cleared through the 'credit clearing' of the clearing house, which operates in a similar way as for the clearing of cheques. Even non-customers of a bank may make use of this facility for a small charge. A direct debiting service is also operated by some banks. This service is designed to assist organizations which receive large number of payments on a regular basis. A creditor is thereby enabled, with the prior approval of the debtor, to claim any money due to him direct from the debtor's bank account. To some organizations, for example, insurance companies, which receive, say, six equal sums on six dates in a year, the scheme is only an extension of the standing order facility but for the public utilities and traders which send out invoices for valuable amounts at differing times, the scheme is an entirely new one. Credit Cards A credit card is basically a payment mechanism which allows the holder of the card to make purchases without any immediate cash payment. Credit limit is fixed by the issuing bank and the limit is determined by the financial history as well as the type of card. Users are issued with a card on production of which their signatures are accepted on invoices in merchant establishments participating in the scheme. The issuing bank makes the payment to the merchant establishment selling the relevant goods or services. The holder to whom the card is issued, in turn, reimburses the bank on receipt of the billing statement. Generally it is not necessary to reimburse the bank with the entire amount on the billing statement. After making payment of the minimum amount due every month, the balance could be staggered over a period. Of course, outstanding balance plus any overdue will attract service charge at a certain rate. Also, users are generally required to pay a regular subscription for the use of the service. Different types of cards are available. The benefits attached to the card vary according to the type of the card. Often, the bank which issues the card will be a member of a payments brand. For instance, VISA is a payments brand with global payments system. Its cards are accepted at numerous locations (about 23 million merchant establishments) all over the world. All establishments displaying VISA logo accept VISA cards for all transactions. Of course, VISA itself does not offer cards or financial services; it only advances new payment products and technologies on behalf of its members. On every card transaction conducted, the merchant establishment will give a commission which will be shared by the issuing bank and the acquirer bank (i.e., the bank which approaches the merchant establishment for its acceptance of the card). If it is a branded card, a part of the commission will go to the payments brand. For instance, if it is a VISA card, a part of the commission will go to VISA. Suppose Bank 'A' has convinced merchant establishment 'X' to accept VISA cards. This means that all VISA cards will be accepted by establishment 'X'. In case establishment 'X' accepts the VISA card issued by Bank 'B', then the commission will be shared by Bank 'A', Bank 'B' and VISA. Establishment 'X'

Banking and Credit Control NOTES Self - Learning 206 Material will collect the amount due to it from Bank 'A' and Bank 'A' will collect the amount from Bank 'B' (the bank which has issued the card). Bank 'B' will collect the amount from the card holder. The entire transaction is routed via VISA. Kisan Credit Cards and Laghu Udyami Credit Cards A Kisan Credit Card (used to be designated as ' green card' by some banks) issued by Indian banks, aimed at providing adequate and timely support from the banking system to the farmers for their cultivation needs including purchase of inputs in a flexible and cost effective manner. More specifically, kisan credit cards will facilitate farmers in the purchase of agricultural inputs such as seeds, fertilizers and pesticides and to draw cash for other production and ancillary needs as many times as they wish. Unlike the usual credit cards, kisan credit cards are issued based on the landholding of agriculturists. As such, the provision of one-by-six scheme (i.e., the provision requiring the holder of a credit card to furnish income tax return) is not applicable to holders of kisan credit cards. The credit extended in the case of a kisan credit card would be revolving cash credit and provides for any number of drawals and repayments within the limit. The quantum of limit is based on operational landholding, the cropping pattern and scales of finance approved for the area. The cards are valid for three years and subject to an annual review. Encouraged by the kisan credit card scheme, Laghu Udyami Credit Cards have been introduced in India for providing simplified and borrower-friendly credit facilities to retail traders, artisans, professionals and self-employed persons, small industrial units and small businessmen including those in the tiny sector. Debit Cards The main difference between credit cards and debit cards lies in the words 'credit' and 'debit'. In case of a credit card, the card holder makes the cash payment at the end of the month. On other hand, in the case of a debit card, it runs down ones deposit account the moment the sale is made. In other words, while using a debit card, one is using ones own money in the bank account. Thus, while making a payment to a merchant establishment by using a debit card, it assumes the form of a transaction between the establishment and ones bank account. Debit cards are more readily accepted by merchant establishments since they get instant payment. Debit cards free the card holder from carrying cash for his/her purchases. Although debit cards are convenient in one sense, the card holder has to be extremely careful with the card. If the card is lost or is stolen, the entire balance in the bank account could be emptied with a single purchase by an unscrupulous person. ATM Cards An ATM (Automatic Teller Machine) Card is a variation of a debit card which one can use in a cash machine by punching in ones PIN (Personal Identification Number) for making cash withdrawals from ones bank account. ATM cards have the advantage over debit cards in that a person other than the card holder will not be able to use it for cash withdrawals because of the secrecy surrounding the card holder's Personal Identification Number. Also, most banks limit the amount of cash that can be withdrawn on any single day. Banking and Credit Control NOTES Self - Learning Material 207 Budget Accounts Some banks are opening budget accounts for credit-worthy customers. The bank guarantees to pay, for a specific charge, certain types of annual bills (e.g., fuel bills, rates, etc.,) promptly as they become due, while repayments are spread over a twelve-monthly period from the customer's account. All these money transmission services have particular regard to the developments in computerised book-keeping which the banks in most countries have already introduced. EFT (Electronic Funds Transfer) Service Another important service which is of comparatively recent origin is the Electronic Funds Transfer (EFT) service. This is a service under which funds are transferred electronically over the telephone, either nationally or internationally. International funds transfers from applicant to beneficiary are made in as little as a few seconds. The international network known as 'SWIFT' (Society for Worldwide Interbank Financial Telecommunications), an organization promoted by banks and financial institutions around the world, is utilized to facilitate the speedy transfer of funds across international destinations without any paper work and expeditious efficiency. SWIFT is the largest network in the world which has around 4,800 users in 130 countries. This is a path breaking technology that will ultimately pave the way for paperless banking. In addition to the service which it renders to individual customers, it will go a long way in curing the corporate sector's headaches of cash management in multiple locations. Overseas Trading Services Recognition of overseas trade has encouraged modern commercial banks to set up branches specializing in the finance of foreign trade. Banks in some countries have taken interest in export houses and factoring organizations. Assisted by banks affiliated to them in overseas territories, they are able to provide a comprehensive network of services for foreign banking business, and many transactions can be carried through from the start to finish by a home bank or subsidiary. In places where banks are not directly represented by such affiliated undertakings, they have working arrangements with correspondents so that the banks are in a position to undertake foreign banking business in any part of the world. The banks provide more than just a means for the settlement of debts between traders, both at home and abroad for the goods they buy and sell. They are also providers of credit and enable the company to release the capital which would otherwise be tied up in the goods exported. An outline of some of the services provided by banks for overseas traders is given. For centuries, the bill of exchange has been one of the chief means of settlement in trade. Its function is to enable a seller or exporter of goods to obtain cash as soon as possible after the dispatch of goods, and yet enable the buyer or importer to defer payment until the goods reach him or later.

Banking and Credit Control NOTES Self - Learning 208 Material There are many ways in which trade may be financed with bills of exchange. Two common ways are: 1. The exporter will draw a bill of exchange on the importer, or, by arrangement between the parties, on the importer's bank, for the amount of the exporter's invoice for the goods. Shipping documents (usually the invoice, marine insurance policy and the 'bill of lading' which is the shipowner's receipt for the goods) which will convey title to the goods are attached to the bill of exchange. The exporter will sell ('negotiate' in technical terms) the bill with the documents to a local banker. The receipt of the documents of title along with the bill means that, in effect, goods are in possession. Thus, the bank will be willing to pay the exporter practically the full amount of his invoice and bill. The bank will immediately forward the bill and the documents to its banking correspondents or agents in the importer's country to be presented to the importer, or the importer's bank as the case may be, for payment if the bill is payable on demand , or for acceptance if the bill is a 'term bill'. 2. The importer's bank, at its request, will arrange for its banking correspondents or agents in the exporter's country to accept a term bill drawn on them by the exporter, and to be accompanied by shipping documents mentioned in (1) above. (Such an arrangement is an example of 'opening credit' which is mentioned below). When the bill is accepted, it will be returned to the exporter who can either keep it until the period of the bill expires and then claim payment from the accepting bank, or, as is more likely in practice, sell the bill to his own or other banks. The accepting bank, upon accepting the bill, will detach the shipping documents and send them to the importer's bank. If a bill is payable on demand (i.e., a 'demand bill'), the importer, or his bank on his behalf if the bill is drawn on that bank, has to pay the whole amount when the bill is presented. If the bill is drawn payable at a later date (i.e., a 'time bill' or a 'term bill'), for example three months after presentation, it is, upon presentation, accepted by the importer if it is drawn on him, or by his bank on his behalf if it is drawn on it by special arrangement. But the importer is not called upon to pay until the three months are up. Usually the arrangement between the buyer and the seller will be that the shipping documents which accompany the bill are to be detached upon payment or acceptance of the bill by the importer or by a bank on his behalf. The documents thus become available to the buyer so that he can take delivery of the goods when the ship arrives, resell them in the ordinary way; and from the proceeds recoup himself or his bank, or make funds available to meet the bill when it matures. An overseas buyer may arrange through his bank in the home country to open a documentary credit in favour of the seller. This is an undertaking that the bank will honour drafts drawn in accordance with the terms of credit, if accompanied by stipulated shipping documents, insurance policies, etc., and presented not later than the date of expiry of the credit. The terms usually cover the nature, price and quantity of the goods, the method of shipment, the documents to be attached and

Banking and Credit Control NOTES Self - Learning Material 209 the date by which shipment must be effected. The creditor may undertake payment of a demand draft or acceptance of a term draft. It may be expressed in home currency or in foreign currency, this depending on the condition of sale. It may be either revocable or irrevocable. The former may be cancelled at any time but the latter cannot be cancelled without the consent of both the parties. Therefore, an irrevocable credit provides much greater protection to the exporter. If, for instance, a foreign importer has no account with an Indian bank, he will open the credit with his local bank. The exporter may, however, prefer to receive a corresponding advice that the credit is opened from an Indian bank. Consequently, it is usual for the foreign bank to instruct its Indian banking correspondent to advise the credit to the exporter. As an additional safeguard, an Indian exporter may require his bank not only to advice but also to undertake responsibility by adding its confirmation. This is known as a 'confirmed credit'. Having received the advice on shipment of the goods, the exporter must lodge the documents within the time allowed by the credit. If the documents are in order as stipulated in the credit, the exporter will receive immediate payment if it provides for sight payment. If it calls for a bill drawn payable after sight, the bank will accept the bill which will then be available for discount. If, for any reason, the exporter is unable to present the document he must request the importer to instruct the relevant bank to extend or amend the credit. In case where it is not possible to arrange a documentary credit and the arrangement is for payment to be made only when the goods have been sold, a bank can usually undertake the dispatch of the shipping documents and arrange the goods to be warehoused and insured in the name of a correspondent bank, pending delivery of the goods in part or in whole to the exporter's agent against payment. The correspondent bank will then remit proceeds of sales as and when they are made by the agent. Exporters who are dealing with first-class agents may be prepared to ship their goods on open account. In such cases, the exporter usually sends the documents directly by air mail to the consignee, who acts as his agent for the sale of the goods. Remittances, in order to avoid the inconveniences of collection, may be by a cheque on an Indian bank or by a telegraphic transfer. Information and Other Services As part of their comprehensive banking services, many banks act as a major source of information on overseas trade in all its aspects. Some banks produce regular bulletins on trade and economic conditions at home and abroad, and special reports on commodities and markets. In some cases, they invite enquiries from those wishing to extend their foreign trade, and are able through their correspondents to furnish the names of reputable and interested dealers of goods and commodities and to advise on the appointment of suitable agents. For businessmen travelling abroad, letters of introduction indicating the purpose of journey undertaken, can be issued addressed to banking correspondents in the various centres it is proposed to visit. In this way, it is often possible to establish new avenues of business. On request, banks obtain confidential opinions on the financial standing of companies, firms or individuals at home or overseas for customers for the purpose of business.

Banking and Credit Control NOTES Self - Learning 210 Material Commercial banks furnish advice and information of trade, outside its scope. If it is desired to set up a subsidiary or branch overseas(or, for an overseas company to set up in the home country) they provide detailed information on local legal requirements on company formation, tax requirements, exchange control and insurance, helping to establish contact with local banking organizations. To sum up, the services rendered by a modern commercial bank is of inestimable value. It constitutes the very life blood of an advanced economic society. In the words of Walter Leaf: 'The banker is the universal arbiter of the world's economy.' 5.7 PROCESS OF CREDIT CREATION From the previous analysis, it is clear that commercial banks always try to maintain their holdings of idle cash to the lowest extent possible. In their attempt to achieve this end, they unwittingly increase the total amount of money in circulation in the community. It, however, does not mean that they increase the total amount of legal tender currency which is an exclusive prerogative of the central bank. When it is said that a banker is lending money, he is actually lending money in the deposit credit with a right to the borrower to draw cheques against it. For instance, let us take the case of a loan granted to a customer. Instead of paying away the whole loan in the form of liquid cash, the bank will place the amount to the credit of the borrower. Thus, the borrower acquires a claim against the bank, just as a sum of money deposited by him with the bank creates a claim against the bank. Assuming the borrower draws cheques in favour of other people, they pay these cheques into their own banks for collection, and their deposits go up. Here one may agree with Hartley Withers in that ' every loan creates a deposit '. Again, by purchasing securities or any other banking assets also a bank is adding to the total supply of money. When the bank buys securities, it pays for them by its own cheque. This cheque, like a currency note issued by the central bank, is an IOU (' I Owe You') of the bank issuing it. And this is accepted by the seller of the securities because of his faith in the ability of the bank to produce cash on demand. The seller deposits this cheque in the very same bank or with any other bank where he has an account, thereby creating additional deposit money. Thus, the commercial banks as a system can and do increase the total amount of money in circulation by increasing the purchasing power of the people through the deposit money created by them. A close analytical study of the mechanism of banking will simplify matters more. Let us take the case of a community where there is only one bank and where the people are highly banking minded so that all transactions are settled by means of cheques. Further, let us assume that that total amount of legal tender currency in circulation is 10,000 and the bank knows by experience that 10 per cent of its deposits as cash reserves is sufficient to meet the demands of its customers. Since there is only one bank in the community, people will deposit all their money in this particular bank. The balance sheet of the bank would then be:
Banking and Credit Control NOTES Self - Learning Material 211 Liabilities Assets Deposits 10,000 Cash in Hand 10,000 According to our assumption, the bank need maintain a cash reserve of only 10 per cent of the deposits and can safely lend the balance amount of 9,000 to those who are in need of funds. The bank will place this amount to the credit of the borrowers, giving them the right to operate their accounts with cheques. Their deposits will consequently go up by this amount. The balance sheet of the bank, then, would be: Liabilities Assets Deposits (original) 10,000 Cash in Hand 10,000 Deposits (i.e. credit Balance of borrowers) 9,000 Loans to clients 9,000 19,000 19,000 These deposits, now standing to the credit of the borrowers are, as we know, claims against the bank. As such they command a purchasing power and hence they may be considered as good as money. Suppose the borrowers draw cheques in favour of their creditors. The payees of these cheques will not require liquid cash over the counter since they are highly banking minded, according to our supposition. On the other hand, they will deposit these cheques with our supposed single bank for collection. Here what happens is merely a transfer of the credit balance of the borrowers to the credit of the accounts of the payees of their cheques. In short, although the total amount of legal tender currency in circulation is only to the order of 10,000, our bank, through the process of creating additional deposit money, has brought into effective circulation an additional amount of 9,000, thereby raising the total supply of money from 10,000 to 19,000. The power of the bank to increase the amount of money in circulation does not come to an end here. It can further increase the supply of money. As shown in the above balance sheet, the amount of the deposits of the bank is now 19,000. The assumption is that the bank should maintain a cash reserve ratio of only 10 per cent. To maintain this, the bank only needs to provide an additional amount of 900 over and above the amount of 1,000 which it already maintains. Even then there is a balance of 8,100 in the vaults of the bank which it can lend without undergoing any risk. Now the balance sheet position would be: Liabilities Assets Deposits (original) 10,000 Cash in Hand 10,000 Deposits (deposited by the Payees of the cheques issued by the first borrowers 9,000 Loans to Clients. Deposits (credit balance of 9,000 Subsequent borrowers) 8,100 8,100 17,100 27,100 27,100 Here the bank has to keep an additional cash reserve of 810. The total cash reserves increase to 2,710. Still there is a balance of loanable funds with the bank, amounting to 7,290.

Banking and Credit Control NOTES Self - Learning 212 Material Thus, the bank can go on increasing the creation of additional money. However, there are questions that crop up. Is it possible for the bank to increase credit without any limit? Is the power of the bank to increase the supply of deposit money unlimited? The answer is definitely in the negative. Limitations on the Creation of Credit The power of commercial banks to create credit is limited mainly by the cash reserves which they have to hold against their deposits and the total amount of legal tender currency issued by the central bank. Every bank has to meet the demands of its customers to pay cash over the counter. So a working reserve of liquid cash is always necessary for a bank. Of course, if the people are highly banking minded, a lower cash reserve will be sufficient. But in the case of a community where the habits are not well developed, a higher cash reserve will be essential. In either case, a cash reserve is necessary. This acts as a brake on the power of the banks to create credit. To revert to the previous illustration, our supposed bank can go on creating further and further credit money till it finds that it has no more liquid cash to maintain the 10 per cent cash reserve ratio. In other words, it is in a position to supply more and more credit up to an additional amount of 90,000. If it wants to expand credit still further, either there should be an additional supply of liquid cash, which entirely is the sole prerogative of the central bank, or the cash ratio should be lowered which can be done only at its own peril. Moreover, a minimum cash reserve ratio is prescribed by law in most countries. Thus, a bank's power to create credit is limited by two factors, viz., the cash reserve ratio and the total amount of legal tender currency. So far the analysis was confined to a community where there is only one bank. This is not a realistic assumption. But admittedly, the multiplicity of banks will not make any material alteration in the mechanism of credit creation and the limitations on it. The banking system, taken as a whole, will be conducting its operations on the very same lines. The only difference is that if any bank tries in an isolated manner to expand credit more than the other banks, it will lose cash to other banks. So in the case of a network of branches, each bank will have to keep in step with the others whenever it is creating credit. In conclusion, commercial banks can increase the total amount of money in circulation through the process of credit creation. In the words of Sayers, ' Bankers

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are not merely purveyors of money, but also, in an important sense, manufacturers of money.' 5.8

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are not merely purveyors of money, but also, in an important sense, manufacturers of money.' 5.8

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are not merely purveyors of money, but also, in an important sense, manufacturers of money.' 5.8

MUDRA Pradhan Mantri MUDRA Yojana (PMMY) is a scheme launched by PM Modi for providing loans up to 10 lakh to the non-corporate, non-farm small/micro enterprises. These loans are classified as MUDRA loans under PMMY. These loans are given by Commercial Banks, RRBs, Small Finance Banks, MFIs and NBFCs. The borrower can approach any of the lending institutions mentioned above or can apply online through the portal www.udyamimitra.in . Under the aegis of PMMY, MUDRA has created three products namely 'Shishu', 'Kishore'

Banking and Credit Control NOTES Self - Learning Material 213 and 'Tarun' to signify the stage of growth/development and funding needs of the beneficiary micro unit/entrepreneur and also provide a reference point for the next phase of graduation/growth. The Micro Units Development & Refinance Agency Ltd (MUDRA) was set up by the Government of India (GoI). MUDRA has been initially formed as a wholly owned subsidiary of Small Industries Development bank of India (SIDBI) with 100% capital being contributed by it. Presently, the authorized capital of MUDRA is 1000 crores and paid up capital is 750 crore, fully subscribed by SIDBI. More capital is expected to enhance the functioning of MUDRA. This Agency would be responsible for developing and refinancing all Micro- enterprises sector by supporting the finance Institutions which are in the business of lending to micro / small business entities engaged in manufacturing, trading and service activities. MUDRA would partner with Banks, MFIs and other lending institutions at state level / regional level to provide micro finance support to the micro enterprise sector in the country. Micro Finance is an economic development tool whose objective is to provide income generating opportunities to the people at the bottom of the pyramid. It covers a range of services which include, in addition to the provision of credit, many other credit plus services, financial literacy and other social support services. Roles and Responsibilities of MUDRA MUDRA has been formed with primary objective of developing the micro enterprise sector in the country by extending various support including financial support in the form of refinance, so as to achieve the goal of funding the unfunded. The GOI Press release of 2 March 2015 has laid down the roles and responsibilities of MUDRA. Subsequently GOI has also decided that MUDRA will provide refinance support, monitor the PMMY data by managing the web portal, facilitate offering guarantees for loans granted under PMMY and take up other activities assigned to it from time to time. Accordingly, MUDRA has been carrying out these functions over the last one year. 5.8.1 Jan Dhan Yojana Pradhan Mantri Jan-Dhan Yojana (PMJDY) is National Mission for Financial Inclusion to ensure access to financial services, namely, Banking/ Savings & Deposit Accounts, Remittance, Credit, Insurance, Pension in an affordable manner. It was initially launched for a period of 4 years on 28th August 2014. The scheme envisages

Later on, the Government decided to extend the comprehensive PMJDY program beyond 28.8.2018 with the change in focus on opening accounts from 'every household' to 'every adult'. Under the scheme, an account can be opened in any bank branch or Business Correspondent (Bank Mitr) outlet. Accounts opened under PMJDY are being
Banking and Credit Control NOTES Self - Learning 214 Material opened with Zero balance. However, if the account-holder wishes to get cheque book, he/she will have to fulfil minimum balance criteria. PMJDY has also provided a platform for the three social security schemes viz. Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY), Pradhan Mantri Suraksha Bima Yojana (PMSBY), Atal Pension Yojana (APY) and Pradhan Mantri Mudra Yojana (PMMY). Under the scheme, an account can be opened by presenting an officially valid document such as a passport, driving license, PAN card, Voter I Card, job card issued by NREGA, Aadhaar, or any other document as notified by the Central Government in consultation with the regulator. Check Your Progress 8. What are commercial banks? 9. Mention the different types of letter of credits. 10. Define budget accounts. 11. What is SWIFT? 5.9 ANSWERS TO 'CHECK YOUR PROGRESS' 1. The power of commercial banks to create credit is limited mainly by the cash reserves which they have to hold against their deposits and the total amount of legal tender currency issued by the central bank. 2. The principles of credit control by the central bank were discovered and enunciated after the publication of Bagehot's Lombard Street in 1873. 3. The extent of success of central bank's open market operations mainly depends on (i) the stage of development of the money and capital markets in the economy, and (ii) the extent to which the central bank is prepared to indulge in the buying and selling operations. 4. 'Moral Suasion' implies persuasion of banks to follow certain lines of policies, impressing upon them the necessity to do so. 5. Monetary policy is essentially a programme of action undertaken by the monetary authorities, generally the central bank, to control and regulate the demand for and supply of money with the public and the flow of credit with a view to achieving predetermined macroeconomic goal 6. The scope of monetary policy depends, by and large, on two factors. (i) The level of monetized economy and (ii) The level of development of the capital market. 7. In addition to traditional monetary control measures, RBI uses repo rate (repurchase operation rate) and reverse repo rate under its Liquidity Adjustment Facility (LAF) programme. Repo rate is the rate that RBI charges the banks when they borrow from the RBI. Reverse repo rate is the rate

Banking and Credit Control NOTES Self - Learning Material 215 that it offers the banks willing to keep their money with it. Depending on the need of the country, the RBI keeps changing these rates. Repo operation increases liquidity and reverse repo rate reduces the liquidity (or money supply) in the country. 8. A commercial bank is a type of financial intermediary. Commercial banking is also known as business banking. 9. The following are the different types of letter of credit: o When the promise to accept is conditional on the receipt of documents of title to goods, it is called a 'documentary letter of credit'. o When the promise is unconditional, it is called a 'clean letter of credit'. o A 'revocable letter of credit' is one which can be cancelled at any time by the issuing banker. An 'irrevocable letter of credit' is one which cannot be cancelled before the expiry of the period of its currency. o 'Circular letters of credit' are generally intended for travellers who may require money in different countries. They may be divided into 'travellers letter of credit' and 'guarantee letters of credit'. A 'travellers letter of credit' carries the instruction of the issuing bank to its foreign agents to honour the beneficiary's drafts, cheques, etc., to a stated amount which it undertakes to meet on presentation. 10. Banks are opening budget accounts for credit-worthy customers. The bank guarantees to pay, for a specific charge, certain types of annual bills (e.g., fuel bills, rates, etc.,) promptly as they become due, while repayments are spread over a twelve-monthly period from the customer's account. 11. SWIFT (Society for Worldwide Interbank Financial Telecommunications), an organization promoted by banks and financial institutions around the world, is utilized to facilitate the speedy transfer of funds across international destinations without any paperwork and expeditious efficiency. SWIFT is the largest network in the world which has around 4,800 users in 130 countries. 5.10 SUMMARY ?Banking plays a pivotal role in modern trade and commerce. Banks perform the twin functions of accepting deposits from the public and making loans to needy and deserving people in society. Deposits become liabilities and loans appear on the assets side of their balance sheets. Banks lend money to different categories of borrowers. The interest received on those loans becomes their primary source of income and the interest on deposits constitutes the main item of expenditure for a bank. ?Banks in India are regulated by the Banking Regulation Act, 1949. The repayment of deposit on demand is a necessary requirement to qualify to become a bank.
Banking and Credit Control NOTES Self - Learning 216 Material ?Banks in India are classified into the following categories in accordance to their functions, which include the following: o Central Bank o Commercial Banks o Development Banks o Cooperative Banks o Specialized Banks ?The central bank is an important financial institution in every sovereign independent state in modern times. It is the apex of an economy's monetary and banking system. ?The functions of a central bank are different from those of commercial banks. ?The preamble to the Reserve Bank of India Act, 1934, lays down the object of

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the RBI to be 'to regulate the issue of bank notes and the keeping of reserve with a view to securing monetary stability

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to regulate the issue of bank notes and the keeping of reserve with a view to securing monetary stability in

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India and generally to operate the currency and credit system of the country to its advantage'. The

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and generally to operate the currency and credit system of the country to its advantage'.

financial system of India, before the establishment of the RBI, had been utterly inadequate mainly because of the dual control of currency by the government and of credit by the Imperial Bank. ?The central bank employs several monetary instruments to control aggregate credit in the country. While some of these instruments like the open market operations, minimum legal cash reserve ratio and the bank rate, are indirect and traditional, others like the rationing of credit and direct credit control are relatively new having been evolved recently. ?Besides quantitative controls discussed above, the RBI may resort to qualitative restrictions to make effective its monetary policy measures. ?The instruments of monetary policy refer to the monetary variables that the central bank can change at its discretion with a view to controlling and regulating the money supply and the availability of credit. ?The quantitative measures or the traditional measures of monetary control are following: (i) Open Market Operations, (ii) Discount Rate or Bank rate and (iii) Cash Reserve Ratio (CRR) ?The objectives of credit control are not well served by the quantitative measures of credit control. The monetary authorities then resort to selective credit controls like rationing of credit, changing lending margins and moral suasion minimum legal cash reserve ratio of 10 per cent required against the demand deposits and of 3 per cent required against the time deposits, ?The quantitative methods of monetary control affect the entire credit market in the same direction. their impact on all the sectors of the economy is uniform ?The effectiveness of monetary policy, or any policy for that matter, depends on a number of factors. I)Time Lag, ii) Problem in Forecasting iii) Non-
Banking and Credit Control NOTES Self - Learning Material 217 banking financial intermediaries iv) Underdevelopment of money and capital market. ?The power of commercial banks to create credit is limited mainly by the cash reserves which they have to hold against their deposits and the total amount of legal tender currency issued by the central bank. ? Commercial banks can increase the total amount of money in circulation through the process of credit creation. In the words of Sayers, 'Bankers

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are not merely purveyors of money, but also, in an important sense, manufacturers of money.' ?

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are not merely purveyors of money, but also, in an important sense, manufacturers of money.' ?

The two essential functions of a commercial bank may best be summarized as the borrowing and the lending of money. ?Commercial banks can increase the total amount of money in circulation through the process of credit creation. ? MUDRA has been formed with primary objective of developing the micro enterprise sector in the country by extending various support including financial support in the form of refinance, so as to achieve the goal of funding the unfunded. ? The

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Jan Dhan Yojana scheme envisages universal access to banking facilities with at least one basic banking account for every household, financial literacy, access to credit, insurance and pension. 5.11

KEY TERMS ?Discount Rate or

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Bank Rate Policy: It is the rate at which the central bank rediscounts the bills of exchange

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Bank Rate Policy: It is the rate at which the central bank

presented by the commercial banks. ?Cash Reserve Ratio or Statutory Reserve Ratio : It is the percentage

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of total deposits which commercial banks are required to maintain in the form of cash

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commercial banks are required to maintain in the form of

the central bank. ?Banker's draft: It is an order, addressed by one office of a bank to any other of its branches or by any one bank to another, to pay a specified sum to the person concerned. ?Circular notes: These are cheques on the issuing banker for certain round sums in his own currency. ?Bank rate: It is the rate which the central bank charges on the loans and advances to the commercial banks. ?Pradhan Mantri MUDRA Yojana (PMMY): It is a scheme launched by PM Modi for providing loans up to 10 lakh to the non-corporate, non-farm small/microenterprises. ?Micro Finance: It is an economic development tool whose objective is to provide income generating opportunities to the people at the bottom of the pyramid.

Banking and Credit Control NOTES Self - Learning 218 Material 5.12 SELF-ASSESSMENT QUESTIONS AND EXERCISES Short-Answer Questions 1. Briefly mention the significant functions of Reserve Bank of India. 2. What are the main reasons to grant monopoly of note-issue to the central bank? 3. Mention the instruments of credit control. 4. What is the scope of monetary policy? 5. List the limitations of monetary policy. 6. What are the various ways to do selective credit controls? 7. What are the limitations of credit creation? 8. What are the roles and responsibilities of MUDRA? 9. Write a short note on Jan Dhan yojana. Long-Answer Questions 1. Describe the special functions of the central bank in a free enterprise economy. 2. Elaborate the various processes of credit control. 3. Give a detailed explanation of all the functions of the commercial banks. 5.13 FURTHER READING Mankiw, N Gregory. 2010. Macroeconomics . New York: Worth Publishers. Shapiro, Edward. 1996. Macroeconomic Analysis . New Delhi: Galgotia Publication. Jha, R. 1999. Contemporary Macroeconomic Theory and Policy . New Delhi: New Age International. Gupta, SB. 2011. Monetary Economics: Instruments and Policy . New Delhi: S Chand & Co.

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a) they hire factors of production from the households and (b) they produce and sell their final products to the households.

SA B.A. Prog principles Macro Eco-I.doc (D110585671)

10/683 **SUBMITTED TEXT** 21 WORDS **64%** **MATCHING TEXT** 21 WORDS

a) they hire factors of production from the households and (b) they produce and sell their final products to the households.

SA Introductory Microeconomics.pdf (D110811121)

11/683 **SUBMITTED TEXT** 21 WORDS **64%** **MATCHING TEXT** 21 WORDS

a) they hire factors of production from the households and (b) they produce and sell their final products to the households.

SA Introductory Microeconomics.pdf (D110840503)

12/683 **SUBMITTED TEXT** 21 WORDS **64%** **MATCHING TEXT** 21 WORDS

a) they hire factors of production from the households and (b) they produce and sell their final products to the households.

SA Introductory Microeconomics.pdf (D110864780)

Ouriginal by Turnitin

13/683	SUBMITTED TEXT	21 WORDS	64%	MATCHING TEXT	21 WORDS

a) they hire factors of production from the households and (b) they produce and sell their final products to the households.

SA Introductory Macroeconomics.pdf (D110867721)

14/683	SUBMITTED TEXT	21 WORDS	64%	MATCHING TEXT	21 WORDS

a) they hire factors of production from the households and (b) they produce and sell their final products to the households.

SA Introductory Microeconomics.pdf (D110843122)

15/683	SUBMITTED TEXT	14 WORDS	90%	MATCHING TEXT	14 WORDS

OBJECTIVES After going through this unit, you will be able to: ?Explain the practical and

SA Macro Economics I.pdf (D138997544)

16/683	SUBMITTED TEXT	23 WORDS	87%	MATCHING TEXT	23 WORDS

macroeconomics concerns itself with such variables as aggregate volume of an economy, with the extent to which its resources are employed, with size of

SA B.A. Prog principles Macro Eco-I.doc (D110585671)

17/683	SUBMITTED TEXT	26 WORDS	91%	MATCHING TEXT	26 WORDS

such variables as aggregate volume of an economy, with the extent to which its resources are employed, with size of the national income, with the 'general price level'."

SA 17.4.23 Macroeconomiics(2).doc (D164309062)

18/683	SUBMITTED TEXT	38 WORDS	78%	MATCHING TEXT	38 WORDS

macroeconomics concerns itself with such variables as aggregate volume of an economy, with the extent to which its resources are employed, with size of the national income, with the 'general price level'." Kenneth E Boulding: "Macroeconomics is the study of

SA Sambalpur-BBA-SEM-III-Macroeconomics.pdf (D156210285)

Ouriginal by Turnitin

19/683	SUBMITTED TEXT	24 WORDS	98%	MATCHING TEXT	24 WORDS

not with individual incomes, but the national income, not with individual prices, but with the price levels, not with individual output, but with the national output".

SA Sambalpur-BBA-SEM-III-Macroeconomics.pdf (D156210285)

20/683	SUBMITTED TEXT	38 WORDS	84%	MATCHING TEXT	38 WORDS

Macroeconomics ... deals not with individual quantities as such, but aggregates of these quantities ... not with individual incomes, but the national income, not with individual prices, but with the price levels, not with individual output, but with the national output".

SA Macro Economics I.pdf (D138997544)

21/683	SUBMITTED TEXT	37 WORDS	79%	MATCHING TEXT	37 WORDS

aggregates of these quantities ... not with individual incomes, but the national income, not with individual prices, but with the price levels, not with individual output, but with the national output". J. M. Culburtson: "Macroeconomic theory is the theory of

SA 17.4.23 Macroeconomiics(2).doc (D164309062)

22/683	SUBMITTED TEXT	16 WORDS	62%	MATCHING TEXT	16 WORDS

Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

SA B.A. Prog principles Macro Eco-I.doc (D110585671)

23/683	SUBMITTED TEXT	16 WORDS	62%	MATCHING TEXT	16 WORDS

Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

SA Introductory Microeconomics.pdf (D110811121)

24/683	SUBMITTED TEXT	16 WORDS	62%	MATCHING TEXT	16 WORDS

Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

SA Introductory Microeconomics.pdf (D110840503)

Ouriginal by Turnitin

25/683 **SUBMITTED TEXT** 16 WORDS **62%** **MATCHING TEXT** 16 WORDS

Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

SA Introductory Microeconomics.pdf (D110864780)

26/683 **SUBMITTED TEXT** 16 WORDS **62%** **MATCHING TEXT** 16 WORDS

Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

SA Introductory Macroeconomics.pdf (D110867721)

27/683 **SUBMITTED TEXT** 16 WORDS **62%** **MATCHING TEXT** 16 WORDS

Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

SA Introductory Microeconomics.pdf (D110843122)

28/683 **SUBMITTED TEXT** 11 WORDS **100%** **MATCHING TEXT** 11 WORDS

fiscal and monetary policies of India failed to achieve their goals?

SA 4-PRINCIPLES OF MACRO--GE Eco(Hons.) Sem-II SLM.pdf (D143600893)

29/683 **SUBMITTED TEXT** 11 WORDS **100%** **MATCHING TEXT** 11 WORDS

fiscal and monetary policies of India failed to achieve their goals?

SA economic_environment_for_business - Copy.docx (D143644113)

30/683 **SUBMITTED TEXT** 12 WORDS **95%** **MATCHING TEXT** 12 WORDS

to study the system as a whole, to explain the behaviour of

To study the system as a whole and to explain the behaviour of

W https://mu.ac.in/wp-content/uploads/2021/11/Elements-of-Macroeconomics-English-Version.pdf

Ouriginal by Turnitin

31/683	SUBMITTED TEXT	12 WORDS	95%	MATCHING TEXT	12 WORDS

to study the system as a whole, to explain the behaviour of

To study the system as a whole and to explain the behaviour of

W https://scholarsclasses.com/blog/wp-content/uploads/2022/05/Elements-of-Macroeconomics-English-Ve ...

32/683	SUBMITTED TEXT	13 WORDS	76%	MATCHING TEXT	13 WORDS

constituent elements of the aggregate. Therefore, the 'conclusions drawn from the analysis of

constituent elements of the aggregate. Hence conclusions drawn from the analysis of

W https://mu.ac.in/wp-content/uploads/2021/11/Elements-of-Macroeconomics-English-Version.pdf

33/683	SUBMITTED TEXT	13 WORDS	76%	MATCHING TEXT	13 WORDS

constituent elements of the aggregate. Therefore, the 'conclusions drawn from the analysis of

constituent elements of the aggregate. Hence conclusions drawn from the analysis of

W https://scholarsclasses.com/blog/wp-content/uploads/2022/05/Elements-of-Macroeconomics-English-Ve ...

34/683	SUBMITTED TEXT	27 WORDS	89%	MATCHING TEXT	27 WORDS

not with individual, incomes, but with the national income, not with individual prices, but with the [general] price level, not .with individual output, but with the national output."

SA Sambalpur-BBA-SEM-III-Macroeconomics.pdf (D156210285)

35/683	SUBMITTED TEXT	38 WORDS	69%	MATCHING TEXT	38 WORDS

of these quantities—not with individual, incomes, but with the national income, not with individual prices, but with the [general] price level, not .with individual output, but with the national output." In brief, macroeconomics studies the working and performance of the

SA 17.4.23 Macroeconomiics(2).doc (D164309062)

Ouriginal by Turnitin

36/683	SUBMITTED TEXT	51 WORDS	62%	MATCHING TEXT	51 WORDS

Macroeconomics... deals not with individual quantities as such, but aggregate of these quantities—not with individual, incomes, but with the national income, not with individual prices, but with the [general] price level, not .with individual output, but with the national output." In brief, macroeconomics studies the working and performance of the economy as a whole.

SA Macro Economics I.pdf (D138997544)

37/683	SUBMITTED TEXT	35 WORDS	86%	MATCHING TEXT	35 WORDS

Macroeconomics uses certain economic aggregates, called macroeconomic variables , to assess the performance and to analyze the behaviour of an economy. Macroeconomic variables that figure in macroeconomic studies are generally grouped under (i) stock variables , and (

SA 4-PRINCIPLES OF MACRO--GE Eco(Hons.) Sem-II SLM.pdf (D143600893)

38/683	SUBMITTED TEXT	16 WORDS	62%	MATCHING TEXT	16 WORDS

only two sectors, viz., households and firms, and there is no government and no foreign trade.

only two – sectors, the household and business firms which represent a closed economy and there is no government and no foreign trade.

W https://mu.ac.in/wp-content/uploads/2021/11/Elements-of-Macroeconomics-English-Version.pdf

39/683	SUBMITTED TEXT	16 WORDS	62%	MATCHING TEXT	16 WORDS

only two sectors, viz., households and firms, and there is no government and no foreign trade.

only two – sectors, the household and business firms which represent a closed economy and there is no government and no foreign trade.

W https://scholarsclasses.com/blog/wp-content/uploads/2022/05/Elements-of-Macroeconomics-English-Ve ...

40/683	SUBMITTED TEXT	35 WORDS	86%	MATCHING TEXT	35 WORDS

Macroeconomics uses certain economic aggregates, called macroeconomic variables , to assess the performance and to analyze the behaviour of an economy. Macroeconomic variables that figure in macroeconomic studies are generally grouped under (i) stock variables , and (

SA economic_environment_for_business - Copy.docx (D143644113)

Ouriginal by Turnitin

41/683	SUBMITTED TEXT	20 WORDS	84%	MATCHING TEXT	20 WORDS

hire factors of production from the households; (ii) they produce and sell goods and services to the households; and (

SA B.A. Prog principles Macro Eco-I.doc (D110585671)

42/683	SUBMITTED TEXT	20 WORDS	81%	MATCHING TEXT	20 WORDS

hire factors of production from the households; (ii) they produce and sell goods and services to the households; and (

SA Introductory Microeconomics.pdf (D110811121)

43/683	SUBMITTED TEXT	20 WORDS	81%	MATCHING TEXT	20 WORDS

hire factors of production from the households; (ii) they produce and sell goods and services to the households; and (

SA Introductory Microeconomics.pdf (D110840503)

44/683	SUBMITTED TEXT	20 WORDS	81%	MATCHING TEXT	20 WORDS

hire factors of production from the households; (ii) they produce and sell goods and services to the households; and (

SA Introductory Microeconomics.pdf (D110864780)

45/683	SUBMITTED TEXT	20 WORDS	81%	MATCHING TEXT	20 WORDS

hire factors of production from the households; (ii) they produce and sell goods and services to the households; and (

SA Introductory Macroeconomics.pdf (D110867721)

46/683	SUBMITTED TEXT	20 WORDS	81%	MATCHING TEXT	20 WORDS

hire factors of production from the households; (ii) they produce and sell goods and services to the households; and (

SA Introductory Microeconomics.pdf (D110843122)

Ouriginal by Turnitin

47/683	SUBMITTED TEXT	15 WORDS	73%	MATCHING TEXT	15 WORDS

firms to the households in the form of factor payments as wages, interest, rent and

SA Macro Eco SLM after Review.docx (D46015425)

48/683	SUBMITTED TEXT	15 WORDS	73%	MATCHING TEXT	15 WORDS

firms to the households in the form of factor payments as wages, interest, rent and

SA Macro Eco SLM after Review.docx (D46015354)

49/683	SUBMITTED TEXT	15 WORDS	73%	MATCHING TEXT	15 WORDS

firms to the households in the form of factor payments as wages, interest, rent and

SA Macro Eco SLM after Review.docx (D46016358)

50/683	SUBMITTED TEXT	15 WORDS	80%	MATCHING TEXT	15 WORDS

from the households to the firms in the form of payments for goods and services.

SA 4-PRINCIPLES OF MACRO--GE Eco(Hons.) Sem-II SLM.pdf (D143600893)

51/683	SUBMITTED TEXT	15 WORDS	80%	MATCHING TEXT	15 WORDS

from the households to the firms in the form of payments for goods and services.

SA economic_environment_for_business - Copy.docx (D143644113)

52/683	SUBMITTED TEXT	17 WORDS	69%	MATCHING TEXT	17 WORDS

is simply the aggregate of factor earnings, it excludes capital consumption allowance, government, business and individual transfer payments

SA BA IInd semester EC103 final2 AMU.docx (D142326393)

53/683	SUBMITTED TEXT	17 WORDS	69%	MATCHING TEXT	17 WORDS

is simply the aggregate of factor earnings, it excludes capital consumption allowance, government, business and individual transfer payments

SA BA IInd semester EC103 final2 AMU.docx (D142429509)

Ouriginal by Turnitin

54/683	SUBMITTED TEXT	13 WORDS	95%	MATCHING TEXT	13 WORDS

the market value of the final goods and services produced in the

SA Introductory Microeconomics.pdf (D110811121)

55/683	SUBMITTED TEXT	13 WORDS	95%	MATCHING TEXT	13 WORDS

the market value of the final goods and services produced in the

SA Introductory Microeconomics.pdf (D110840503)

56/683	SUBMITTED TEXT	13 WORDS	95%	MATCHING TEXT	13 WORDS

the market value of the final goods and services produced in the

SA Introductory Microeconomics.pdf (D110864780)

57/683	SUBMITTED TEXT	13 WORDS	95%	MATCHING TEXT	13 WORDS

the market value of the final goods and services produced in the

SA Introductory Macroeconomics.pdf (D110867721)

58/683	SUBMITTED TEXT	13 WORDS	95%	MATCHING TEXT	13 WORDS

the market value of the final goods and services produced in the

SA Introductory Microeconomics.pdf (D110843122)

59/683	SUBMITTED TEXT	18 WORDS	83%	MATCHING TEXT	18 WORDS

the market value of the final goods and services produced in the economy during any given time period

SA 6.3 Economics for Business Block 3.pdf (D165800765)

60/683	SUBMITTED TEXT	12 WORDS	100%	MATCHING TEXT	12 WORDS

the total market value of all final goods and services produced in

the total market value of all final goods and services produced in

W https://mu.ac.in/wp-content/uploads/2021/11/Elements-of-Macroeconomics-English-Version.pdf

Ouriginal by Turnitin

61/683	SUBMITTED TEXT	12 WORDS	100%	MATCHING TEXT	12 WORDS

the total market value of all final goods and services produced in

the total market value of all final goods and services produced in

W https://scholarsclasses.com/blog/wp-content/uploads/2022/05/Elements-of-Macroeconomics-English-Ve ...

62/683	SUBMITTED TEXT	12 WORDS	100%	MATCHING TEXT	12 WORDS

the total market value of all final goods and services produced in

SA Original_Macroeconomics-amp-Business-Environment.docx (D117056979)

63/683	SUBMITTED TEXT	12 WORDS	100%	MATCHING TEXT	12 WORDS

the total market value of all final goods and services produced in

SA MEBE.pdf (D113066356)

64/683	SUBMITTED TEXT	17 WORDS	64%	MATCHING TEXT	17 WORDS

is referred to as the total market value of all final goods and services produced in the

SA 17.4.23 Macroeconomiics(2).doc (D164309062)

65/683	SUBMITTED TEXT	17 WORDS	73%	MATCHING TEXT	17 WORDS

market value of all final goods and services produced in the country within a specific time period,

SA 6.3 Economics for Business Block 3.pdf (D165800765)

66/683	SUBMITTED TEXT	12 WORDS	100%	MATCHING TEXT	12 WORDS

is defined as the value of all final goods and services produced

SA Original_Macroeconomics-amp-Business-Environment.docx (D117056979)

Ouriginal by Turnitin

67/683 **SUBMITTED TEXT** 12 WORDS **100%** **MATCHING TEXT** 12 WORDS

is defined as the value of all final goods and services produced

SA MEBE.pdf (D113066356)

68/683 **SUBMITTED TEXT** 24 WORDS **51%** **MATCHING TEXT** 24 WORDS

It is the most comprehensive measure of the nation's productive activities. The GNP is defined as the value of all final goods and services produced

SA 4-PRINCIPLES OF MACRO--GE Eco(Hons.) Sem-II SLM.pdf (D143600893)

69/683 **SUBMITTED TEXT** 13 WORDS **100%** **MATCHING TEXT** 13 WORDS

GNP is defined as the value of all final goods and services produced

SA PAPER CP 202 FULL PDF.pdf (D165318885)

70/683 **SUBMITTED TEXT** 24 WORDS **51%** **MATCHING TEXT** 24 WORDS

It is the most comprehensive measure of the nation's productive activities. The GNP is defined as the value of all final goods and services produced

SA economic_environment_for_business - Copy.docx (D143644113)

71/683 **SUBMITTED TEXT** 15 WORDS **83%** **MATCHING TEXT** 15 WORDS

GNP is defined as the value of all final goods and services produced during a

GNP) is as the total value of all the final goods and services produced a

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

72/683 **SUBMITTED TEXT** 13 WORDS **76%** **MATCHING TEXT** 13 WORDS

defined as the total output of final goods and services produced by the

defined as the total value of all the final goods and services produced by all the

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

Ouriginal by Turnitin

73/683	SUBMITTED TEXT	13 WORDS	80%	MATCHING TEXT	13 WORDS

defined as the total output of final goods and services produced by the

SA BA IInd semester EC103 final2 AMU.docx (D142326393)

74/683	SUBMITTED TEXT	13 WORDS	80%	MATCHING TEXT	13 WORDS

defined as the total output of final goods and services produced by the

SA BA IInd semester EC103 final2 AMU.docx (D142429509)

75/683	SUBMITTED TEXT	17 WORDS	73%	MATCHING TEXT	17 WORDS

It can be defined as the total output of final goods and services produced by the nationals

SA final book.docx (D143611479)

76/683	SUBMITTED TEXT	19 WORDS	52%	MATCHING TEXT	19 WORDS

defined as the total output of final goods and services produced by the nationals or residents of a country

SA Introductory Microeconomics.pdf (D110811121)

77/683	SUBMITTED TEXT	19 WORDS	52%	MATCHING TEXT	19 WORDS

defined as the total output of final goods and services produced by the nationals or residents of a country

SA Introductory Microeconomics.pdf (D110840503)

78/683	SUBMITTED TEXT	13 WORDS	88%	MATCHING TEXT	13 WORDS

value of the final goods and services produced by the residents of a

SA 17.4.23 Macroeconomiics(2).doc (D164309062)

79/683	SUBMITTED TEXT	11 WORDS	95%	MATCHING TEXT	11 WORDS

the amount of goods and services that an economy produces during

SA B.A. Prog principles Macro Eco-I.doc (D110585671)

Ouriginal by Turnitin

80/683	SUBMITTED TEXT	17 WORDS	82%	MATCHING TEXT	17 WORDS

the total money value of the final goods and services produced by the residents of a country.

SA 4-PRINCIPLES OF MACRO--GE Eco(Hons.) Sem-II SLM.pdf (D143600893)

81/683	SUBMITTED TEXT	18 WORDS	63%	MATCHING TEXT	18 WORDS

of the total money value of the final goods and services produced by the residents of a country.

SA slm business eco macro - complete.docx (D44840960)

82/683	SUBMITTED TEXT	18 WORDS	63%	MATCHING TEXT	18 WORDS

of the total money value of the final goods and services produced by the residents of a country.

SA NJ.docx (D45656676)

83/683	SUBMITTED TEXT	18 WORDS	63%	MATCHING TEXT	18 WORDS

of the total money value of the final goods and services produced by the residents of a country.

SA for plag.docx (D45796083)

84/683	SUBMITTED TEXT	18 WORDS	69%	MATCHING TEXT	18 WORDS

the total money value of all the final goods and services produced by the residents of a country

the total value of all the final goods and services produced by all the enterprises within the domestic territory of a country

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

85/683	SUBMITTED TEXT	17 WORDS	82%	MATCHING TEXT	17 WORDS

the total money value of the final goods and services produced by the residents of a country.

SA economic_environment_for_business - Copy.docx (D143644113)

Ouriginal by Turnitin

86/683	SUBMITTED TEXT	20 WORDS	70%	MATCHING TEXT	20 WORDS

as the total money value of all the final goods and services produced by the residents of a country during

SA 17.4.23 Macroeconomiics(2).doc (D164309062)

87/683	SUBMITTED TEXT	23 WORDS	77%	MATCHING TEXT	23 WORDS

the total money value of all the final goods and services produced by the residents of a country during any given period of time,

SA 4-PRINCIPLES OF MACRO--GE Eco(Hons.) Sem-II SLM.pdf (D143600893)

88/683	SUBMITTED TEXT	23 WORDS	77%	MATCHING TEXT	23 WORDS

the total money value of all the final goods and services produced by the residents of a country during any given period of time,

SA economic_environment_for_business - Copy.docx (D143644113)

89/683	SUBMITTED TEXT	20 WORDS	62%	MATCHING TEXT	20 WORDS

final goods and services produced by the residents of a country during any given period of time, usually one year .

SA Original_Macroeconomics-amp-Business-Environment.docx (D117056979)

90/683	SUBMITTED TEXT	15 WORDS	80%	MATCHING TEXT	15 WORDS

Gross national product (GNP) is the total output of the final goods and services produced

Gross national product (GNP) is defined as the total value of all the final goods and services produced

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

91/683	SUBMITTED TEXT	20 WORDS	62%	MATCHING TEXT	20 WORDS

final goods and services produced by the residents of a country during any given period of time, usually one year .

SA MEBE.pdf (D113066356)

92/683 **SUBMITTED TEXT** 15 WORDS **66%** **MATCHING TEXT** 15 WORDS

Gross national product (GNP) is the total output of the final goods and services produced

SA slm business eco macro - complete.docx (D44840960)

93/683 **SUBMITTED TEXT** 15 WORDS **66%** **MATCHING TEXT** 15 WORDS

Gross national product (GNP) is the total output of the final goods and services produced

SA NJ.docx (D45656676)

94/683 **SUBMITTED TEXT** 15 WORDS **66%** **MATCHING TEXT** 15 WORDS

Gross national product (GNP) is the total output of the final goods and services produced

SA for plag.docx (D45796083)

95/683 **SUBMITTED TEXT** 15 WORDS **66%** **MATCHING TEXT** 15 WORDS

Gross national product (GNP) is the total output of the final goods and services produced

SA Macro Eco SLM after Review.docx (D46015425)

96/683 **SUBMITTED TEXT** 15 WORDS **66%** **MATCHING TEXT** 15 WORDS

Gross national product (GNP) is the total output of the final goods and services produced

SA Macro Eco SLM after Review.docx (D46015354)

97/683 **SUBMITTED TEXT** 21 WORDS **59%** **MATCHING TEXT** 21 WORDS

national product is the total money value of the total final goods and services produced by the residents of a country

SA NJ.docx (D45656676)

Ouriginal by Turnitin

98/683	SUBMITTED TEXT	21 WORDS	59%	MATCHING TEXT	21 WORDS

national product is the total money value of the total final goods and services produced by the residents of a country

SA slm business eco macro - complete.docx (D44840960)

99/683	SUBMITTED TEXT	23 WORDS	62%	MATCHING TEXT	23 WORDS

is the total money value of the total final goods and services produced by the residents of a country during any given time period,

SA 4-PRINCIPLES OF MACRO--GE Eco(Hons.) Sem-II SLM.pdf (D143600893)

100/683	SUBMITTED TEXT	23 WORDS	62%	MATCHING TEXT	23 WORDS

is the total money value of the total final goods and services produced by the residents of a country during any given time period,

SA economic_environment_for_business - Copy.docx (D143644113)

101/683	SUBMITTED TEXT	18 WORDS	77%	MATCHING TEXT	18 WORDS

goods and services produced by the residents of a country during any given time period, which is usually

SA BA IInd semester EC103 final2 AMU.docx (D142429509)

102/683	SUBMITTED TEXT	18 WORDS	77%	MATCHING TEXT	18 WORDS

goods and services produced by the residents of a country during any given time period, which is usually

SA BA IInd semester EC103 final2 AMU.docx (D142326393)

103/683	SUBMITTED TEXT	14 WORDS	76%	MATCHING TEXT	14 WORDS

product is the total money value of all these final goods and services

Product is the total value of all the final goods and services

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

Ouriginal by Turnitin

104/683	SUBMITTED TEXT	15 WORDS	78%	MATCHING TEXT	15 WORDS

national product is the total money value of all these final goods and services

SA Original_Macroeconomics-amp-Business-Environment.docx (D117056979)

105/683	SUBMITTED TEXT	15 WORDS	78%	MATCHING TEXT	15 WORDS

national product is the total money value of all these final goods and services

SA MEBE.pdf (D113066356)

106/683	SUBMITTED TEXT	18 WORDS	65%	MATCHING TEXT	18 WORDS

the net national product is the total money value of all these final goods and services after providing for

the net national product. It means the market value of all the final goods and services after providing for

W https://mu.ac.in/wp-content/uploads/2021/11/Elements-of-Macroeconomics-English-Version.pdf

107/683	SUBMITTED TEXT	18 WORDS	65%	MATCHING TEXT	18 WORDS

the net national product is the total money value of all these final goods and services after providing for

the net national product. It means the market value of all the final goods and services after providing for

W https://scholarsclasses.com/blog/wp-content/uploads/2022/05/Elements-of-Macroeconomics-English-Ve ...

108/683	SUBMITTED TEXT	11 WORDS	95%	MATCHING TEXT	11 WORDS

gross national product (GNP), net national product (NNP), national income (NI)

Gross National Product (GNP), Net National Product (NNP) and National Income (NI)? 5. '

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

109/683	SUBMITTED TEXT	15 WORDS	71%	MATCHING TEXT	15 WORDS

national product is the total money value of all these final goods and services

SA final book.docx (D143611479)

110/683	SUBMITTED TEXT	10 WORDS	100%	MATCHING TEXT	10 WORDS

Gross National Product (GNP); Net National Product (NNP); National Income (

SA economic_environment_for_business - Copy.docx (D143644113)

Ouriginal by Turnitin

111/683	SUBMITTED TEXT	11 WORDS	100%	MATCHING TEXT	11 WORDS

gross national product (GNP), net national product (NNP), national income (NI)

SA economic_environment_for_business - Copy.docx (D143644113)

112/683	SUBMITTED TEXT	12 WORDS	100%	MATCHING TEXT	12 WORDS

gross national product (GNP), net national product (NNP) and national income (NI)

Gross National Product (GNP), Net National Product (NNP) and National Income (NI)? 5. ‘

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

113/683	SUBMITTED TEXT	98 WORDS	93%	MATCHING TEXT	98 WORDS

For measuring national income, the economy through which people participate in economic activities, earn their livelihood, produce goods and services and share the national products is viewed from three different angles. (1) The national economy is considered as an aggregate of producing units combining different sectors such as agriculture, mining, manufacturing and trade and commerce. (2) The whole national economy is viewed as a combination of individuals and households owning different kinds of factors of production which they use themselves or sell factor-services to make their livelihood. (3) The national economy may also be viewed as a collection of consuming, saving and investing units (individuals, households and government).

For measuring national income, the economy through which people participate in economic activities, earn their livelihood, produce goods and services and share the national products is viewed from three different angles : 1. The national economy is considered as an aggregate of producing units combining different sectors such as agriculture, mining, manufacturing, trade and commerce, etc. 2. The whole national economy is viewed as a combination of individuals and households owing different kinds of factors of production which they use themselves or sell factor services to make their livelihood. 3. The national economy may also be viewed as a collection of consuming, saving and investing units (individuals, households and government).

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114/683	SUBMITTED TEXT	98 WORDS	93%	MATCHING TEXT	98 WORDS

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115/683	SUBMITTED TEXT	11 WORDS	100%	MATCHING TEXT	11 WORDS

gross national product (GNP), net national product (NNP) and national income (

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116/683	SUBMITTED TEXT	12 WORDS	96%	MATCHING TEXT	12 WORDS

national income may be measured by three different corresponding methods: ?Net product method:

National income may be measured by three different corresponding methods : A) Net product method

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117/683	SUBMITTED TEXT	12 WORDS	96%	MATCHING TEXT	12 WORDS

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118/683	SUBMITTED TEXT	9 WORDS	100%	MATCHING TEXT	9 WORDS

national economy is considered as an aggregate of producing units. ?

national economy is considered as an aggregate of producing units

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119/683	SUBMITTED TEXT	9 WORDS	100%	MATCHING TEXT	9 WORDS

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120/683	SUBMITTED TEXT	53 WORDS	90%	MATCHING TEXT	53 WORDS

method consists of three stages: (1) Estimating the gross value of domestic output in the various branches of production. (2) Determining the cost of material and services used and also the depreciation of physical assets. (3) Deducting these costs and depreciation from gross value to obtain the net value of domestic output. The net value of domestic product

Method. It consists of three stages: i) estimating the gross value of domestic output in the various branches of production; ii) determining the cost of material and services 16 used and also the depreciation of physical assets; iii) deducting these costs and depreciation from gross value to obtain the net value of domestic output. Measuring gross value : For measuring the gross value of domestic product,

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121/683	SUBMITTED TEXT	53 WORDS	90%	MATCHING TEXT	53 WORDS

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122/683	SUBMITTED TEXT	16 WORDS	100%	MATCHING TEXT	16 WORDS

Measuring gross value For measuring the gross value of domestic product, output is classified under various categories

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123/683	SUBMITTED TEXT	16 WORDS	100%	MATCHING TEXT	16 WORDS

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124/683	SUBMITTED TEXT	18 WORDS	61%	MATCHING TEXT	18 WORDS

the value of gross output is computed in two alternative ways: (i) by multiplying the output of each

the value of the output is estimated from the sectors in two ways: (i) By multiplying the output of each

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125/683	SUBMITTED TEXT	72 WORDS	100%	MATCHING TEXT	72 WORDS

is computed in two alternative ways: (i) by multiplying the output of each category of sector by their respective market price and adding them together, or (ii) by collective data about the gross sales and changes in inventories from the account of the manufacturing enterprises and computing the value of GDP on the basis thereof. If there are gaps in data, some estimates are made thereof and gaps are filled. Estimating cost of production

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126/683	SUBMITTED TEXT	72 WORDS	100%	MATCHING TEXT	72 WORDS

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127/683	SUBMITTED TEXT	20 WORDS	100%	MATCHING TEXT	20 WORDS

Estimating cost of production is, however, a relatively more complicated and difficult task because of non-availability of adequate and requisite data.

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128/683	SUBMITTED TEXT	20 WORDS	100%	MATCHING TEXT	20 WORDS

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129/683	SUBMITTED TEXT	19 WORDS	100%	MATCHING TEXT	19 WORDS

net-product method find some ways and means to calculate the deductible cost. The costs are estimated either in absolute terms (

net-product method find some ways and means to calculate the deductible cost. The costs are estimated either in absolute terms

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130/683	SUBMITTED TEXT	19 WORDS	100%	MATCHING TEXT	19 WORDS

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131/683	SUBMITTED TEXT	26 WORDS	100%	MATCHING TEXT	26 WORDS

or as an overall ratio of input to the total output. The general practice in estimating depreciation is to follow the usual business practice of depreciation accounting.

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132/683	SUBMITTED TEXT	26 WORDS	100%	MATCHING TEXT	26 WORDS

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133/683	SUBMITTED TEXT	62 WORDS	100%	MATCHING TEXT	62 WORDS

Following a suitable method, deductible costs including depreciation are estimated for each sector. The cost estimates are then deducted from the sectoral gross output to obtain the net sectoral products. The net sectoral products are then added together. The total thus obtained is taken to be the measure of net national products or national income by net product method. Factor-income method This method is also known as

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134/683	SUBMITTED TEXT	62 WORDS	100%	MATCHING TEXT	62 WORDS

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135/683	SUBMITTED TEXT	14 WORDS	89%	MATCHING TEXT	14 WORDS

factor-share method. Under this method, the national income is calculated by adding up all

factor-income method. Under this method, the national income is calculated by adding up all

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136/683	SUBMITTED TEXT	14 WORDS	89%	MATCHING TEXT	14 WORDS

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137/683	SUBMITTED TEXT	13 WORDS	100%	MATCHING TEXT	13 WORDS

incomes accruing to the basic factors of production used in producing the national product.

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138/683	SUBMITTED TEXT	13 WORDS	100%	MATCHING TEXT	13 WORDS

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139/683	SUBMITTED TEXT	36 WORDS	91%	MATCHING TEXT	36 WORDS

Labour incomes included in the national income have three components: (i) Wages and salaries paid to the residents of the country including bonus and commission, and social security payments; (ii) Supplementary labour incomes including employer's contribution to social security and

Labour income : included in the national income have three components : a) wages and salaries paid to the residents of the country including bonus and commission and social security payments; b) supplementary labour incomes including employer's contribution to social security and

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140/683	SUBMITTED TEXT	36 WORDS	91%	MATCHING TEXT	36 WORDS

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141/683	SUBMITTED TEXT	34 WORDS	95%	MATCHING TEXT	34 WORDS

welfare funds, and direct pension payments to retired employees; (iii) Supplementary labour incomes in kind, e.g., free health and education, food and clothing, and accommodation, etc. Compensations in kind in the form of domestic servants and

welfare funds and direct pension payments to retired employees; c) supplementary labour incomes in kind, e.g. free health and education, food and clothing, and accommodation, etc. Compensations in kind in the form of domestic servants and

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142/683 **SUBMITTED TEXT** 34 WORDS **95%** **MATCHING TEXT** 34 WORDS

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143/683 **SUBMITTED TEXT** 45 WORDS **100%** **MATCHING TEXT** 45 WORDS

other free-of-cost services provided to the employees are included in labour income. War bonuses, pensions, service grants are not included in labour income as they are regarded as 'transfer payments'. Certain other categories of income, e.g., incomes from incidental jobs, gratuities, tips, etc., are ignored for lack of data. 2.Capital

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144/683 **SUBMITTED TEXT** 45 WORDS **100%** **MATCHING TEXT** 45 WORDS

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145/683 **SUBMITTED TEXT** 18 WORDS **63%** **MATCHING TEXT** 18 WORDS

insurance policy reserves. (v) Net interest paid out by commercial banks. (vi) Net rents from land, buildings, etc., including imputed

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146/683	SUBMITTED TEXT	63 WORDS	80%	MATCHING TEXT	63 WORDS

Studenski, capital incomes include the following capital earnings: (i) Dividends excluding intercorporate dividends. (ii) Undistributed before-tax profits of corporations. (iii) Interest on bonds, mortgages, and saving deposits (excluding interests on war bonds, and on consumer-credit). (iv) Interest earned by insurance companies and credited to the insurance policy reserves. (v) Net interest paid out by commercial banks. (vi) Net rents from land, buildings, etc., including imputed net rents on owner-occupied dwellings. (vii) Royalties. (

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147/683	SUBMITTED TEXT	63 WORDS	80%	MATCHING TEXT	63 WORDS

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148/683	SUBMITTED TEXT	38 WORDS	100%	MATCHING TEXT	38 WORDS

c) other professions, e.g., legal and medical practices, consultancy services, trading and transporting, etc. This category also includes the incomes of those who earn their living through various sources as wages, rent on own property, interest on own capital, etc. All

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149/683	SUBMITTED TEXT	38 WORDS	100%	MATCHING TEXT	38 WORDS

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150/683	SUBMITTED TEXT	11 WORDS	100%	MATCHING TEXT	11 WORDS

incomes added together give the measure of national income by

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151/683	SUBMITTED TEXT	11 WORDS	100%	MATCHING TEXT	11 WORDS

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152/683	SUBMITTED TEXT	29 WORDS	66%	MATCHING TEXT	29 WORDS

the total national expenditure, either of the following methods can be followed: first, all the money expenditures at market price are computed and put together, and second, the computation of the

the total national expenditure, any of the two following methods are follows; First, all the money expenditures at market price are computed and added up together, and Second, the value of all the

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153/683	SUBMITTED TEXT	29 WORDS	66%	MATCHING TEXT	29 WORDS

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154/683	SUBMITTED TEXT	68 WORDS	80%	MATCHING TEXT	68 WORDS

the total national income. The following items of expenditure are taken into account under the first method: ?Private consumption expenditure ?Direct tax payments ?Payments to the non-profit institutions and charitable organizations (schools, hospitals, orphanages, etc.) ?Private savings. Under the second method, the following items are considered: (a) private consumer goods and service (b) Private investment goods ?Public goods and services, and ?Net investment abroad. Under the second method, the data required can be collected with greater ease and accuracy.

the total national expenditure. The items of expenditure which are taken into account under the first method are Private consumption expenditure; Direct tax payments; 18 Payments to the non-profit making institutions and charitable organizations like schools, hospitals, orphanages, etc., Private savings. Under the second method, the following items are considered Private consumer goods and services; Private investment goods; Public goods and services; Net investment abroad. The second method is more extensively used because the data required in this method can be collected with greater ease and accuracy.

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155/683	SUBMITTED TEXT	68 WORDS	80%	MATCHING TEXT	68 WORDS

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156/683	SUBMITTED TEXT	127 WORDS	99%	MATCHING TEXT	127 WORDS

most economies are open in the sense that they carry out foreign trade in goods and services and financial transactions with the rest of the world. In the process, some nations get net income through foreign trade while some lose their income to foreigners. The net earnings or loss in foreign trade affects the national income. In measuring the national income, therefore, the net result of external transactions are adjusted to the total. Net incomes from abroad are added to, and net losses to the foreigners are deducted from the total national income arrived at through any of the three methods. Briefly speaking, all exports of merchandise and of services like shipping, insurance, banking, tourism, and gifts are added to the national income. All the imports of the corresponding items are deducted from the value of

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157/683	SUBMITTED TEXT	127 WORDS	99%	MATCHING TEXT	127 WORDS

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158/683	SUBMITTED TEXT	26 WORDS	100%	MATCHING TEXT	26 WORDS

national income. To this is added the net income from foreign investment. These adjustments for international transactions are based on the international balance of payments of the nations.

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159/683	SUBMITTED TEXT	18 WORDS	63%	MATCHING TEXT	18 WORDS

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160/683	SUBMITTED TEXT	26 WORDS	100%	MATCHING TEXT	26 WORDS

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national income. To this is added the net income from foreign investment. These adjustments for international transactions are based on the international balance of payments of the nations. 1.18

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161/683 **SUBMITTED TEXT** 17 WORDS **61%** **MATCHING TEXT** 17 WORDS

industrial breakdown of final expenditure and income payments that have been entered into the national income accounts

industrial breakdowns of the final expenditures and income payments that enter into the national income accounts.' (93 1681

W https://www.askokorpela.fi/Kindle/Book/Jhingan-Macro-all.htm

162/683 **SUBMITTED TEXT** 16 WORDS **69%** **MATCHING TEXT** 16 WORDS

the total of the economy in the input-output table. Therefore, the total gross output must be equal

the column total of the economy in the input-output table. It means that total gross output must equal

W https://www.askokorpela.fi/Kindle/Book/Jhingan-Macro-all.htm

163/683 **SUBMITTED TEXT** 19 WORDS **62%** **MATCHING TEXT** 19 WORDS

systematic recording of all economic transactions with the rest of the world in a specific time period, i.e., one year.

SA Original_Macroeconomics-amp-Business-Environment.docx (D117056979)

164/683 **SUBMITTED TEXT** 13 WORDS **87%** **MATCHING TEXT** 13 WORDS

on the right side of the balance sheet. Under the balance of payments

on the right side of the balance sheet. 0102 Is Balance of Payments

W https://www.askokorpela.fi/Kindle/Book/Jhingan-Macro-all.htm

165/683 **SUBMITTED TEXT** 19 WORDS **62%** **MATCHING TEXT** 19 WORDS

systematic recording of all economic transactions with the rest of the world in a specific time period, i.e., one year.

SA MEBE.pdf (D113066356)

166/683 **SUBMITTED TEXT** 12 WORDS **100%** **MATCHING TEXT** 12 WORDS

is defined as the value of all final goods and services produced

SA Original_Macroeconomics-amp-Business-Environment.docx (D117056979)

Ouriginal by Turnitin

167/683 **SUBMITTED TEXT** 12 WORDS **100%** **MATCHING TEXT** 12 WORDS

is defined as the value of all final goods and services produced

SA MEBE.pdf (D113066356)

168/683 **SUBMITTED TEXT** 15 WORDS **83%** **MATCHING TEXT** 15 WORDS

GNP is defined as the value of all final goods and services produced during a

GNP) is as the total value of all the final goods and services produced a

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

169/683 **SUBMITTED TEXT** 18 WORDS **61%** **MATCHING TEXT** 18 WORDS

The value of gross output is computed in two alternative ways: (i) by multiplying the output of each

the value of the output is estimated from the sectors in two ways: (i) By multiplying the output of each

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

170/683 **SUBMITTED TEXT** 52 WORDS **100%** **MATCHING TEXT** 52 WORDS

is computed in two alternative ways: (i) by multiplying the output of each category of sector by their respective market price and adding them together, or (ii) by collective data about the gross sales and changes in inventories from the account of the manufacturing enterprises and computing the value of GDP on the basis thereof. 7.

is computed in two alternative ways : i) by multiplying the output of each category of sector by their respective market price and adding them together, or ii) by collective data about the gross sales and changes in inventories from the account of the manufacturing enterprises and computing the value of GDP on the basis thereof.

W https://mu.ac.in/wp-content/uploads/2021/11/Elements-of-Macroeconomics-English-Version.pdf

171/683 **SUBMITTED TEXT** 52 WORDS **100%** **MATCHING TEXT** 52 WORDS

is computed in two alternative ways: (i) by multiplying the output of each category of sector by their respective market price and adding them together, or (ii) by collective data about the gross sales and changes in inventories from the account of the manufacturing enterprises and computing the value of GDP on the basis thereof. 7.

is computed in two alternative ways : i) by multiplying the output of each category of sector by their respective market price and adding them together, or ii) by collective data about the gross sales and changes in inventories from the account of the manufacturing enterprises and computing the value of GDP on the basis thereof.

W https://scholarsclasses.com/blog/wp-content/uploads/2022/05/Elements-of-Macroeconomics-English-Ve ...

172/683 **SUBMITTED TEXT** 24 WORDS **51%** **MATCHING TEXT** 24 WORDS

It is the most comprehensive measure of the nation's productive activities. The GNP is defined as the value of all final goods and services produced

SA 4-PRINCIPLES OF MACRO--GE Eco(Hons.) Sem-II SLM.pdf (D143600893)

173/683 **SUBMITTED TEXT** 13 WORDS **100%** **MATCHING TEXT** 13 WORDS

GNP is defined as the value of all final goods and services produced

SA PAPER CP 202 FULL PDF.pdf (D165318885)

174/683 **SUBMITTED TEXT** 24 WORDS **51%** **MATCHING TEXT** 24 WORDS

It is the most comprehensive measure of the nation's productive activities. The GNP is defined as the value of all final goods and services produced

SA economic_environment_for_business - Copy.docx (D143644113)

175/683 **SUBMITTED TEXT** 16 WORDS **MATCHING TEXT** 16 WORDS

Macroeconomics is the study of the behaviour of the economy as a whole. It examines the **62%**

SA Introductory Microeconomics.pdf (D110811121)

176/683 **SUBMITTED TEXT** 16 WORDS **62%** **MATCHING TEXT** 16 WORDS

Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

SA B.A. Prog principles Macro Eco-I.doc (D110585671)

177/683 **SUBMITTED TEXT** 10 WORDS **100%** **MATCHING TEXT** 10 WORDS

incomes added together give the measure of national income by

incomes added together give the measure of national income by

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Ouriginal by Turnitin

178/683	SUBMITTED TEXT	10 WORDS	100%	MATCHING TEXT	10 WORDS

incomes added together give the measure of national income by

incomes added together give the measure of national income by

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179/683	SUBMITTED TEXT	16 WORDS	62%	MATCHING TEXT	16 WORDS

Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

SA Introductory Microeconomics.pdf (D110840503)

180/683	SUBMITTED TEXT	16 WORDS	62%	MATCHING TEXT	16 WORDS

Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

SA Introductory Macroeconomics.pdf (D110867721)

181/683	SUBMITTED TEXT	16 WORDS	62%	MATCHING TEXT	16 WORDS

Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

SA Introductory Microeconomics.pdf (D110843122)

182/683	SUBMITTED TEXT	16 WORDS	62%	MATCHING TEXT	16 WORDS

Macroeconomics is the study of the behaviour of the economy as a whole. It examines the

SA Introductory Microeconomics.pdf (D110864780)

183/683	SUBMITTED TEXT	38 WORDS	47%	MATCHING TEXT	38 WORDS

Gross Domestic Product (GDP): It is the total market value of all final goods and services produced in the country within a specific time period. ?Gross National Product (GNP): It is the value of all final goods and services produced

SA slm business eco macro - complete.docx (D44840960)

Ouriginal by Turnitin

184/683	SUBMITTED TEXT	38 WORDS	47%	MATCHING TEXT	38 WORDS

Gross Domestic Product (GDP): It is the total market value of all final goods and services produced in the country within a specific time period. ?Gross National Product (GNP): It is the value of all final goods and services produced

SA NJ.docx (D45656676)

185/683	SUBMITTED TEXT	38 WORDS	47%	MATCHING TEXT	38 WORDS

Gross Domestic Product (GDP): It is the total market value of all final goods and services produced in the country within a specific time period. ?Gross National Product (GNP): It is the value of all final goods and services produced

SA for plag.docx (D45796083)

186/683	SUBMITTED TEXT	38 WORDS	47%	MATCHING TEXT	38 WORDS

Gross Domestic Product (GDP): It is the total market value of all final goods and services produced in the country within a specific time period. ?Gross National Product (GNP): It is the value of all final goods and services produced

SA Macro Eco SLM after Review.docx (D46015425)

187/683	SUBMITTED TEXT	38 WORDS	47%	MATCHING TEXT	38 WORDS

Gross Domestic Product (GDP): It is the total market value of all final goods and services produced in the country within a specific time period. ?Gross National Product (GNP): It is the value of all final goods and services produced

SA Macro Eco SLM after Review.docx (D46015354)

Ouriginal by Turnitin

188/683 **SUBMITTED TEXT** 38 WORDS **47%** **MATCHING TEXT** 38 WORDS

Gross Domestic Product (GDP): It is the total market value of all final goods and services produced in the country within a specific time period. ?Gross National Product (GNP): It is the value of all final goods and services produced

SA Macro Eco SLM after Review.docx (D46016358)

189/683 **SUBMITTED TEXT** 19 WORDS **78%** **MATCHING TEXT** 19 WORDS

It is the total money value of all the final goods and services produced by the residents of a

SA 17.4.23 Macroeconomiics(2).doc (D164309062)

190/683 **SUBMITTED TEXT** 20 WORDS **60%** **MATCHING TEXT** 20 WORDS

is the total money value of all the final goods and services produced by the residents of a country during

SA slm business eco macro - complete.docx (D44840960)

191/683 **SUBMITTED TEXT** 24 WORDS **78%** **MATCHING TEXT** 24 WORDS

is the total money value of all the final goods and services produced by the residents of a country during any given period of time,

SA 4-PRINCIPLES OF MACRO--GE Eco(Hons.) Sem-II SLM.pdf (D143600893)

192/683 **SUBMITTED TEXT** 24 WORDS **78%** **MATCHING TEXT** 24 WORDS

is the total money value of all the final goods and services produced by the residents of a country during any given period of time,

SA economic_environment_for_business - Copy.docx (D143644113)

193/683 **SUBMITTED TEXT** 9 WORDS **100%** **MATCHING TEXT** 9 WORDS

national economy is considered as an aggregate of producing units. ?

national economy is considered as an aggregate of producing units

W https://mu.ac.in/wp-content/uploads/2021/11/Elements-of-Macroeconomics-English-Version.pdf

Ouriginal by Turnitin

194/683	SUBMITTED TEXT	9 WORDS	100%	MATCHING TEXT	9 WORDS

national economy is considered as an aggregate of producing units. ?

national economy is considered as an aggregate of producing units

W https://scholarsclasses.com/blog/wp-content/uploads/2022/05/Elements-of-Macroeconomics-English-Ve ...

195/683	SUBMITTED TEXT	18 WORDS	62%	MATCHING TEXT	18 WORDS

final goods and services produced by the residents of a country during any given period of time, usually one year. ?

SA Original_Macroeconomics-amp-Business-Environment.docx (D117056979)

196/683	SUBMITTED TEXT	18 WORDS	62%	MATCHING TEXT	18 WORDS

final goods and services produced by the residents of a country during any given period of time, usually one year. ?

SA MEBE.pdf (D113066356)

197/683	SUBMITTED TEXT	20 WORDS	55%	MATCHING TEXT	20 WORDS

Balance of payments: It is the systematic recording of all economic transactions with the rest of the world in a

SA final book.docx (D143611479)

198/683	SUBMITTED TEXT	11 WORDS	95%	MATCHING TEXT	11 WORDS

General Theory of Employment, Interest and Money by John Maynard Keynes,

SA PAPER CP 202 FULL PDF.pdf (D165318885)

199/683	SUBMITTED TEXT	18 WORDS	62%	MATCHING TEXT	18 WORDS

systematic recording of all economic transactions with the rest of the world in a specific time period, i.e., one year. ?

SA MEBE.pdf (D113066356)

Ouriginal by Turnitin

200/683	SUBMITTED TEXT	18 WORDS	62%	MATCHING TEXT	18 WORDS

systematic recording of all economic transactions with the rest of the world in a specific time period, i.e., one year. ?

SA Original_Macroeconomics-amp-Business-Environment.docx (D117056979)

201/683	SUBMITTED TEXT	14 WORDS	76%	MATCHING TEXT	14 WORDS

General Theory of Employment, Interest and Money by John Maynard Keynes, criticized the fundamentals of

SA 3-INTRODUCTORY MACRO-DSC-4- Eco Sem-II-2.pdf (D143600892)

202/683	SUBMITTED TEXT	10 WORDS	100%	MATCHING TEXT	10 WORDS

OBJECTIVES After going through this unit, you will be able to: ?

SA Macro Economics I.pdf (D138997544)

203/683	SUBMITTED TEXT	12 WORDS	84%	MATCHING TEXT	12 WORDS

output and employment. The levels of output and employment are determined by the

SA economic_environment_for_business - Copy.docx (D143644113)

204/683	SUBMITTED TEXT	12 WORDS	84%	MATCHING TEXT	12 WORDS

output and employment. The levels of output and employment are determined by the

SA 3-INTRODUCTORY MACRO-DSC-4- Eco Sem-II-2.pdf (D143600892)

205/683	SUBMITTED TEXT	12 WORDS	92%	MATCHING TEXT	12 WORDS

classical economists held the view that, an economy based on laissez-faire principles,

SA economic_environment_for_business - Copy.docx (D143644113)

206/683 **SUBMITTED TEXT** 13 WORDS **96%** **MATCHING TEXT** 13 WORDS

The classical economists held the view that, an economy based on laissez-faire principles,

SA 3-INTRODUCTORY MACRO-DSC-4- Eco Sem-II-2.pdf (D143600892)

207/683 **SUBMITTED TEXT** 19 WORDS **62%** **MATCHING TEXT** 19 WORDS

The entire market system works automatically and it maintains the economy in equilibrium. Whenever there is a deviation from equilibrium,

SA 3-INTRODUCTORY MACRO-DSC-4- Eco Sem-II-2.pdf (D143600892)

208/683 **SUBMITTED TEXT** 12 WORDS **71%** **MATCHING TEXT** 12 WORDS

the economy back to equilibrium. Say's Law: Supply Creates its Own Demand The

SA Sem 1_M23ECO2DC.docx (D165393069)

209/683 **SUBMITTED TEXT** 23 WORDS **93%** **MATCHING TEXT** 23 WORDS

The classical model presented below displays the determination of the real output and employment required to produce equilibrium level of national output, and the

SA 3-INTRODUCTORY MACRO-DSC-4- Eco Sem-II-2.pdf (D143600892)

210/683 **SUBMITTED TEXT** 19 WORDS **52%** **MATCHING TEXT** 19 WORDS

equilibrium of the labour market determines the level of employment. Determination of employment determines the level of national output. The

SA economic_environment_for_business - Copy.docx (D143644113)

211/683 **SUBMITTED TEXT** 15 WORDS **MATCHING TEXT** 15 WORDS

factors operating on the supply side of the market determine the level of employment and

83% factors operating on the supply side in the labour market determine the level of employment, output and

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

Ouriginal by Turnitin

212/683	SUBMITTED TEXT	11 WORDS	100%	MATCHING TEXT	11 WORDS

market equilibrium is determined by the demand for and supply of

market equilibrium is determined by the demand for and supply of

W https://mu.ac.in/wp-content/uploads/2021/11/Elements-of-Macroeconomics-English-Version.pdf

213/683	SUBMITTED TEXT	11 WORDS	100%	MATCHING TEXT	11 WORDS

market equilibrium is determined by the demand for and supply of

market equilibrium is determined by the demand for and supply of

W https://scholarsclasses.com/blog/wp-content/uploads/2022/05/Elements-of-Macroeconomics-English-Ve ...

214/683	SUBMITTED TEXT	16 WORDS	62%	MATCHING TEXT	16 WORDS

The supply of labour (N s) is a function of real wages.
The supply of labour

SA 3-INTRODUCTORY MACRO-DSC-4- Eco Sem-II-2.pdf (D143600892)

215/683	SUBMITTED TEXT	16 WORDS	71%	MATCHING TEXT	16 WORDS

labour market equilibrium is shown in panel (a) of Figure
2.4. The labour demand and

SA PAPER CP 202 FULL PDF.pdf (D165318885)

216/683	SUBMITTED TEXT	14 WORDS	78%	MATCHING TEXT	14 WORDS

labour market equilibrium is determined by the demand
for and supply of labour. The

SA Sambalpur-BBA-SEM-III-Macroeconomics.pdf (D156210285)

217/683	SUBMITTED TEXT	11 WORDS	95%	MATCHING TEXT	11 WORDS

is determined by the demand for and supply of labour.
The

SA slm business eco macro - complete.docx (D44840960)

Ouriginal by Turnitin

218/683	SUBMITTED TEXT	11 WORDS	95%	MATCHING TEXT	11 WORDS

is determined by the demand for and supply of labour.
The

SA NJ.docx (D45656676)

219/683	SUBMITTED TEXT	13 WORDS	71%	MATCHING TEXT	13 WORDS

the factors operating on the supply side of the labour market. Theory of Employment

the factors operating on the supply side in the labour market determine level of employment,

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

220/683	SUBMITTED TEXT	18 WORDS	58%	MATCHING TEXT	18 WORDS

a negative relationship between the investment demand and rate of interest. At a higher rate of interest, the

a negative relationship between the level of investment and the rate of interest. CHANGES IN THE RATE OF INTEREST, THE

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

221/683	SUBMITTED TEXT	11 WORDS	95%	MATCHING TEXT	11 WORDS

is determined by the demand for and supply of labour.
The

SA for plag.docx (D45796083)

222/683	SUBMITTED TEXT	16 WORDS	71%	MATCHING TEXT	16 WORDS

the equilibrium rate of interest, the demand for investment is just equal to the supply of

the equilibrium rate of interest. It shows that the demand for money is exactly equal to the supply of

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223/683	SUBMITTED TEXT	16 WORDS	71%	MATCHING TEXT	16 WORDS

the equilibrium rate of interest, the demand for investment is just equal to the supply of

the equilibrium rate of interest. It shows that the demand for money is exactly equal to the supply of

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Ouriginal by Turnitin

224/683	SUBMITTED TEXT	17 WORDS	61%	MATCHING TEXT	17 WORDS
at the equilibrium rate of interest, the demand for investment is just equal to the supply of			at the equilibrium rate OW* where the demand for labour is equal to the supply of		

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

225/683	SUBMITTED TEXT	28 WORDS	70%	MATCHING TEXT	28 WORDS
the investment demand is less than the intended supply of savings. On the other hand at a lower rate of interest, the demand for investment exceeds the supply of savings.					

SA Sem 1_M23ECO2DC.docx (D165393069)

226/683	SUBMITTED TEXT	11 WORDS	100%	MATCHING TEXT	11 WORDS
According to him, 'in the long-run, we are all dead.'			According to him. In the long run, we are all dead. 3.		

W https://mu.ac.in/wp-content/uploads/2021/11/Elements-of-Macroeconomics-English-Version.pdf

227/683	SUBMITTED TEXT	11 WORDS	100%	MATCHING TEXT	11 WORDS
According to him, 'in the long-run, we are all dead.'			According to him. In the long run, we are all dead. 3.		

W https://scholarsclasses.com/blog/wp-content/uploads/2022/05/Elements-of-Macroeconomics-English-Ve ...

228/683	SUBMITTED TEXT	14 WORDS	66%	MATCHING TEXT	14 WORDS
The classical theory of income and employment completely depends upon Say's Law of Market,			the Classical theory of Income and Employment x To study Say's Law of market		

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

229/683	SUBMITTED TEXT	16 WORDS	62%	MATCHING TEXT	16 WORDS
the equilibrium rate of interest, the demand for investment is just equal to the supply of					

SA Macro Economics I.pdf (D138997544)

230/683	SUBMITTED TEXT	14 WORDS	66%	MATCHING TEXT	14 WORDS
The classical theory of income and employment completely depends upon Say's Law of Market,			the Classical theory of Income and Employment x To study Say's Law of market		

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

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231/683	SUBMITTED TEXT	14 WORDS	66%	MATCHING TEXT	14 WORDS

The classical theory of income and employment completely depends upon Say's Law of Market,

the Classical theory of Income and Employment x To study Say's Law of market

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232/683	SUBMITTED TEXT	11 WORDS	87%	MATCHING TEXT	11 WORDS

Say's Law of Market, i.e., supply creates its own demand. According

Say's law of market- . Supply creates its own demand according

W https://mu.ac.in/wp-content/uploads/2021/11/Elements-of-Macroeconomics-English-Version.pdf

233/683	SUBMITTED TEXT	11 WORDS	87%	MATCHING TEXT	11 WORDS

Say's Law of Market, i.e., supply creates its own demand. According

Say's law of market- . Supply creates its own demand according

W https://scholarsclasses.com/blog/wp-content/uploads/2022/05/Elements-of-Macroeconomics-English-Ve ...

234/683	SUBMITTED TEXT	21 WORDS	59%	MATCHING TEXT	21 WORDS

Aggregate supply price is the amount all the entrepreneurs in the economy expect to receive from the sale of output produced

aggregate demand price is the amount of money, which the expect to receive from the sale of output produced

W https://mu.ac.in/wp-content/uploads/2021/11/Elements-of-Macroeconomics-English-Version.pdf

235/683	SUBMITTED TEXT	21 WORDS	59%	MATCHING TEXT	21 WORDS

Aggregate supply price is the amount all the entrepreneurs in the economy expect to receive from the sale of output produced

aggregate demand price is the amount of money, which the expect to receive from the sale of output produced

W https://scholarsclasses.com/blog/wp-content/uploads/2022/05/Elements-of-Macroeconomics-English-Ve ...

236/683	SUBMITTED TEXT	21 WORDS	59%	MATCHING TEXT	21 WORDS

Aggregate supply price is the amount all the entrepreneurs in the economy expect to receive from the sale of output produced

aggregate demand price is the amount of money, which the expect to receive from the sale of output produced

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

237/683 **SUBMITTED TEXT** 14 WORDS **71%** **MATCHING TEXT** 14 WORDS

rate of interest, the demand for investment is just equal to the supply of

SA Introductory Microeconomics.pdf (D110811121)

238/683 **SUBMITTED TEXT** 21 WORDS **59%** **MATCHING TEXT** 21 WORDS

Aggregate supply price is the amount all the entrepreneurs in the economy expect to receive from the sale of output produced

aggregate demand price is the amount of money, which the expect to receive from the sale of output produced

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

239/683 **SUBMITTED TEXT** 15 WORDS **83%** **MATCHING TEXT** 15 WORDS

rate of interest, the demand for investment is just equal to the supply of savings.

SA Sem 1_M23ECO2DC.docx (D165393069)

240/683 **SUBMITTED TEXT** 21 WORDS **59%** **MATCHING TEXT** 21 WORDS

Aggregate supply price is the amount all the entrepreneurs in the economy expect to receive from the sale of output produced

aggregate demand price is the amount of money, which the expect to receive from the sale of output produced

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

241/683 **SUBMITTED TEXT** 21 WORDS **59%** **MATCHING TEXT** 21 WORDS

Aggregate supply price is the amount all the entrepreneurs in the economy expect to receive from the sale of output produced

aggregate demand price is the amount of money, which the expect to receive from the sale of output produced

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

242/683 **SUBMITTED TEXT** 11 WORDS **100%** **MATCHING TEXT** 11 WORDS

in his book, The General Theory of Employment, Interest and Money

in his book "The General Theory of Employment, Interest and Money,

W https://mu.ac.in/wp-content/uploads/2021/11/Elements-of-Macroeconomics-English-Version.pdf

243/683 **SUBMITTED TEXT** 11 WORDS **100%** **MATCHING TEXT** 11 WORDS

in his book, The General Theory of Employment, Interest and Money

in his book "The General Theory of Employment, Interest and Money,

W https://scholarsclasses.com/blog/wp-content/uploads/2022/05/Elements-of-Macroeconomics-English-Ve ...

244/683 **SUBMITTED TEXT** 11 WORDS **100%** **MATCHING TEXT** 11 WORDS

in his book, The General Theory of Employment, Interest and Money

in his book "The General Theory of Employment, Interest and Money",

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

245/683 **SUBMITTED TEXT** 12 WORDS **88%** **MATCHING TEXT** 12 WORDS

Say's Law of Market, i.e., supply creates its own demand. According to

SA Macro Economics I.pdf (D138997544)

246/683 **SUBMITTED TEXT** 11 WORDS **100%** **MATCHING TEXT** 11 WORDS

in his book, The General Theory of Employment, Interest and Money

in his book "The General Theory of Employment, Interest and Money",

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247/683 **SUBMITTED TEXT** 11 WORDS **100%** **MATCHING TEXT** 11 WORDS

in his book, The General Theory of Employment, Interest and Money

SA slm business eco macro - complete.docx (D44840960)

248/683 **SUBMITTED TEXT** 11 WORDS **100%** **MATCHING TEXT** 11 WORDS

in his book, The General Theory of Employment, Interest and Money

SA Sambalpur-BBA-SEM-III-Macroeconomics.pdf (D156210285)

249/683	SUBMITTED TEXT	11 WORDS	100%	MATCHING TEXT	11 WORDS

average propensity to consume and the marginal propensity to consume

average propensity to consume and the marginal propensity to consume,

W https://old.amu.ac.in/emp/studym/99995713.pdf

250/683	SUBMITTED TEXT	13 WORDS	70%	MATCHING TEXT	13 WORDS

Y =?C + ?S Dividing both sides by ?Y, we get 1 = C S Y Y or

Y C S Dividing both sides of the equation by Y, we get S C __ 1 __ Y or 1

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

251/683	SUBMITTED TEXT	13 WORDS	96%	MATCHING TEXT	13 WORDS

Y =?C + ?S Dividing both sides by ?Y, we get 1 = C S Y Y

SA B.A. Prog principles Macro Eco-I.doc (D110585671)

252/683	SUBMITTED TEXT	23 WORDS	87%	MATCHING TEXT	23 WORDS

investment refers to real investment which adds to capital equipment. It leads to increase in the levels of income and production by increasing the

SA B.A. Prog principles Macro Eco-I.doc (D110585671)

253/683	SUBMITTED TEXT	46 WORDS	95%	MATCHING TEXT	46 WORDS

leads to increase in the levels of income and production by increasing the production and purchase of capital goods. Investment thus includes new plant and equipment, construction of public works like dams, roads, buildings, etc., net foreign investment, inventories and stocks and shares of new companies. Marginal propensity to

SA 17.4.23 Macroeconomiics(2).doc (D164309062)

254/683	SUBMITTED TEXT	16 WORDS	96%	MATCHING TEXT	16 WORDS

Marginal propensity to invest is the ratio of change in investment to change in income. The

marginal propensity to invest is the ratio of change in investment to the change in income, 0702 The

W https://www.askokorpela.fi/Kindle/Book/Jhingan-Macro-all.htm

255/683 **SUBMITTED TEXT** 29 WORDS **95%** **MATCHING TEXT** 29 WORDS

purchase of capital goods. Investment thus includes new plant and equipment, construction of public works like dams, roads, buildings, etc., net foreign investment, inventories and stocks and shares of new companies.

SA B.A. Prog principles Macro Eco-I.doc (D110585671)

256/683 **SUBMITTED TEXT** 15 WORDS **76%** **MATCHING TEXT** 15 WORDS

Marginal propensity to invest is the ratio of change in investment to change in income.

SA Macro Economics I.pdf (D138997544)

257/683 **SUBMITTED TEXT** 15 WORDS **73%** **MATCHING TEXT** 15 WORDS

Marginal propensity to invest is the ratio of change in investment to change in income.

SA MA Ist Year AMU.docx (D142324729)

258/683 **SUBMITTED TEXT** 16 WORDS **81%** **MATCHING TEXT** 16 WORDS

Marginal propensity to invest is the ratio of change in investment to change in income. The

SA BA IInd semester EC103 final2 AMU.docx (D142326393)

259/683 **SUBMITTED TEXT** 16 WORDS **81%** **MATCHING TEXT** 16 WORDS

Marginal propensity to invest is the ratio of change in investment to change in income. The

SA BA IInd semester EC103 final2 AMU.docx (D142429509)

260/683 **SUBMITTED TEXT** 14 WORDS **75%** **MATCHING TEXT** 14 WORDS

ratio of change in investment to change in income. The marginal propensity to invest

SA final book.docx (D143611479)

261/683 **SUBMITTED TEXT** 17 WORDS **58%** **MATCHING TEXT** 17 WORDS

the concepts of aggregate demand and aggregate supply curves, let's derive the equilibrium level of employment. The	The intersection of the aggregate demand and aggregate supply curves of labour determines the equilibrium level of output, employment and the

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

262/683 **SUBMITTED TEXT** 98 WORDS **100%** **MATCHING TEXT** 98 WORDS

Effective Demand Effective demand refers to the willingness and ability of consumers to purchase goods at different prices. It shows the amount of goods that consumers are actually buying - supported by their ability to pay. Effective demand excludes latent demand - where the willingness to purchase goods may be limited by the inability to afford it - or lack of knowledge. In Keynes's macroeconomic theory, effective demand is the point of equilibrium where aggregate demand = aggregate supply. The importance of Keynes' view is that effective demand may be insufficient to achieve full employment due to unemployment and workers without income to produce unsold goods.

SA Sambalpur-BBA-SEM-III-Macroeconomics.pdf (D156210285)

263/683 **SUBMITTED TEXT** 10 WORDS **100%** **MATCHING TEXT** 10 WORDS

two factors: rate of interest and marginal efficiency of capital (

SA B.A. Prog principles Macro Eco-I.doc (D110585671)

264/683 **SUBMITTED TEXT** 13 WORDS **80%** **MATCHING TEXT** 13 WORDS

Let us suppose that the economy is initially in equilibrium at point E 1

SA PAPER CP 202 FULL PDF.pdf (D165318885)

265/683 **SUBMITTED TEXT** 20 WORDS **70%** **MATCHING TEXT** 20 WORDS

The multiplier may now be defined as the ratio of the change in national income due to change in investment.	the investmentmay be defined as "the ratio of the change in income to the change in investment."

W https://mu.ac.in/wp-content/uploads/2021/11/Elements-of-Macroeconomics-English-Version.pdf

266/683	SUBMITTED TEXT	20 WORDS		MATCHING TEXT	20 WORDS
The multiplier may now be defined as the ratio of the change in national income due to change in investment.			70%	the investmentmay be defined as "the ratio of the change in income to the change in investment."	

W https://scholarsclasses.com/blog/wp-content/uploads/2022/05/Elements-of-Macroeconomics-English-Ve ...

267/683	SUBMITTED TEXT	17 WORDS	64%	MATCHING TEXT	17 WORDS
may now be defined as the ratio of the change in national income due to change in					

SA final book.docx (D143611479)

268/683	SUBMITTED TEXT	17 WORDS	61%	MATCHING TEXT	17 WORDS
may now be defined as the ratio of the change in national income due to change in					

SA BA IInd semester EC103 final2 AMU.docx (D142326393)

269/683	SUBMITTED TEXT	17 WORDS	73%	MATCHING TEXT	17 WORDS
the amount by which the national income of a nation will be increased by increasing a unit					

SA Original_Macroeconomics-amp-Business-Environment.docx (D117056979)

270/683	SUBMITTED TEXT	17 WORDS	73%	MATCHING TEXT	17 WORDS
the amount by which the national income of a nation will be increased by increasing a unit					

SA MEBE.pdf (D113066356)

271/683	SUBMITTED TEXT	17 WORDS	73%	MATCHING TEXT	17 WORDS
the amount by which the national income of a nation will be increased by increasing a unit					

SA Sambalpur-BBA-SEM-III-Macroeconomics.pdf (D156210285)

272/683 **SUBMITTED TEXT** 16 WORDS **65%** **MATCHING TEXT** 16 WORDS

the income of the owners of the factors of production.
The national income rise by the

SA Sambalpur-BBA-SEM-III-Macroeconomics.pdf (D156210285)

273/683 **SUBMITTED TEXT** 53 WORDS **63%** **MATCHING TEXT** 53 WORDS

the foreign trade multiplier. The national income is defined as Y = C + I + X – M Where Y= national income C= national consumption I= total investment X= exports and M= imports The same can be written as Y C = I + X S = I + X (Since S= Y-C) S+ M= I+ X

SA Original_Macroeconomics-amp-Business-Environment.docx (D117056979)

274/683 **SUBMITTED TEXT** 53 WORDS **63%** **MATCHING TEXT** 53 WORDS

the foreign trade multiplier. The national income is defined as Y = C + I + X – M Where Y= national income C= national consumption I= total investment X= exports and M= imports The same can be written as Y C = I + X S = I + X (Since S= Y-C) S+ M= I+ X

SA MEBE.pdf (D113066356)

275/683 **SUBMITTED TEXT** 11 WORDS **100%** **MATCHING TEXT** 11 WORDS

the less developed countries (LDCs) have a lower per capita income

The less developed countries (LDCs) have a lower per capita income

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

276/683 **SUBMITTED TEXT** 24 WORDS **66%** **MATCHING TEXT** 24 WORDS

gross investment in period t, v = accelerator, Y t = national output in period t, Y t -1= national output in the previous period (t—1), and R = replacement investment

gross investment in period t, v is the accelerator, Yt is the national output in period t, Yt-1 is the national output in the previous period (t— 1), and R is the replacement investment. 110101

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277/683 **SUBMITTED TEXT** 11 WORDS **100%** **MATCHING TEXT** 11 WORDS

the multiplier theory, the higher the MPC, the higher the

SA BA IInd semester EC103 final2 AMU.docx (D142326393)

278/683 **SUBMITTED TEXT** 23 WORDS **43%** **MATCHING TEXT** 23 WORDS

increase in the investment. The increase in investment follows rather than precede the increase in output. The sixth assumption is that the increase in

increase in the output. Thus, the increase in the investment is greater than the increase in the output that is responsible for the increase in

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

279/683 **SUBMITTED TEXT** 12 WORDS **100%** **MATCHING TEXT** 12 WORDS

the value of the marginal propensity to consume b (= 0.5) is

the value of the marginal propensity to consume 'b' is 0.60,

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

280/683 **SUBMITTED TEXT** 11 WORDS **100%** **MATCHING TEXT** 11 WORDS

the multiplier theory, the higher the MPC, the higher the

SA BA IInd semester EC103 final2 AMU.docx (D142429509)

281/683 **SUBMITTED TEXT** 13 WORDS **92%** **MATCHING TEXT** 13 WORDS

classical economists held the view that an economy based on laissez- faire principles,

SA economic_environment_for_business - Copy.docx (D143644113)

282/683 **SUBMITTED TEXT** 33 WORDS **37%** **MATCHING TEXT** 33 WORDS

Aggregate supply price is the amount all the entrepreneurs in the economy expect to receive from the sale of output produced by those labourers employed, at any given level of employment of labour. ?Aggregate demand

aggregate demand price is the amount of money, which the expect to receive from the sale of output produced at a particular level of employment. The aggregate demand

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283/683	SUBMITTED TEXT	33 WORDS	37%	MATCHING TEXT	33 WORDS

Aggregate supply price is the amount all the entrepreneurs in the economy expect to receive from the sale of output produced by those labourers employed, at any given level of employment of labour. ?Aggregate demand

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284/683	SUBMITTED TEXT	33 WORDS	37%	MATCHING TEXT	33 WORDS

Aggregate supply price is the amount all the entrepreneurs in the economy expect to receive from the sale of output produced by those labourers employed, at any given level of employment of labour. ?Aggregate demand

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285/683	SUBMITTED TEXT	33 WORDS	37%	MATCHING TEXT	33 WORDS

Aggregate supply price is the amount all the entrepreneurs in the economy expect to receive from the sale of output produced by those labourers employed, at any given level of employment of labour. ?Aggregate demand

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286/683	SUBMITTED TEXT	33 WORDS	37%	MATCHING TEXT	33 WORDS

Aggregate supply price is the amount all the entrepreneurs in the economy expect to receive from the sale of output produced by those labourers employed, at any given level of employment of labour. ?Aggregate demand

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287/683	SUBMITTED TEXT	33 WORDS	37%	MATCHING TEXT	33 WORDS

Aggregate supply price is the amount all the entrepreneurs in the economy expect to receive from the sale of output produced by those labourers employed, at any given level of employment of labour. ?Aggregate demand

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W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

288/683	SUBMITTED TEXT	16 WORDS	73%	MATCHING TEXT	16 WORDS

Marginal Propensity to consume: It is the ratio of change in consumption to the change in income. ?

Marginal propensity to consume refers the rate of change in consumption to the change in income.

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289/683	SUBMITTED TEXT	16 WORDS	73%	MATCHING TEXT	16 WORDS

Marginal Propensity to consume: It is the ratio of change in consumption to the change in income. ?

Marginal propensity to consume refers the rate of change in consumption to the change in income.

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290/683	SUBMITTED TEXT	14 WORDS	96%	MATCHING TEXT	14 WORDS

The classical economists held the view that an economy based on laissez- faire principles,

SA 3-INTRODUCTORY MACRO-DSC-4- Eco Sem-II-2.pdf (D143600892)

291/683	SUBMITTED TEXT	16 WORDS	73%	MATCHING TEXT	16 WORDS

Marginal Propensity to consume: It is the ratio of change in consumption to the change in income. ?

Marginal propensity to consume refers the rate of change in consumption to the change in income.

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292/683	SUBMITTED TEXT	16 WORDS	62%	MATCHING TEXT	16 WORDS

The supply of labour (N s) is a function of real wages.
The supply of labour

SA 3-INTRODUCTORY MACRO-DSC-4- Eco Sem-II-2.pdf (D143600892)

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293/683 **SUBMITTED TEXT** 23 WORDS **75%** **MATCHING TEXT** 23 WORDS

Marginal Propensity to consume: It is the ratio of change in consumption to the change in income. ?Marginal Propensity to save: It is the

SA Macro Economics I.pdf (D138997544)

294/683 **SUBMITTED TEXT** 27 WORDS **46%** **MATCHING TEXT** 27 WORDS

Marginal Propensity to consume: It is the ratio of change in consumption to the change in income. ?Marginal Propensity to save: It is the ratio of change in

SA BA IInd semester EC103 final2 AMU.docx (D142326393)

295/683 **SUBMITTED TEXT** 26 WORDS **50%** **MATCHING TEXT** 26 WORDS

is the ratio of change in consumption to the change in income. ?Marginal Propensity to save: It is the ratio of change in savings to the change in

is the ratio of the change in deposits to the change in Deposit is the ratio Thus of the change in deposits to the change in

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

296/683 **SUBMITTED TEXT** 16 WORDS **73%** **MATCHING TEXT** 16 WORDS

Marginal Propensity to save: It is the ratio of change in savings to the change in income. ?

marginal propensity to is the ratio of change in investment to the change in income, 0702

W https://www.askokorpela.fi/Kindle/Book/Jhingan-Macro-all.htm

297/683 **SUBMITTED TEXT** 14 WORDS **84%** **MATCHING TEXT** 14 WORDS

Marginal Propensity to save: It is the ratio of change in savings to

SA MA Ist Year AMU.docx (D142324729)

298/683 **SUBMITTED TEXT** 16 WORDS **73%** **MATCHING TEXT** 16 WORDS

Marginal Propensity to save: It is the ratio of change in savings to the change in income. ?

SA BA IInd semester EC103 final2 AMU.docx (D142429509)

Ouriginal by Turnitin

299/683	SUBMITTED TEXT	18 WORDS	65%	MATCHING TEXT	18 WORDS

defined as the ratio of the change in national income due to change in investment. ?Fiscal multipliers: It is

defined as "the ratio of the change in income to the change in investment." It is

W https://mu.ac.in/wp-content/uploads/2021/11/Elements-of-Macroeconomics-English-Version.pdf

300/683	SUBMITTED TEXT	14 WORDS	70%	MATCHING TEXT	14 WORDS

ratio of change in savings to the change in income. ?
Investment multiplier: It is the

SA Macro Economics I.pdf (D138997544)

301/683	SUBMITTED TEXT	18 WORDS	65%	MATCHING TEXT	18 WORDS

defined as the ratio of the change in national income due to change in investment. ?Fiscal multipliers: It is

defined as "the ratio of the change in income to the change in investment." It is

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302/683	SUBMITTED TEXT	15 WORDS	66%	MATCHING TEXT	15 WORDS

multiplier defined as the ratio of the change in national income due to change in

SA B.A. Prog principles Macro Eco-I.doc (D110585671)

303/683	SUBMITTED TEXT	12 WORDS	90%	MATCHING TEXT	12 WORDS

the accumulated stock of plant and equipment held by the business

the accumulated stock of plant and equipment, which is held by the business

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

304/683	SUBMITTED TEXT	18 WORDS	55%	MATCHING TEXT	18 WORDS

the market rate of interest— to finance the purchase of the machine. If the market rate of interest

the market rate of interest rises to 8%, the value of this bond falls to Rs 50 in the market. If the market rate of interest

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305/683	SUBMITTED TEXT	10 WORDS	100%	MATCHING TEXT	10 WORDS

OBJECTIVES After going through this unit, you will be able to: ?

SA Macro Economics I.pdf (D138997544)

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306/683	SUBMITTED TEXT	29 WORDS	33%	MATCHING TEXT	29 WORDS

the sum of the present values of the prospective annual yields to the present cost of the capital good (investment project) is equal to the market rate of interest, the

the sum of the present value of the cash-flow items (that is the present value of the asset) will be equal to the market price of the

W https://www.mnb.hu/letoltes/monet-en.pdf

307/683	SUBMITTED TEXT	19 WORDS	52%	MATCHING TEXT	19 WORDS

marginal efficiency of capital is 'equal to that rate of discount which would make the present value of the

SA BA IInd semester EC103 final2 AMU.docx (D142326393)

308/683	SUBMITTED TEXT	37 WORDS	91%	MATCHING TEXT	37 WORDS

marginal efficiency of capital is 'equal to that rate of discount which would make the present value of the series of annuities given by the returns expected from the capital-asset during its life just equal to its supply price.'

marginal efficiency of capital as "equal to that rate of discount which would make the present value of the series of annuities given by the return expected from the capital asset during its life just equal to its supply price

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309/683	SUBMITTED TEXT	37 WORDS	91%	MATCHING TEXT	37 WORDS

marginal efficiency of capital is 'equal to that rate of discount which would make the present value of the series of annuities given by the returns expected from the capital-asset during its life just equal to its supply price.'

marginal efficiency of capital as "equal to that rate of discount which would make the present value of the series of annuities given by the return expected from the capital asset during its life just equal to its supply price

W https://scholarsclasses.com/blog/wp-content/uploads/2022/05/Elements-of-Macroeconomics-English-Ve ...

310/683	SUBMITTED TEXT	19 WORDS	52%	MATCHING TEXT	19 WORDS

marginal efficiency of capital is 'equal to that rate of discount which would make the present value of the

SA BA IInd semester EC103 final2 AMU.docx (D142429509)

311/683	SUBMITTED TEXT	12 WORDS	87%	MATCHING TEXT	12 WORDS

cost) of the capital asset, the marginal efficiency of capital (r) will

cost of the capital good, the marginal efficiency of capital r will

W https://old.amu.ac.in/emp/studym/99995713.pdf

Ouriginal by Turnitin

312/683	SUBMITTED TEXT	14 WORDS	76%	MATCHING TEXT	14 WORDS

the marginal efficiency of capital r and the rate of interest i gives the

The marginal efficiency of capital and 2) The rate of interest. The

W https://mu.ac.in/wp-content/uploads/2021/11/Elements-of-Macroeconomics-English-Version.pdf

313/683	SUBMITTED TEXT	32 WORDS	95%	MATCHING TEXT	32 WORDS

equal to that rate of discount which would make the present value of the series of annuities given by the returns expected from the capital-asset during its life just equal to its supply price.'

SA final book.docx (D143611479)

314/683	SUBMITTED TEXT	14 WORDS	76%	MATCHING TEXT	14 WORDS

the marginal efficiency of capital r and the rate of interest i gives the

The marginal efficiency of capital and 2) The rate of interest. The

W https://scholarsclasses.com/blog/wp-content/uploads/2022/05/Elements-of-Macroeconomics-English-Ve ...

315/683	SUBMITTED TEXT	21 WORDS	58%	MATCHING TEXT	21 WORDS

the marginal efficiency of capital. Given the marginal efficiency of capital (r), the market rate of interest (i) determines

the marginal efficiency of capital and the rate of interest. The marginal efficiency of capital in conjunction with the rate of interest determines

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316/683	SUBMITTED TEXT	21 WORDS	58%	MATCHING TEXT	21 WORDS

the marginal efficiency of capital. Given the marginal efficiency of capital (r), the market rate of interest (i) determines

the marginal efficiency of capital and the rate of interest. The marginal efficiency of capital in conjunction with the rate of interest determines

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

317/683	SUBMITTED TEXT	21 WORDS	58%	MATCHING TEXT	21 WORDS

the marginal efficiency of capital. Given the marginal efficiency of capital (r), the market rate of interest (i) determines

the marginal efficiency of capital and the rate of interest. The marginal efficiency of capital in conjunction with the rate of interest determines

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

318/683 **SUBMITTED TEXT** 21 WORDS **58%** **MATCHING TEXT** 21 WORDS

the marginal efficiency of capital. Given the marginal efficiency of capital (r), the market rate of interest (i) determines	the marginal efficiency of capital and the rate of interest. The marginal efficiency of capital in conjunction with the rate of interest determines

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

319/683 **SUBMITTED TEXT** 38 WORDS **96%** **MATCHING TEXT** 38 WORDS

the marginal efficiency of capital is 'equal to that rate of discount which would make the present value of the series of annuities given by the returns expected from the capital-asset during its life just equal to its supply price.'	

SA B.A. Prog principles Macro Eco-I.doc (D110585671)

320/683 **SUBMITTED TEXT** 22 WORDS **45%** **MATCHING TEXT** 22 WORDS

the gap between the desired and actual capital stock? The answer to this question will depend on the production capacity of the capital	The gap between the desired output and the actual output of the firms is closed within a single time period. In practice, this will depend on the production capacity of the capital

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

321/683 **SUBMITTED TEXT** 22 WORDS **52%** **MATCHING TEXT** 22 WORDS

transaction , demand for money is positively related to income – the higher the income, the higher the transaction demand for money	Transaction demand for money by the households is directly related to the level of income, i.e. higher the level of income, higher will be the transaction demand for money

W https://mu.ac.in/wp-content/uploads/2021/11/Elements-of-Macroeconomics-English-Version.pdf

322/683 **SUBMITTED TEXT** 22 WORDS **52%** **MATCHING TEXT** 22 WORDS

transaction , demand for money is positively related to income – the higher the income, the higher the transaction demand for money	Transaction demand for money by the households is directly related to the level of income, i.e. higher the level of income, higher will be the transaction demand for money

W https://scholarsclasses.com/blog/wp-content/uploads/2022/05/Elements-of-Macroeconomics-English-Ve ...

323/683	SUBMITTED TEXT	10 WORDS	95%	MATCHING TEXT	10 WORDS

according to Keynes, the transaction demand for money is interest-inelastic.

According to Keynes, the transactions demand for money is perfectly interest inelastic

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

324/683	SUBMITTED TEXT	12 WORDS	76%	MATCHING TEXT	12 WORDS

Transaction Demand for Money (ii) Precautionary demand for money. Precautionary demand for money

transaction demand for money , (ii) the precautionary demand for money ,(iii) the speculative demand for money . 1)

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325/683	SUBMITTED TEXT	12 WORDS	76%	MATCHING TEXT	12 WORDS

Transaction Demand for Money (ii) Precautionary demand for money. Precautionary demand for money

transaction demand for money , (ii) the precautionary demand for money ,(iii) the speculative demand for money . 1)

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

326/683	SUBMITTED TEXT	12 WORDS	76%	MATCHING TEXT	12 WORDS

Transaction Demand for Money (ii) Precautionary demand for money. Precautionary demand for money

transaction demand for money , (ii) the precautionary demand for money ,(iii) the speculative demand for money . 1)

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

327/683	SUBMITTED TEXT	12 WORDS	76%	MATCHING TEXT	12 WORDS

Transaction Demand for Money (ii) Precautionary demand for money. Precautionary demand for money

transaction demand for money , (ii) the precautionary demand for money ,(iii) the speculative demand for money . 1)

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328/683	SUBMITTED TEXT	16 WORDS	70%	MATCHING TEXT	16 WORDS

like transaction demand, the precautionary demand for money (M p) is also a constant function of income.

like the transaction demand , the precautionary demand for money is also a function of income .

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Ouriginal by Turnitin

329/683	SUBMITTED TEXT	16 WORDS	70%	MATCHING TEXT	16 WORDS

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like the transaction demand , the precautionary demand for money is also a function of income .

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

330/683	SUBMITTED TEXT	16 WORDS	70%	MATCHING TEXT	16 WORDS

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W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

331/683	SUBMITTED TEXT	16 WORDS	70%	MATCHING TEXT	16 WORDS

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like the transaction demand , the precautionary demand for money is also a function of income .

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

332/683	SUBMITTED TEXT	12 WORDS	95%	MATCHING TEXT	12 WORDS

hold a part of their income in the form of idle cash

hold a greater part of their income in the form of idle cash

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333/683	SUBMITTED TEXT	12 WORDS	95%	MATCHING TEXT	12 WORDS

hold a part of their income in the form of idle cash

hold a greater part of their income in the form of idle cash

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334/683	SUBMITTED TEXT	12 WORDS	76%	MATCHING TEXT	12 WORDS

Transaction Demand for Money (ii) Precautionary demand for money. Precautionary demand for money

SA Macro Economics I.pdf (D138997544)

335/683	SUBMITTED TEXT	12 WORDS	80%	MATCHING TEXT	12 WORDS

The relationship between market rate of interest and speculative demand for money is

The inverse relationship between the rate of interest and the speculative demand for money is

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336/683	SUBMITTED TEXT	12 WORDS	80%	MATCHING TEXT	12 WORDS
The relationship between market rate of interest and speculative demand for money is			The inverse relationship between the rate of interest and the speculative demand for money is		

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337/683	SUBMITTED TEXT	12 WORDS	80%	MATCHING TEXT	12 WORDS
The relationship between market rate of interest and speculative demand for money is			The inverse relationship between the rate of interest and the speculative demand for money is		

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338/683	SUBMITTED TEXT	12 WORDS	80%	MATCHING TEXT	12 WORDS
The relationship between market rate of interest and speculative demand for money is			The inverse relationship between the rate of interest and the speculative demand for money is		

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339/683	SUBMITTED TEXT	16 WORDS	70%	MATCHING TEXT	16 WORDS
The relationship between market rate of interest and speculative demand for money is illustrated graphically in Fig. 3.7.			The opposite relationship between rate of interest and speculative demand for money is shown in Fig.7.2		

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340/683	SUBMITTED TEXT	16 WORDS	70%	MATCHING TEXT	16 WORDS
The relationship between market rate of interest and speculative demand for money is illustrated graphically in Fig. 3.7.			The opposite relationship between rate of interest and speculative demand for money is shown in Fig.7.2		

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341/683	SUBMITTED TEXT	18 WORDS	89%	MATCHING TEXT	18 WORDS
without saving there cannot be liquidity to surrender... the rate of interest is the return for saving without liquidity.'			Without saving there can be no liquidity to surrender. The rate of interest is the return for saving without liquidity". 5.		

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342/683 **SUBMITTED TEXT** 18 WORDS **89%** **MATCHING TEXT** 18 WORDS

without saving there cannot be liquidity to surrender... the rate of interest is the return for saving without liquidity.'

Without saving there can be no liquidity to surrender. The rate of interest is the return for saving without liquidity". 5.

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343/683 **SUBMITTED TEXT** 18 WORDS **89%** **MATCHING TEXT** 18 WORDS

without saving there cannot be liquidity to surrender... the rate of interest is the return for saving without liquidity.'

Without saving there can be no liquidity to surrender. The rate of interest is the return for saving without liquidity." (526 9461

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344/683 **SUBMITTED TEXT** 20 WORDS **55%** **MATCHING TEXT** 20 WORDS

demand for money. According to Keynes, people hold a part of their income in the form of idle cash balance

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345/683 **SUBMITTED TEXT** 9 WORDS **100%** **MATCHING TEXT** 9 WORDS

the transactions motive, the precautionary motive and the speculative motive. ?

the transaction motive, the precautionary motive and the speculative motive.

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346/683 **SUBMITTED TEXT** 9 WORDS **100%** **MATCHING TEXT** 9 WORDS

the transactions motive, the precautionary motive and the speculative motive. ?

the transaction motive, the precautionary motive and the speculative motive.

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347/683 **SUBMITTED TEXT** 9 WORDS **100%** **MATCHING TEXT** 9 WORDS

the transactions motive, the precautionary motive and the speculative motive. ?

the transaction motive, (2) the precautionary motive, and (3) the speculative motive. (519 9347

W https://www.askokorpela.fi/Kindle/Book/Jhingan-Macro-all.htm

348/683 **SUBMITTED TEXT** 16 WORDS **62%** **MATCHING TEXT** 16 WORDS

the rate of interest and the demand for money, more particularly the speculative demand for money,

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349/683 **SUBMITTED TEXT** 16 WORDS **62%** **MATCHING TEXT** 16 WORDS

the rate of interest and the demand for money, more particularly the speculative demand for money,

SA 17.4.23 Macroeconomiics(2).doc (D164309062)

350/683 **SUBMITTED TEXT** 9 WORDS **100%** **MATCHING TEXT** 9 WORDS

the transactions motive, the precautionary motive and the speculative motive. ?

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351/683 **SUBMITTED TEXT** 9 WORDS **100%** **MATCHING TEXT** 9 WORDS

the transactions motive, the precautionary motive and the speculative motive. ?

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352/683 **SUBMITTED TEXT** 27 WORDS **37%** **MATCHING TEXT** 27 WORDS

Marginal efficiency of capital: It is that rate of discount which equates the present cost of the capital good and the expected future annual returns from the capital

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353/683 **SUBMITTED TEXT** 20 WORDS **97%** **MATCHING TEXT** 20 WORDS

trade-off between the liquidity advantage of holding money and the interest advantage of holding other assets. The demand for money is

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354/683 **SUBMITTED TEXT** 14 WORDS **80%** **MATCHING TEXT** 14 WORDS

OBJECTIVES After going through this unit, you will be able to: ?Describe the meaning and

SA Macro Economics I.pdf (D138997544)

355/683	SUBMITTED TEXT	18 WORDS	52%	MATCHING TEXT	18 WORDS

this unit, you will be able to: ?Describe the meaning and functions of money ?Elaborate on stock of money

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356/683	SUBMITTED TEXT	33 WORDS	79%	MATCHING TEXT	33 WORDS

money is very difficult to define. It belongs to the category of things which are not amenable to any single definition. It is partly so because money performs not one but four important functions

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357/683	SUBMITTED TEXT	33 WORDS	79%	MATCHING TEXT	33 WORDS

money is very difficult to define. It belongs to the category of things which are not amenable to any single definition. It is partly so because money performs not one but four important functions

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358/683	SUBMITTED TEXT	13 WORDS	85%	MATCHING TEXT	13 WORDS

a medium of exchange, a store of value and a standard of deferred payments–

SA slm business eco macro - complete.docx (D44840960)

359/683	SUBMITTED TEXT	13 WORDS	85%	MATCHING TEXT	13 WORDS

a medium of exchange, a store of value and a standard of deferred payments–

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360/683	SUBMITTED TEXT	13 WORDS	85%	MATCHING TEXT	13 WORDS

a medium of exchange, a store of value and a standard of deferred payments–

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361/683 **SUBMITTED TEXT** 13 WORDS **85%** **MATCHING TEXT** 13 WORDS

a medium of exchange, a store of value and a standard of deferred payments–

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362/683 **SUBMITTED TEXT** 13 WORDS **85%** **MATCHING TEXT** 13 WORDS

a medium of exchange, a store of value and a standard of deferred payments–

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363/683 **SUBMITTED TEXT** 13 WORDS **85%** **MATCHING TEXT** 13 WORDS

a medium of exchange, a store of value and a standard of deferred payments–

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364/683 **SUBMITTED TEXT** 14 WORDS **71%** **MATCHING TEXT** 14 WORDS

approaches to the definition of money: 1. Conventional Approach 2. Chicago Approach 3. Gurley and Shaw Approach;

approaches to the definition of money. 1) Conventional Approach: 2) The Modern Approach: i) The Chicago Approach: ii) Gurley and Approach:

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365/683 **SUBMITTED TEXT** 27 WORDS **92%** **MATCHING TEXT** 27 WORDS

According to Harry G Johnson and Edgar L Feige, there are the following four important approaches to the definition of money: 1. Conventional Approach 2. Chicago Approach 3. Gurley and Shaw

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366/683 **SUBMITTED TEXT** 14 WORDS **71%** **MATCHING TEXT** 14 WORDS

approaches to the definition of money: 1. Conventional Approach 2. Chicago Approach 3. Gurley and Shaw Approach;

approaches to the definition of money. 1) Conventional Approach: 2) The Modern Approach: i) The Chicago Approach: ii) Gurley and Approach:

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367/683	SUBMITTED TEXT	14 WORDS	71%	MATCHING TEXT	14 WORDS

approaches to the definition of money: 1. Conventional Approach 2. Chicago Approach 3. Gurley and Shaw Approach;

approaches to the definition of money. 1) Conventional Approach: 2) The Modern Approach: i) The Chicago Approach: ii) Gurley and Approach:

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368/683	SUBMITTED TEXT	14 WORDS	71%	MATCHING TEXT	14 WORDS

approaches to the definition of money: 1. Conventional Approach 2. Chicago Approach 3. Gurley and Shaw Approach;

approaches to the definition of money. 1) Conventional Approach: 2) The Modern Approach: i) The Chicago Approach: ii) Gurley and Approach:

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369/683	SUBMITTED TEXT	27 WORDS	92%	MATCHING TEXT	27 WORDS

According to Harry G Johnson and Edgar L Feige, there are the following four important approaches to the definition of money: 1. Conventional Approach 2. Chicago Approach 3. Gurley and Shaw

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370/683	SUBMITTED TEXT	17 WORDS	73%	MATCHING TEXT	17 WORDS

one of these four principal approaches to the definition of money may be briefly described as below. 1.

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371/683	SUBMITTED TEXT	17 WORDS	73%	MATCHING TEXT	17 WORDS

one of these four principal approaches to the definition of money may be briefly described as below. 1.

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372/683	SUBMITTED TEXT	30 WORDS	90%	MATCHING TEXT	30 WORDS

below. 1. Conventional Approach The conventional approach to the definition of money is the oldest known approach. According to this approach, the most important function of money in society is to act as

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373/683	SUBMITTED TEXT	30 WORDS	90%	MATCHING TEXT	30 WORDS

below. 1. Conventional Approach The conventional approach to the definition of money is the oldest known approach. According to this approach, the most important function of money in society is to act as

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374/683	SUBMITTED TEXT	23 WORDS	60%	MATCHING TEXT	23 WORDS

medium of exchange. Money is what money uniquely does. It pays for all the goods and services that are transacted in the community.

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375/683	SUBMITTED TEXT	23 WORDS	60%	MATCHING TEXT	23 WORDS

medium of exchange. Money is what money uniquely does. It pays for all the goods and services that are transacted in the community.

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376/683	SUBMITTED TEXT	12 WORDS	100%	MATCHING TEXT	12 WORDS

money is 'anything that is generally acceptable as a means of exchange (

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377/683	SUBMITTED TEXT	12 WORDS	100%	MATCHING TEXT	12 WORDS

money is 'anything that is generally acceptable as a means of exchange (

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378/683	SUBMITTED TEXT	12 WORDS	100%	MATCHING TEXT	12 WORDS

money is 'anything that is generally acceptable as a means of exchange (

SA Introductory Microeconomics.pdf (D110840503)

379/683 **SUBMITTED TEXT** 12 WORDS **100%** **MATCHING TEXT** 12 WORDS

money is 'anything that is generally acceptable as a means of exchange (

SA Introductory Microeconomics.pdf (D110864780)

380/683 **SUBMITTED TEXT** 25 WORDS **94%** **MATCHING TEXT** 25 WORDS

anything that is generally acceptable as a means of exchange (i.e., as a means of settling debts) and that at the same time acts as a

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381/683 **SUBMITTED TEXT** 25 WORDS **94%** **MATCHING TEXT** 25 WORDS

anything that is generally acceptable as a means of exchange (i.e., as a means of settling debts) and that at the same time acts as a

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382/683 **SUBMITTED TEXT** 13 WORDS **96%** **MATCHING TEXT** 13 WORDS

at the same time acts as a measure and a store of value.'

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383/683 **SUBMITTED TEXT** 13 WORDS **96%** **MATCHING TEXT** 13 WORDS

at the same time acts as a measure and a store of value.'

SA Introductory Microeconomics.pdf (D110811121)

384/683 **SUBMITTED TEXT** 21 WORDS **90%** **MATCHING TEXT** 21 WORDS

that by delivery of which debt contracts and price contracts are discharged and in the shape of which General Purchasing Power is

that commodity by delivery of which debt – contracts and price contracts are discharged and in the shape of which a store of general purchasing power is

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385/683 **SUBMITTED TEXT** 13 WORDS **96%** **MATCHING TEXT** 13 WORDS

at the same time acts as a measure and a store of value.'

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386/683 **SUBMITTED TEXT** 21 WORDS **90%** **MATCHING TEXT** 21 WORDS

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387/683 **SUBMITTED TEXT** 21 WORDS **90%** **MATCHING TEXT** 21 WORDS

that by delivery of which debt contracts and price contracts are discharged and in the shape of which General Purchasing Power is

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388/683 **SUBMITTED TEXT** 21 WORDS **90%** **MATCHING TEXT** 21 WORDS

that by delivery of which debt contracts and price contracts are discharged and in the shape of which General Purchasing Power is

that commodity by delivery of which debt – contracts and price contracts are discharged and in the shape of which a store of general purchasing power is

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389/683 **SUBMITTED TEXT** 13 WORDS **96%** **MATCHING TEXT** 13 WORDS

at the same time acts as a measure and a store of value.'

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390/683 **SUBMITTED TEXT** 22 WORDS **93%** **MATCHING TEXT** 22 WORDS

that by delivery of which debt contracts and price contracts are discharged and in the shape of which General Purchasing Power is held.'

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391/683 **SUBMITTED TEXT** 22 WORDS **93%** **MATCHING TEXT** 22 WORDS

that by delivery of which debt contracts and price contracts are discharged and in the shape of which General Purchasing Power is held.'

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392/683 **SUBMITTED TEXT** 13 WORDS **88%** **MATCHING TEXT** 13 WORDS

money as 'anything which is widely accepted in payment for goods, or in

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393/683 **SUBMITTED TEXT** 13 WORDS **88%** **MATCHING TEXT** 13 WORDS

money as 'anything which is widely accepted in payment for goods, or in

SA Introductory Microeconomics.pdf (D110840503)

394/683 **SUBMITTED TEXT** 13 WORDS **88%** **MATCHING TEXT** 13 WORDS

money as 'anything which is widely accepted in payment for goods, or in

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395/683 **SUBMITTED TEXT** 13 WORDS **88%** **MATCHING TEXT** 13 WORDS

money as 'anything which is widely accepted in payment for goods, or in

SA Introductory Macroeconomics.pdf (D110867721)

396/683 **SUBMITTED TEXT** 13 WORDS **88%** **MATCHING TEXT** 13 WORDS

money as 'anything which is widely accepted in payment for goods, or in

SA Introductory Microeconomics.pdf (D110843122)

397/683 **SUBMITTED TEXT** 19 WORDS **60%** **MATCHING TEXT** 19 WORDS

anything which is widely accepted in payment for goods, or in the discharge of other kinds of business obligations.

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398/683	SUBMITTED TEXT	20 WORDS	67%	MATCHING TEXT	20 WORDS

money is anything that is commonly used and generally accepted as a medium of exchange or as a standard of

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399/683	SUBMITTED TEXT	18 WORDS	92%	MATCHING TEXT	18 WORDS

anything that is commonly used and generally accepted as a medium of exchange or as a standard of value.'

Anything which is commonly used and generally accepted as a medium of exchange or as a standard of value." -

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400/683	SUBMITTED TEXT	18 WORDS	92%	MATCHING TEXT	18 WORDS

anything that is commonly used and generally accepted as a medium of exchange or as a standard of value.'

Anything which is commonly used and generally accepted as a medium of exchange or as a standard of value." -

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401/683	SUBMITTED TEXT	18 WORDS	92%	MATCHING TEXT	18 WORDS

anything that is commonly used and generally accepted as a medium of exchange or as a standard of value.'

Anything which is commonly used and generally accepted as a medium of exchange or as a standard of value." -

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402/683	SUBMITTED TEXT	18 WORDS	92%	MATCHING TEXT	18 WORDS

anything that is commonly used and generally accepted as a medium of exchange or as a standard of value.'

Anything which is commonly used and generally accepted as a medium of exchange or as a standard of value." -

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403/683	SUBMITTED TEXT	20 WORDS	67%	MATCHING TEXT	20 WORDS

money is anything that is commonly used and generally accepted as a medium of exchange or as a standard of

SA Introductory Microeconomics.pdf (D110811121)

404/683 **SUBMITTED TEXT** 35 WORDS **62%** **MATCHING TEXT** 35 WORDS

Defined on the basis of its function as a medium of exchange, a nation's total money stock would comprise those things which are generally accepted as the means of payment. This definition of money includes only

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405/683 **SUBMITTED TEXT** 35 WORDS **62%** **MATCHING TEXT** 35 WORDS

Defined on the basis of its function as a medium of exchange, a nation's total money stock would comprise those things which are generally accepted as the means of payment. This definition of money includes only

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406/683 **SUBMITTED TEXT** 17 WORDS **86%** **MATCHING TEXT** 17 WORDS

demand deposits in commercial banks as constituting the supply of money, i.e., M = C + D.

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407/683 **SUBMITTED TEXT** 17 WORDS **86%** **MATCHING TEXT** 17 WORDS

demand deposits in commercial banks as constituting the supply of money, i.e., M = C + D.

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408/683 **SUBMITTED TEXT** 13 WORDS **92%** **MATCHING TEXT** 13 WORDS

Chicago Approach The Chicago approach to the concept of money is associated with

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409/683	SUBMITTED TEXT	13 WORDS	92%	MATCHING TEXT	13 WORDS

Chicago Approach The Chicago approach to the concept of money is associated with

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410/683	SUBMITTED TEXT	16 WORDS	61%	MATCHING TEXT	16 WORDS

to the definition of money conflicts with the conventional approach to the definition of money since the

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411/683	SUBMITTED TEXT	16 WORDS	61%	MATCHING TEXT	16 WORDS

to the definition of money conflicts with the conventional approach to the definition of money since the

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412/683	SUBMITTED TEXT	18 WORDS	92%	MATCHING TEXT	18 WORDS

Gurley and Shaw Approach This approach, associated with the names of Professors John G Gurley and Edward S Shaw,

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413/683	SUBMITTED TEXT	18 WORDS	92%	MATCHING TEXT	18 WORDS

Gurley and Shaw Approach This approach, associated with the names of Professors John G Gurley and Edward S Shaw,

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414/683	SUBMITTED TEXT	27 WORDS	79%	MATCHING TEXT	27 WORDS

Approach This approach, which has been favoured by the central banking authorities, takes the broadest possible view of money as though it was synonymous with credit-funds lent to

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415/683	SUBMITTED TEXT	27 WORDS	79%	MATCHING TEXT	27 WORDS

Approach This approach, which has been favoured by the central banking authorities, takes the broadest possible view of money as though it was synonymous with credit-funds lent to

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416/683	SUBMITTED TEXT	13 WORDS	100%	MATCHING TEXT	13 WORDS

mention the long established theory of the Federal Reserve Board according to which

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417/683	SUBMITTED TEXT	13 WORDS	100%	MATCHING TEXT	13 WORDS

mention the long established theory of the Federal Reserve Board according to which

SA MA Ist Year AMU.docx (D142429512)

418/683	SUBMITTED TEXT	52 WORDS	68%	MATCHING TEXT	52 WORDS

the quantity of money exercising its influence only because bank credit is a part of total credit. The example of the unmeasurable concept is the Radcliffe Committee's concept of liquidity of the economy and credit can be substituted for money without limit. Consequently, money is identified with the credit extended by a wide variety of

SA MA Ist Year AMU.docx (D142324729)

419/683	SUBMITTED TEXT	52 WORDS	68%	MATCHING TEXT	52 WORDS

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420/683	SUBMITTED TEXT	19 WORDS	100%	MATCHING TEXT	19 WORDS

great instrument of commerce and industry in the economy by performing the four essential specific functions which have removed the

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421/683	SUBMITTED TEXT	19 WORDS	100%	MATCHING TEXT	19 WORDS

great instrument of commerce and industry in the economy by performing the four essential specific functions which have removed the

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422/683	SUBMITTED TEXT	14 WORDS	68%	MATCHING TEXT	14 WORDS

medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. Money

SA B.A. Prog principles Macro Eco-I.doc (D110585671)

423/683	SUBMITTED TEXT	14 WORDS	68%	MATCHING TEXT	14 WORDS

medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. Money

SA Introductory Microeconomics.pdf (D110811121)

424/683	SUBMITTED TEXT	14 WORDS	68%	MATCHING TEXT	14 WORDS

medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. Money

SA Introductory Microeconomics.pdf (D110840503)

425/683	SUBMITTED TEXT	14 WORDS	68%	MATCHING TEXT	14 WORDS

medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. Money

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426/683	SUBMITTED TEXT	14 WORDS	68%	MATCHING TEXT	14 WORDS

medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. Money

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427/683 **SUBMITTED TEXT** 14 WORDS **68%** **MATCHING TEXT** 14 WORDS

medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. Money

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428/683 **SUBMITTED TEXT** 18 WORDS **69%** **MATCHING TEXT** 18 WORDS

serves as a unit of measurement in terms of which the 'values' of all the goods and services

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429/683 **SUBMITTED TEXT** 18 WORDS **69%** **MATCHING TEXT** 18 WORDS

serves as a unit of measurement in terms of which the 'values' of all the goods and services

SA 3-INTRODUCTORY MACRO-DSC-4- Eco Sem-II-2.pdf (D143600892)

430/683 **SUBMITTED TEXT** 14 WORDS **75%** **MATCHING TEXT** 14 WORDS

unit of account in terms of which the values of different goods and services

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431/683 **SUBMITTED TEXT** 14 WORDS **75%** **MATCHING TEXT** 14 WORDS

unit of account in terms of which the values of different goods and services

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432/683 **SUBMITTED TEXT** 25 WORDS **44%** **MATCHING TEXT** 25 WORDS

medium of exchange in society, money removes the clumsiness, inconvenience and inefficiency which barter entails. The introduction of money as a medium of exchange in the

SA Sambalpur-BBA-SEM-III-Macroeconomics.pdf (D156210285)

433/683 **SUBMITTED TEXT** 12 WORDS **87%** **MATCHING TEXT** 12 WORDS

standard of deferred payments. However, money as a standard of deferred payments

SA slm business eco macro - complete.docx (D44840960)

434/683 **SUBMITTED TEXT** 12 WORDS **87%** **MATCHING TEXT** 12 WORDS

standard of deferred payments. However, money as a
standard of deferred payments

SA BFG 201 Money, Central Banking in India and International Financial Institutions BFG - I.pdf (D165093763)

435/683 **SUBMITTED TEXT** 12 WORDS **87%** **MATCHING TEXT** 12 WORDS

standard of deferred payments. However, money as a
standard of deferred payments

SA NJ.docx (D45656676)

436/683 **SUBMITTED TEXT** 12 WORDS **87%** **MATCHING TEXT** 12 WORDS

standard of deferred payments. However, money as a
standard of deferred payments

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437/683 **SUBMITTED TEXT** 12 WORDS **87%** **MATCHING TEXT** 12 WORDS

standard of deferred payments. However, money as a
standard of deferred payments

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438/683 **SUBMITTED TEXT** 12 WORDS **87%** **MATCHING TEXT** 12 WORDS

standard of deferred payments. However, money as a
standard of deferred payments

SA Macro Eco SLM after Review.docx (D46015354)

439/683 **SUBMITTED TEXT** 21 WORDS **45%** **MATCHING TEXT** 21 WORDS

the demand for money arising from wealth-holders'
choosing to hold a part of their total assets in the form of
money.

SA Macro Economics I.pdf (D138997544)

440/683 **SUBMITTED TEXT** 15 WORDS **70%** **MATCHING TEXT** 15 WORDS

assumed that the supply of high-powered money (M) is
exogenously determined by the monetary

assumed that the supply of money is exogenously
determined by the monetary

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

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441/683	SUBMITTED TEXT	20 WORDS	55%	MATCHING TEXT	20 WORDS

to the views of the monetarists who argue that the total supply of money is primarily determined exogenously by the

to the supply of money. The monetarists are of the view that the supply of money is preliminary determined exogenously by the

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

442/683	SUBMITTED TEXT	21 WORDS	50%	MATCHING TEXT	21 WORDS

the chief advantages of these assets are that unlike money, these yield income in the form of interest, rent, profit or

SA Sambalpur-BBA-SEM-III-Macroeconomics.pdf (D156210285)

443/683	SUBMITTED TEXT	20 WORDS	55%	MATCHING TEXT	20 WORDS

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to the supply of money. The monetarists are of the view that the supply of money is preliminary determined exogenously by the

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

444/683	SUBMITTED TEXT	20 WORDS	55%	MATCHING TEXT	20 WORDS

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W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

445/683	SUBMITTED TEXT	20 WORDS	55%	MATCHING TEXT	20 WORDS

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to the supply of money. The monetarists are of the view that the supply of money is preliminary determined exogenously by the

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446/683	SUBMITTED TEXT	17 WORDS	92%	MATCHING TEXT	17 WORDS

hold that the total money supply in the economy is largely determined endogenously in response to the economy's

hold that the total money supply in the economy is mainly determines endogenously in response to the economy's

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447/683	SUBMITTED TEXT	17 WORDS	92%	MATCHING TEXT	17 WORDS

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hold that the total money supply in the economy is mainly determines endogenously in response to the economy's

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448/683	SUBMITTED TEXT	17 WORDS	92%	MATCHING TEXT	17 WORDS

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hold that the total money supply in the economy is mainly determines endogenously in response to the economy's

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449/683	SUBMITTED TEXT	17 WORDS	92%	MATCHING TEXT	17 WORDS

hold that the total money supply in the economy is largely determined endogenously in response to the economy's

hold that the total money supply in the economy is mainly determines endogenously in response to the economy's

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450/683	SUBMITTED TEXT	13 WORDS	100%	MATCHING TEXT	13 WORDS

the quantity of money has been largely determined "endogenously" by the demands/needs of

the quantity of money has been largely determined 'endogenously' by the demands / needs of

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451/683	SUBMITTED TEXT	13 WORDS	100%	MATCHING TEXT	13 WORDS

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the quantity of money has been largely determined 'endogenously' by the demands / needs of

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452/683	SUBMITTED TEXT	13 WORDS	100%	MATCHING TEXT	13 WORDS

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W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

453/683	SUBMITTED TEXT	13 WORDS	100%	MATCHING TEXT	13 WORDS

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the quantity of money has been largely determined 'endogenously' by the demands / needs of

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454/683	SUBMITTED TEXT	13 WORDS	100%	MATCHING TEXT	13 WORDS

economy, rather than "exogenously" imposed on the economy by the Central Bank as

economy rather than 'exogenously' imposed on the economy by the central bank as

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

455/683	SUBMITTED TEXT	13 WORDS	100%	MATCHING TEXT	13 WORDS

economy, rather than "exogenously" imposed on the economy by the Central Bank as

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W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

456/683	SUBMITTED TEXT	13 WORDS	100%	MATCHING TEXT	13 WORDS

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W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

457/683	SUBMITTED TEXT	13 WORDS	100%	MATCHING TEXT	13 WORDS

economy, rather than "exogenously" imposed on the economy by the Central Bank as

economy rather than 'exogenously' imposed on the economy by the central bank as

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458/683	SUBMITTED TEXT	15 WORDS	70%	MATCHING TEXT	15 WORDS

economy depends on (a) the degree of responsibility of the central bank; and (b) the

economy depends on the degree of responsibility and the judgments of the central bank and the

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459/683	SUBMITTED TEXT	15 WORDS	70%	MATCHING TEXT	15 WORDS

economy depends on (a) the degree of responsibility of the central bank; and (b) the

economy depends on the degree of responsibility and the judgments of the central bank and the

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460/683	SUBMITTED TEXT	15 WORDS	70%	MATCHING TEXT	15 WORDS

economy depends on (a) the degree of responsibility of the central bank; and (b) the

economy depends on the degree of responsibility and the judgments of the central bank and the

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461/683	SUBMITTED TEXT	15 WORDS	70%	MATCHING TEXT	15 WORDS

economy depends on (a) the degree of responsibility of the central bank; and (b) the

economy depends on the degree of responsibility and the judgments of the central bank and the

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462/683	SUBMITTED TEXT	33 WORDS	50%	MATCHING TEXT	33 WORDS

M 1 = currency with public (C) + demand deposits with banks (D): M 2 = M 1 + deposits with post office savings banks; M 3 = M 1 + time deposits with

M 1 = Currency with the public + Demand deposits the commercial Banks + Other deposits the RBI. 2. M 2 = M 1 + Post Office Savings Bank Deposits. 3. M 3 = M 1 + Time deposits with

W https://mu.ac.in/wp-content/uploads/2021/11/Elements-of-Macroeconomics-English-Version.pdf

463/683	SUBMITTED TEXT	33 WORDS	50%	MATCHING TEXT	33 WORDS

M 1 = currency with public (C) + demand deposits with banks (D): M 2 = M 1 + deposits with post office savings banks; M 3 = M 1 + time deposits with

M 1 = Currency with the public + Demand deposits the commercial Banks + Other deposits the RBI. 2. M 2 = M 1 + Post Office Savings Bank Deposits. 3. M 3 = M 1 + Time deposits with

W https://scholarsclasses.com/blog/wp-content/uploads/2022/05/Elements-of-Macroeconomics-English-Ve ...

464/683	SUBMITTED TEXT	21 WORDS	57%	MATCHING TEXT	21 WORDS

M 3) comprise the (i) currency with the public, (ii) demand, deposits with the banks, and (iii) time deposits with the banks.

SA 6.3 Economics for Business Block 3.pdf (D165800765)

Ouriginal by Turnitin

465/683 **SUBMITTED TEXT** 23 WORDS **79%** **MATCHING TEXT** 23 WORDS

deposits with banks (D): M 2 = M 1 + deposits with post office savings banks; M 3 = M 1 + time deposits with

SA MA Ist Year AMU.docx (D142324729)

466/683 **SUBMITTED TEXT** 23 WORDS **79%** **MATCHING TEXT** 23 WORDS

deposits with banks (D): M 2 = M 1 + deposits with post office savings banks; M 3 = M 1 + time deposits with

SA MA Ist Year AMU.docx (D142429512)

467/683 **SUBMITTED TEXT** 22 WORDS **45%** **MATCHING TEXT** 22 WORDS

the total supply of money in the economy. Since the total supply of nominal money consists of the currency held by the public (

the total issue of high powered money. The total supply of nominal high powered money issued by the central Bank consists of, i) The nominal currency held by the public &

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

468/683 **SUBMITTED TEXT** 20 WORDS **82%** **MATCHING TEXT** 20 WORDS

M 2 = M 1 + deposits with post office savings banks; M 3 = M 1 + time deposits with banks:

SA 4-PRINCIPLES OF MACRO--GE Eco(Hons.) Sem-II SLM.pdf (D143600893)

469/683 **SUBMITTED TEXT** 22 WORDS **45%** **MATCHING TEXT** 22 WORDS

the total supply of money in the economy. Since the total supply of nominal money consists of the currency held by the public (

the total issue of high powered money. The total supply of nominal high powered money issued by the central Bank consists of, i) The nominal currency held by the public &

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470/683 **SUBMITTED TEXT** 22 WORDS **45%** **MATCHING TEXT** 22 WORDS

the total supply of money in the economy. Since the total supply of nominal money consists of the currency held by the public (

the total issue of high powered money. The total supply of nominal high powered money issued by the central Bank consists of, i) The nominal currency held by the public &

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471/683	SUBMITTED TEXT	20 WORDS	82%	MATCHING TEXT	20 WORDS

M 2 = M 1 + deposits with post office savings banks; M 3 = M 1 + time deposits with banks:

SA 3-INTRODUCTORY MACRO-DSC-4- Eco Sem-II-2.pdf (D143600892)

472/683	SUBMITTED TEXT	22 WORDS	45%	MATCHING TEXT	22 WORDS

the total supply of money in the economy. Since the total supply of nominal money consists of the currency held by the public (

the total issue of high powered money. The total supply of nominal high powered money issued by the central Bank consists of, i) The nominal currency held by the public &

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473/683	SUBMITTED TEXT	15 WORDS	100%	MATCHING TEXT	15 WORDS

issued by the central bank consists of the nominal currency held by the public (

issued by the central Bank consists of, i) The nominal currency held by the public &

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474/683	SUBMITTED TEXT	15 WORDS	100%	MATCHING TEXT	15 WORDS

issued by the central bank consists of the nominal currency held by the public (

issued by the central Bank consists of, i) The nominal currency held by the public &

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475/683	SUBMITTED TEXT	15 WORDS	100%	MATCHING TEXT	15 WORDS

issued by the central bank consists of the nominal currency held by the public (

issued by the central Bank consists of, i) The nominal currency held by the public &

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476/683	SUBMITTED TEXT	15 WORDS	100%	MATCHING TEXT	15 WORDS

issued by the central bank consists of the nominal currency held by the public (

issued by the central Bank consists of, i) The nominal currency held by the public &

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477/683	SUBMITTED TEXT	12 WORDS	100%	MATCHING TEXT	12 WORDS

cash reserves held by the commercial banks against their deposit liabilities (

Cash reserves held by the commercial banks against their deposit liabilities. 2)

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478/683	SUBMITTED TEXT	12 WORDS	100%	MATCHING TEXT	12 WORDS

cash reserves held by the commercial banks against their deposit liabilities (

Cash reserves held by the commercial banks against their deposit liabilities. 2)

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479/683	SUBMITTED TEXT	12 WORDS	100%	MATCHING TEXT	12 WORDS

cash reserves held by the commercial banks against their deposit liabilities (

Cash reserves held by the commercial banks against their deposit liabilities. 2)

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480/683	SUBMITTED TEXT	12 WORDS	100%	MATCHING TEXT	12 WORDS

cash reserves held by the commercial banks against their deposit liabilities (

Cash reserves held by the commercial banks against their deposit liabilities. 2)

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481/683	SUBMITTED TEXT	33 WORDS	31%	MATCHING TEXT	33 WORDS

of the central bank, commercial banks and the public itself. The behaviour of the central bank is reflected in the supply of the nominal high-powered money. Given the behaviour of the public and the

of the central bank, commercial banks and the public determine the supply of money. The total supply of money consists of the currency held by the public and the

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482/683	SUBMITTED TEXT	33 WORDS	31%	MATCHING TEXT	33 WORDS

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483/683	SUBMITTED TEXT	33 WORDS	31%	MATCHING TEXT	33 WORDS

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484/683	SUBMITTED TEXT	33 WORDS	31%	MATCHING TEXT	33 WORDS

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485/683	SUBMITTED TEXT	12 WORDS	83%	MATCHING TEXT	12 WORDS

the quantity theory of money as an explanation of changes in the

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486/683	SUBMITTED TEXT	12 WORDS	83%	MATCHING TEXT	12 WORDS

the quantity of money. The naive quantity theory of money has been

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487/683	SUBMITTED TEXT	15 WORDS	78%	MATCHING TEXT	15 WORDS

changes in the general price level (P) are equi-proportional to changes in the

SA slm business eco macro - complete.docx (D44840960)

488/683	SUBMITTED TEXT	15 WORDS	78%	MATCHING TEXT	15 WORDS

changes in the general price level (P) are equi-proportional to changes in the

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489/683 **SUBMITTED TEXT** 15 WORDS **78%** **MATCHING TEXT** 15 WORDS

changes in the general price level (P) are equi-
proportional to changes in the

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490/683 **SUBMITTED TEXT** 15 WORDS **78%** **MATCHING TEXT** 15 WORDS

changes in the general price level (P) are equi-
proportional to changes in the

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491/683 **SUBMITTED TEXT** 15 WORDS **78%** **MATCHING TEXT** 15 WORDS

changes in the general price level (P) are equi-
proportional to changes in the

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492/683 **SUBMITTED TEXT** 15 WORDS **78%** **MATCHING TEXT** 15 WORDS

changes in the general price level (P) are equi-
proportional to changes in the

SA Macro Eco SLM after Review.docx (D46016358)

493/683 **SUBMITTED TEXT** 21 WORDS **57%** **MATCHING TEXT** 21 WORDS

the quantity of money to the general price level by stating
that an increase in the quantity of money raises prices

SA BFG 201 Money, Central Banking in India and International Financial Institutions BFG - I.pdf (D165093763)

494/683 **SUBMITTED TEXT** 17 WORDS **64%** **MATCHING TEXT** 17 WORDS

relate changes in the general price level P to changes in
the total quantity of money in

SA 4-PRINCIPLES OF MACRO--GE Eco(Hons.) Sem-II SLM.pdf (D143600893)

495/683 **SUBMITTED TEXT** 17 WORDS **64%** **MATCHING TEXT** 17 WORDS

relate changes in the general price level P to changes in the total quantity of money in

SA 3-INTRODUCTORY MACRO-DSC-4- Eco Sem-II-2.pdf (D143600892)

496/683 **SUBMITTED TEXT** 14 WORDS **75%** **MATCHING TEXT** 14 WORDS

into a theory of the determination of the general price level (value of money)

SA Sambalpur-BBA-SEM-III-Macroeconomics.pdf (D156210285)

497/683 **SUBMITTED TEXT** 17 WORDS **64%** **MATCHING TEXT** 17 WORDS

changes in the quantity of money were the exclusive cause of changes in the general price level

SA 3-INTRODUCTORY MACRO-DSC-4- Eco Sem-II-2.pdf (D143600892)

498/683 **SUBMITTED TEXT** 17 WORDS **64%** **MATCHING TEXT** 17 WORDS

changes in the quantity of money were the exclusive cause of changes in the general price level

SA 4-PRINCIPLES OF MACRO--GE Eco(Hons.) Sem-II SLM.pdf (D143600893)

499/683 **SUBMITTED TEXT** 34 WORDS **94%** **MATCHING TEXT** 34 WORDS

The quantity of money is a secondary factor compared with the volume of expenditure. The notion that the quantity of money is a causative factor in the state of business has given way to regarding it

The quantity of money is a secondary factor compared with the volume of expendi- tures. The notion that the quantity of money is a causative factor in the state of business has given way to regarding it

W https://old.amu.ac.in/emp/studym/99995713.pdf

500/683 **SUBMITTED TEXT** 25 WORDS **100%** **MATCHING TEXT** 25 WORDS

a consequence. Changes in the level of prices are not the most important phenomenon of the economic system, and we hold today that it is

a consequence. Changes in the level of prices are not the most important phenomenon of the economic system, and we hold today that it is

W https://old.amu.ac.in/emp/studym/99995713.pdf

501/683 **SUBMITTED TEXT** 43 WORDS **98%** **MATCHING TEXT** 43 WORDS

lack of spending, a lack of income rather than lack of money that produces a depression. The quantity of money, in short, is not a dominant cause of the fluctuations of prices and is a very imperfect guide to the causes of the trade cycle.'

lack of spending, a lack of income rather than a lack of money, that produces a depression. The quantity of money, in short, is not a dominant cause of the fluctuations of prices and is a very imperfect guide to the causes of the trade cycle."

W https://old.amu.ac.in/emp/studym/99995713.pdf

502/683 **SUBMITTED TEXT** 16 WORDS **100%** **MATCHING TEXT** 16 WORDS

price level as if changes in prices were the most critical and important phenomenon of the

SA BFG 201 Money, Central Banking in India and International Financial Institutions BFG - I.pdf (D165093763)

503/683 **SUBMITTED TEXT** 16 WORDS **100%** **MATCHING TEXT** 16 WORDS

The quantity theory is at best an imperfect guide to the causes of the trade cycle.

SA BFG 201 Money, Central Banking in India and International Financial Institutions BFG - I.pdf (D165093763)

504/683 **SUBMITTED TEXT** 36 WORDS **26%** **MATCHING TEXT** 36 WORDS

the quantity of money is not a determinant of the value of money. The value of money is a consequence of the total income rather than of the total quantity of money. Criticizing the quantity theory of money,

SA BFG 201 Money, Central Banking in India and International Financial Institutions BFG - I.pdf (D165093763)

505/683 **SUBMITTED TEXT** 16 WORDS **68%** **MATCHING TEXT** 16 WORDS

the value of money is also determined by the demand for and the supply of money.

SA BFG 201 Money, Central Banking in India and International Financial Institutions BFG - I.pdf (D165093763)

506/683 **SUBMITTED TEXT** 16 WORDS **68%** **MATCHING TEXT** 16 WORDS

the value of money is also determined by the demand for and the supply of money.

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507/683 **SUBMITTED TEXT** 17 WORDS **64%** **MATCHING TEXT** 17 WORDS

the value of money is also determined by the demand for and the supply of money. The

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508/683 **SUBMITTED TEXT** 17 WORDS **64%** **MATCHING TEXT** 17 WORDS

the value of money is also determined by the demand for and the supply of money. The

SA NJ.docx (D45656676)

509/683 **SUBMITTED TEXT** 17 WORDS **64%** **MATCHING TEXT** 17 WORDS

the value of money is also determined by the demand for and the supply of money. The

SA for plag.docx (D45796083)

510/683 **SUBMITTED TEXT** 17 WORDS **64%** **MATCHING TEXT** 17 WORDS

the value of money is also determined by the demand for and the supply of money. The

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511/683 **SUBMITTED TEXT** 17 WORDS **100%** **MATCHING TEXT** 17 WORDS

keep in the form of currency: it may be a fifth, or a tenth or a twentieth.

SA B.A. Prog principles Macro Eco-I.doc (D110585671)

512/683 **SUBMITTED TEXT** 17 WORDS **100%** **MATCHING TEXT** 17 WORDS

keep in the form of currency: it may be a fifth, or a tenth or a twentieth.

SA Introductory Microeconomics.pdf (D110811121)

513/683 **SUBMITTED TEXT** 17 WORDS **100%** **MATCHING TEXT** 17 WORDS

keep in the form of currency: it may be a fifth, or a tenth or a twentieth.

SA Introductory Microeconomics.pdf (D110840503)

514/683 **SUBMITTED TEXT** 34 WORDS **88%** **MATCHING TEXT** 34 WORDS

In every state of society there is some fraction of their income which people find it worthwhile to keep in the form of currency: it may be a fifth, or a tenth or a twentieth.

In every state of society there is some frac- tion of their income which people find it worth while keep in the form of currency; it may be a fifth, or a tenth, or a twentieth."

W https://old.amu.ac.in/emp/studym/99995713.pdf

515/683 **SUBMITTED TEXT** 17 WORDS **100%** **MATCHING TEXT** 17 WORDS

keep in the form of currency: it may be a fifth, or a tenth or a twentieth.

SA Introductory Microeconomics.pdf (D110864780)

516/683 **SUBMITTED TEXT** 54 WORDS **97%** **MATCHING TEXT** 54 WORDS

Let us suppose that the inhabitants of a country, taken one with another (and including, therefore, all varieties of character and of occupation), find it just worth their while to keep by them on the average ready purchasing power to the extent of a tenth part of their annual income, together with a fifteenth part of their

Let us suppose that the inhabitants of a country, taken one with another (and including therefore all varieties of character and of occupation) find it just worth their while to keep by them on the average ready purchasing power to the extent of a tenth part of their annual income, together with a fiftieth part of their

W https://old.amu.ac.in/emp/studym/99995713.pdf

517/683 **SUBMITTED TEXT** 12 WORDS **83%** **MATCHING TEXT** 12 WORDS

which people find it worthwhile to keep in the form of currency.

which people find it worth while to keep in the form of currency;

W https://old.amu.ac.in/emp/studym/99995713.pdf

518/683 **SUBMITTED TEXT** 34 WORDS **95%** **MATCHING TEXT** 34 WORDS

In every state of society there is some fraction of their income which people find it worthwhile to keep in the form of currency: it may be a fifth, or a tenth or a twentieth.

SA Sem 1_M23ECO2DC.docx (D165393069)

519/683 **SUBMITTED TEXT** 22 WORDS **45%** **MATCHING TEXT** 22 WORDS

is the fraction of R which the community chooses to hold in the form of legal tender; M is the amount of

is the fraction of income which people desire to hold in the form of money, while k' is the fraction of

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520/683	SUBMITTED TEXT	12 WORDS	100%	MATCHING TEXT	12 WORDS

which people find it worthwhile to keep in the form of currency.

SA Sem 1_M23ECO2DC.docx (D165393069)

521/683	SUBMITTED TEXT	13 WORDS	83%	MATCHING TEXT	13 WORDS

the demand for money as a function of the rate of interest

the demand for money is a function of the rate of interest .

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522/683	SUBMITTED TEXT	13 WORDS	83%	MATCHING TEXT	13 WORDS

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523/683	SUBMITTED TEXT	20 WORDS	65%	MATCHING TEXT	20 WORDS

in which K is held partly in the form of currency and partly in the form of bank deposits. In

SA B.A. Prog principles Macro Eco-I.doc (D110585671)

524/683	SUBMITTED TEXT	13 WORDS	83%	MATCHING TEXT	13 WORDS

the demand for money as a function of the rate of interest

the demand for money is a function of the rate of interest .

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525/683	SUBMITTED TEXT	13 WORDS	83%	MATCHING TEXT	13 WORDS

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the demand for money is a function of the rate of interest .

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526/683	SUBMITTED TEXT	13 WORDS	88%	MATCHING TEXT	13 WORDS

demand for money as a function of the rate of interest explains the

Demand for Money as a Function of the Rate of Interest Unlike the

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

527/683 **SUBMITTED TEXT** 118 WORDS **82%** **MATCHING TEXT** 118 WORDS

The Marshallian version of the quantity theory i.e., M = KY represents a fundamentally new approach to the problem of money and prices. It is not true, as is often alleged, that the 'cash-balances' equation is merely the quantity theory in a new algebraic dress. Substituting PO (price level times output) for Y, the Marshallian equation becomes M = KPO. Arithmetically K is, therefore, simply the reciprocal of V in the equation MV = PO. But it does not follow from the mere fact that V = 1/ K as an arithmetical identity that, therefore, the Marshallian analysis is in fact the same thing as the Hume-Fisher analysis. To assert this is to miss entirely the significance of K in the Marshallian equation.' The crucial difference

The Marshallian version ^ of the quantity theory— M = kY — represents a fundamentally new approach to the problem of money and prices. It is not true, as is often alleged, that the "cash-balance" equation is merely the quantity theory in new algebraic dress. Sub- stituting PO (price level tunes output) for F, the MarshaUian equation becomes M = kPO. Arithmetically k is therefore simply the reciprocal of V in the equation MV = PO.' But it does not follow from the mere fact that F = - , as an arithmetic identity, that therefore the Mar- k shallian analysis is in fact the same thing as the Hume-Fisher analysis. To assert this is to miss entirely the significance of the k in the Mar- shallian equation. The difference

W https://old.amu.ac.in/emp/studym/99995713.pdf

528/683 **SUBMITTED TEXT** 33 WORDS **85%** **MATCHING TEXT** 33 WORDS

In terms of the Marshallian approach, sudden and rapid shifts in the desire of public to hold money may profoundly affect prices even though the monetary authority successfully maintains a high stability in the money

In the terms of the Mar- shallian approach, sudden and rapid shifts in the desire of the public to hold money may profoundly affect prices even though the mone- tary authority successfully maintains a high stability in the money '

W https://old.amu.ac.in/emp/studym/99995713.pdf

529/683 **SUBMITTED TEXT** 83 WORDS **93%** **MATCHING TEXT** 83 WORDS

supply. The desire of public to hold cash balances– liquidity preference–enters as a powerful factor. Drastic and sudden shifts in the desire to hold money, reflected in a change in K, may produce large and quickly moving changes in the level of income and prices. Shifts in public psychology, in expectations, must be taken into account no less than changes in the money supply. In the Marshallian analysis a shift in K may start an upward or downward movement. It is K, not M, that holds the stage.'

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W https://old.amu.ac.in/emp/studym/99995713.pdf

530/683 **SUBMITTED TEXT** 20 WORDS **66%** **MATCHING TEXT** 20 WORDS

Inflation Inflation means generally a considerable and persistent rise in the general level of prices. However, a precise meaning of 'inflation'

inflation. 8.9 SUMMARY ™ Inflation means a considerable and persistent rise in the general level of prices over a long period of time. ™ " Inflation

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531/683	SUBMITTED TEXT	13 WORDS	76%	MATCHING TEXT	13 WORDS

demand for money as a function of the rate of interest explains the

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532/683	SUBMITTED TEXT	20 WORDS	66%	MATCHING TEXT	20 WORDS

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533/683	SUBMITTED TEXT	20 WORDS	66%	MATCHING TEXT	20 WORDS

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535/683	SUBMITTED TEXT	15 WORDS	100%	MATCHING TEXT	15 WORDS

Inflation exists when money income is expanding more than in proportion to increase in earning activity."

Inflation exists when money income is expanding more than in proportion to increase in earning activity."

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

536/683	SUBMITTED TEXT	15 WORDS	100%	MATCHING TEXT	15 WORDS

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538/683	SUBMITTED TEXT	15 WORDS	100%	MATCHING TEXT	15 WORDS

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539/683	SUBMITTED TEXT	14 WORDS	89%	MATCHING TEXT	14 WORDS

To Coulborn, inflation is a situation of "too much money chasing too few goods".

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540/683	SUBMITTED TEXT	14 WORDS	89%	MATCHING TEXT	14 WORDS

To Coulborn, inflation is a situation of "too much money chasing too few goods".

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541/683	SUBMITTED TEXT	14 WORDS	89%	MATCHING TEXT	14 WORDS

To Coulborn, inflation is a situation of "too much money chasing too few goods".

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542/683	SUBMITTED TEXT	14 WORDS	89%	MATCHING TEXT	14 WORDS

To Coulborn, inflation is a situation of "too much money chasing too few goods".

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543/683	SUBMITTED TEXT	14 WORDS	89%	MATCHING TEXT	14 WORDS

To Coulborn, inflation is a situation of "too much money chasing too few goods".

SA Macro Eco SLM after Review.docx (D46015354)

544/683	SUBMITTED TEXT	17 WORDS	100%	MATCHING TEXT	17 WORDS

According to Ackley, "Inflation is a persistent and appreciable rise in the general level or average of prices."

According to Ackley:- "Inflation is a persistent and appreciable rise in the general level or average of prices."**

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545/683	SUBMITTED TEXT	17 WORDS	100%	MATCHING TEXT	17 WORDS

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546/683	SUBMITTED TEXT	14 WORDS	89%	MATCHING TEXT	14 WORDS

To Coulborn, inflation is a situation of "too much money chasing too few goods".

SA Macro Eco SLM after Review.docx (D46016358)

547/683	SUBMITTED TEXT	17 WORDS	100%	MATCHING TEXT	17 WORDS

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548/683	SUBMITTED TEXT	17 WORDS	100%	MATCHING TEXT	17 WORDS

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549/683	SUBMITTED TEXT	15 WORDS	66%	MATCHING TEXT	15 WORDS

Inflation is a persistent and appreciable rise in the general level or average of prices."

Inflation is a persistent and an appreciable increase in the general level of prices.

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

550/683 **SUBMITTED TEXT** 13 WORDS **100%** **MATCHING TEXT** 13 WORDS

prices." According to Samuelson, "Inflation denotes a rise in the general level of prices."

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551/683 **SUBMITTED TEXT** 13 WORDS **100%** **MATCHING TEXT** 13 WORDS

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552/683 **SUBMITTED TEXT** 13 WORDS **100%** **MATCHING TEXT** 13 WORDS

a persistent and appreciable rise in the general level or average of prices."

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553/683 **SUBMITTED TEXT** 13 WORDS **100%** **MATCHING TEXT** 13 WORDS

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554/683 **SUBMITTED TEXT** 13 WORDS **100%** **MATCHING TEXT** 13 WORDS

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555/683 **SUBMITTED TEXT** 12 WORDS **95%** **MATCHING TEXT** 12 WORDS

is a 'persistent' and 'appreciable' increase in the general level of prices.

is a persistent and an appreciable increase in the general level of prices.

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556/683	SUBMITTED TEXT	20 WORDS	60%	MATCHING TEXT	20 WORDS

inflation is a situation in which there is a 'persistent' and 'appreciable' increase in the general level of prices. The

Inflation is a sustained rise in prices." ™ "is a persistent and appreciable rise in the general level or average of prices." ™ the

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557/683	SUBMITTED TEXT	20 WORDS	60%	MATCHING TEXT	20 WORDS

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559/683	SUBMITTED TEXT	20 WORDS	60%	MATCHING TEXT	20 WORDS

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560/683	SUBMITTED TEXT	31 WORDS	35%	MATCHING TEXT	31 WORDS

wage rates in the British economy for the period from 1861 to 1957. He found an inverse relationship between the rate of change in the money wage rate and the rate of

wage behavior in the United Kingdom for the years 1861 and 1957. Phillips found an inverse relationship between the rate of unemployment and the rate of inflation or the rate of

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561/683	SUBMITTED TEXT	31 WORDS	35%	MATCHING TEXT	31 WORDS

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562/683	SUBMITTED TEXT	14 WORDS	90%	MATCHING TEXT	14 WORDS

a trade-off between the rate of unemployment and the rate of change in money

a trade-off between the rate of unemployment and the rate of increase in money

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563/683	SUBMITTED TEXT	11 WORDS	87%	MATCHING TEXT	11 WORDS

a trade-off between the rate of unemployment and the rate of

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564/683	SUBMITTED TEXT	12 WORDS	87%	MATCHING TEXT	12 WORDS

between the rate of unemployment and the rate of change in money

SA for plag.docx (D45796083)

565/683	SUBMITTED TEXT	12 WORDS	87%	MATCHING TEXT	12 WORDS

between the rate of unemployment and the rate of change in money

SA NJ.docx (D45656676)

566/683	SUBMITTED TEXT	12 WORDS	87%	MATCHING TEXT	12 WORDS

between the rate of unemployment and the rate of change in money

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567/683	SUBMITTED TEXT	12 WORDS	87%	MATCHING TEXT	12 WORDS

between the rate of unemployment and the rate of change in money

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568/683	SUBMITTED TEXT	13 WORDS	80%	MATCHING TEXT	13 WORDS

relation between the rate of change in money wages and the rate of

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569/683	SUBMITTED TEXT	11 WORDS	100%	MATCHING TEXT	11 WORDS

between the rate of inflation and the rate of unemployment.

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570/683	SUBMITTED TEXT	13 WORDS	76%	MATCHING TEXT	13 WORDS

there existed an inverse relationship between the rate of inflation and rate of

there exists an inverse relationship between the rate of unemployment and rate of

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571/683	SUBMITTED TEXT	12 WORDS	91%	MATCHING TEXT	12 WORDS

the relationship between the rate of inflation and the rate of unemployment.

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572/683	SUBMITTED TEXT	12 WORDS	90%	MATCHING TEXT	12 WORDS

inverse relationship between the rate of inflation and rate of unemployment

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573/683	SUBMITTED TEXT	11 WORDS	83%	MATCHING TEXT	11 WORDS

relationship between the rate of inflation and the rate of employment. The

SA economic_environment_for_business - Copy.docx (D143644113)

574/683 **SUBMITTED TEXT** 17 WORDS **61%** **MATCHING TEXT** 17 WORDS

medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. 3. Disadvantages of money

SA B.A. Prog principles Macro Eco-I.doc (D110585671)

575/683 **SUBMITTED TEXT** 17 WORDS **61%** **MATCHING TEXT** 17 WORDS

medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. 3. Disadvantages of money

SA Introductory Microeconomics.pdf (D110811121)

576/683 **SUBMITTED TEXT** 17 WORDS **61%** **MATCHING TEXT** 17 WORDS

medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. 3. Disadvantages of money

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577/683 **SUBMITTED TEXT** 17 WORDS **61%** **MATCHING TEXT** 17 WORDS

medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. 3. Disadvantages of money

SA Introductory Microeconomics.pdf (D110864780)

578/683 **SUBMITTED TEXT** 11 WORDS **100%** **MATCHING TEXT** 11 WORDS

inflation. 10. According to Pigou, inflation exists 'when money income is expanding

inflation. . 121 According to Pigou:- "Inflation exists when money income is expanding

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579/683 **SUBMITTED TEXT** 11 WORDS **100%** **MATCHING TEXT** 11 WORDS

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580/683	SUBMITTED TEXT	11 WORDS	100%	MATCHING TEXT	11 WORDS

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581/683	SUBMITTED TEXT	11 WORDS	100%	MATCHING TEXT	11 WORDS

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582/683	SUBMITTED TEXT	17 WORDS	61%	MATCHING TEXT	17 WORDS

medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. 3. Disadvantages of money

SA Introductory Microeconomics.pdf (D110843122)

583/683	SUBMITTED TEXT	17 WORDS	61%	MATCHING TEXT	17 WORDS

medium of exchange; (iii) a standard of deferred payments; and (iv) a store of value. 3. Disadvantages of money

SA Introductory Macroeconomics.pdf (D110867721)

584/683	SUBMITTED TEXT	24 WORDS	40%	MATCHING TEXT	24 WORDS

The modern approach to inflation follows the theory of price determination. That is, the general price is determined by aggregate demand for and aggregate supply

the theory. MODERN APPROACH TO INFLATION 1. The modern approach focuses on the fact that the price level is determined by the aggregate demand and the aggregate supply.

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

585/683	SUBMITTED TEXT	14 WORDS	71%	MATCHING TEXT	14 WORDS

price level is caused by the shift in the aggregate demand and aggregate supply

price level is determined by When the increase in the price aggregate demand and aggregate supply,

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586/683 **SUBMITTED TEXT** 20 WORDS **57%** **MATCHING TEXT** 20 WORDS

M3) comprise the (I) currency with the public, (ii) demand, deposits with the banks, and (iii) time deposits with the banks.

SA 6.3 Economics for Business Block 3.pdf (D165800765)

587/683 **SUBMITTED TEXT** 19 WORDS **84%** **MATCHING TEXT** 19 WORDS

The supply of money in the economy depends on the degree of responsibility of the central bank; and the

The supply of money in an economy depends on the degree of responsibility and the judgments of the central bank and the

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

588/683 **SUBMITTED TEXT** 19 WORDS **84%** **MATCHING TEXT** 19 WORDS

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589/683 **SUBMITTED TEXT** 19 WORDS **84%** **MATCHING TEXT** 19 WORDS

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591/683 **SUBMITTED TEXT** 17 WORDS **61%** **MATCHING TEXT** 17 WORDS

of money in the economy depends on the degree of responsibility of the central bank; and the

SA Sambalpur-BBA-SEM-III-Macroeconomics.pdf (D156210285)

592/683 **SUBMITTED TEXT** 15 WORDS **70%** **MATCHING TEXT** 15 WORDS

economy depends on (a) the degree of responsibility of the central bank; and (b) the

economy depends on the degree of responsibility and the judgments of the central bank and the

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

593/683 **SUBMITTED TEXT** 15 WORDS **70%** **MATCHING TEXT** 15 WORDS

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economy depends on the degree of responsibility and the judgments of the central bank and the

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

594/683 **SUBMITTED TEXT** 15 WORDS **70%** **MATCHING TEXT** 15 WORDS

economy depends on (a) the degree of responsibility of the central bank; and (b) the

economy depends on the degree of responsibility and the judgments of the central bank and the

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

595/683 **SUBMITTED TEXT** 11 WORDS **100%** **MATCHING TEXT** 11 WORDS

most important function of money in society is to act as

SA MA Ist Year AMU.docx (D142324729)

596/683 **SUBMITTED TEXT** 15 WORDS **70%** **MATCHING TEXT** 15 WORDS

economy depends on (a) the degree of responsibility of the central bank; and (b) the

economy depends on the degree of responsibility and the judgments of the central bank and the

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

Ouriginal by Turnitin

597/683	SUBMITTED TEXT	13 WORDS	88%	MATCHING TEXT	13 WORDS

economy depends on the degree of responsibility of the central bank; and the

economy depends on the degree of responsibility and the judgments of the central bank and the

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

598/683	SUBMITTED TEXT	13 WORDS	88%	MATCHING TEXT	13 WORDS

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economy depends on the degree of responsibility and the judgments of the central bank and the

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

599/683	SUBMITTED TEXT	11 WORDS	100%	MATCHING TEXT	11 WORDS

most important function of money in society is to act as

SA MA Ist Year AMU.docx (D142429512)

600/683	SUBMITTED TEXT	13 WORDS	88%	MATCHING TEXT	13 WORDS

economy depends on the degree of responsibility of the central bank; and the

economy depends on the degree of responsibility and the judgments of the central bank and the

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

601/683	SUBMITTED TEXT	13 WORDS	88%	MATCHING TEXT	13 WORDS

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economy depends on the degree of responsibility and the judgments of the central bank and the

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

602/683	SUBMITTED TEXT	17 WORDS	61%	MATCHING TEXT	17 WORDS

of money in the economy depends on the degree of responsibility of the central bank; and the

SA Sambalpur-BBA-SEM-III-Macroeconomics.pdf (D156210285)

603/683	SUBMITTED TEXT	19 WORDS	100%	MATCHING TEXT	19 WORDS

The use of high-powered money consists of the demand of commercial banks for the legal limit or required reserves

The use of high-powered money consists of the demand of commercial banks for the legal limit or required reserves (430 7739

W https://www.askokorpela.fi/Kindle/Book/Jhingan-Macro-all.htm

Ouriginal by Turnitin

604/683	SUBMITTED TEXT	20 WORDS	67%	MATCHING TEXT	20 WORDS

Inflation means generally a considerable and persistent rise in the general level of prices. However, a precise meaning of 'inflation'

Inflation means a considerable and persistent rise in the general level of prices over a long period of time. ™ " Inflation

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

605/683	SUBMITTED TEXT	20 WORDS	67%	MATCHING TEXT	20 WORDS

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606/683	SUBMITTED TEXT	20 WORDS	67%	MATCHING TEXT	20 WORDS

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Inflation means a considerable and persistent rise in the general level of prices over a long period of time. ™ " Inflation

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

607/683	SUBMITTED TEXT	20 WORDS	67%	MATCHING TEXT	20 WORDS

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W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

608/683	SUBMITTED TEXT	16 WORDS	66%	MATCHING TEXT	16 WORDS

Write a short note on the methods of measuring inflation. 7. Write a short note on

Write a short note on the secondary functions of money. 5. Write a short note on

W https://vdoc.pub/documents/macroeconomics-theory-and-policy-48s7qvaeana0

609/683	SUBMITTED TEXT	17 WORDS	58%	MATCHING TEXT	17 WORDS

of the money supply ?The theoretical analysis of the demand for money is a function of the

SA PAPER CP 202 FULL PDF.pdf (D165318885)

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610/683	SUBMITTED TEXT	12 WORDS	88%	MATCHING TEXT	12 WORDS

OBJECTIVES After going through this unit, you will be able to: ?Elaborate the

SA Macro Economics I.pdf (D138997544)

611/683	SUBMITTED TEXT	26 WORDS	76%	MATCHING TEXT	26 WORDS

accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise.'

accepting , for the purpose of lending or investments , of deposits of money from the public , repayable on demand or otherwise and withdraw able by cheques , drafts , order or otherwise."

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

612/683	SUBMITTED TEXT	26 WORDS	76%	MATCHING TEXT	26 WORDS

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W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

613/683	SUBMITTED TEXT	26 WORDS	76%	MATCHING TEXT	26 WORDS

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W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

614/683	SUBMITTED TEXT	26 WORDS	76%	MATCHING TEXT	26 WORDS

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W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

615/683 **SUBMITTED TEXT** 15 WORDS **62%** **MATCHING TEXT** 15 WORDS

this unit, you will be able to: ?Elaborate the types of Banks ?Describe the functions of

SA BFG 201 Money, Central Banking in India and International Financial Institutions BFG - I.pdf (D165093763)

616/683 **SUBMITTED TEXT** 14 WORDS **88%** **MATCHING TEXT** 14 WORDS

accepting, for the purpose of lending or investment, of deposits of money from

SA Sambalpur-BBA-SEM-III-Macroeconomics.pdf (D156210285)

617/683 **SUBMITTED TEXT** 15 WORDS **100%** **MATCHING TEXT** 15 WORDS

are not merely purveyors of money, but also, in an important sense, manufacturers of money.' 5.3

are not merely purveyors of money, but also in an important sense, manufacturers of money." 4

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

618/683 **SUBMITTED TEXT** 15 WORDS **100%** **MATCHING TEXT** 15 WORDS

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619/683 **SUBMITTED TEXT** 15 WORDS **100%** **MATCHING TEXT** 15 WORDS

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620/683 **SUBMITTED TEXT** 15 WORDS **100%** **MATCHING TEXT** 15 WORDS

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621/683 **SUBMITTED TEXT** 19 WORDS **97%** **MATCHING TEXT** 19 WORDS

the primary definition of central banking is a banking system in which a single bank has either complete or

The primary definition of central banking is a banking system in which a single bank has either a complete or

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

Ouriginal by Turnitin

622/683	SUBMITTED TEXT	26 WORDS	94%	MATCHING TEXT	26 WORDS

accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise.'

SA 6.3 Economics for Business Block 3.pdf (D165800765)

623/683	SUBMITTED TEXT	19 WORDS	97%	MATCHING TEXT	19 WORDS

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624/683	SUBMITTED TEXT	19 WORDS	97%	MATCHING TEXT	19 WORDS

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625/683	SUBMITTED TEXT	19 WORDS	97%	MATCHING TEXT	19 WORDS

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The primary definition of central banking is a banking system in which a single bank has either a complete or

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626/683	SUBMITTED TEXT	14 WORDS	96%	MATCHING TEXT	14 WORDS

generally to operate the currency and credit system of the country to its advantage.'

generally to operate the currency and the credit system of the country to its advantage." . 163 10.3

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627/683	SUBMITTED TEXT	14 WORDS	96%	MATCHING TEXT	14 WORDS

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628/683 **SUBMITTED TEXT** 15 WORDS **80%** **MATCHING TEXT** 15 WORDS

a bank which constitutes the apex of the monetary and banking structure of its country

SA BFG 201 Money, Central Banking in India and International Financial Institutions BFG - I.pdf (D165093763)

629/683 **SUBMITTED TEXT** 14 WORDS **96%** **MATCHING TEXT** 14 WORDS

generally to operate the currency and credit system of the country to its advantage.'

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630/683 **SUBMITTED TEXT** 14 WORDS **96%** **MATCHING TEXT** 14 WORDS

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generally to operate the currency and the credit system of the country to its advantage." . 163 10.3

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631/683 **SUBMITTED TEXT** 28 WORDS **100%** **MATCHING TEXT** 28 WORDS

It is not only a means of economizing cash and capital, but is also a means of testing at any time the degree of liquidity which the community is maintaining—

SA BFG 201 Money, Central Banking in India and International Financial Institutions BFG - I.pdf (D165093763)

632/683 **SUBMITTED TEXT** 19 WORDS **71%** **MATCHING TEXT** 19 WORDS

the RBI to be 'to regulate the issue of bank notes and the keeping of reserve with a view

the RBI as being To regulate the Issue of the bank notes and the keeping of reserves with a view

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

633/683 **SUBMITTED TEXT** 19 WORDS **71%** **MATCHING TEXT** 19 WORDS

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634/683	SUBMITTED TEXT	19 WORDS	71%	MATCHING TEXT	19 WORDS

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635/683	SUBMITTED TEXT	19 WORDS	71%	MATCHING TEXT	19 WORDS

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636/683	SUBMITTED TEXT	15 WORDS	100%	MATCHING TEXT	15 WORDS

generally to operate the currency and credit system of the country to its advantage.' The

SA 6.3 Economics for Business Block 3.pdf (D165800765)

637/683	SUBMITTED TEXT	15 WORDS	96%	MATCHING TEXT	15 WORDS

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W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

638/683	SUBMITTED TEXT	15 WORDS	96%	MATCHING TEXT	15 WORDS

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W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

639/683	SUBMITTED TEXT	15 WORDS	96%	MATCHING TEXT	15 WORDS

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640/683	SUBMITTED TEXT	16 WORDS	90%	MATCHING TEXT	16 WORDS

to regulate the issue of bank notes and the keeping of reserve with a view

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641/683	SUBMITTED TEXT	15 WORDS	96%	MATCHING TEXT	15 WORDS

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642/683	SUBMITTED TEXT	17 WORDS	63%	MATCHING TEXT	17 WORDS

Rate Bank rate is the rate at which the central bank gives loans to commercial banks against the

Rate: Bank rate is the rate at which Reserve Bank provides loans to the commercial banks in the

W https://mu.ac.in/wp-content/uploads/2021/11/Elements-of-Macroeconomics-English-Version.pdf

643/683	SUBMITTED TEXT	17 WORDS	63%	MATCHING TEXT	17 WORDS

Rate Bank rate is the rate at which the central bank gives loans to commercial banks against the

Rate: Bank rate is the rate at which Reserve Bank provides loans to the commercial banks in the

W https://scholarsclasses.com/blog/wp-content/uploads/2022/05/Elements-of-Macroeconomics-English-Ve ...

644/683	SUBMITTED TEXT	17 WORDS	100%	MATCHING TEXT	17 WORDS

India and generally to operate the currency and credit system of the country to its advantage'. The

SA 6.3 Economics for Business Block 3.pdf (D165800765)

645/683	SUBMITTED TEXT	11 WORDS	95%	MATCHING TEXT	11 WORDS

The important function of the central bank is to control the credit-

The most important function of the central bank is to control the credit

W https://www.askokorpela.fi/Kindle/Book/Jhingan-Macro-all.htm

646/683	SUBMITTED TEXT	17 WORDS	55%	MATCHING TEXT	17 WORDS

Rate Bank rate is the rate at which the central bank gives loans to commercial banks against the

SA final book.docx (D143611479)

647/683 **SUBMITTED TEXT** 11 WORDS **95%** **MATCHING TEXT** 11 WORDS

The important function of the central bank is to control the credit-

SA BFG 201 Money, Central Banking in India and International Financial Institutions BFG - I.pdf (D165093763)

648/683 **SUBMITTED TEXT** 11 WORDS **90%** **MATCHING TEXT** 11 WORDS

the commercial banks. In India, the Reserve Bank of India has

SA economic_environment_for_business - Copy.docx (D143644113)

649/683 **SUBMITTED TEXT** 11 WORDS **100%** **MATCHING TEXT** 11 WORDS

by the Board of Governors of the Federal Reserve System

by the board of governors of the Federal Reserve System

W https://www.investopedia.com/terms/m/multiplierеffect.asp

650/683 **SUBMITTED TEXT** 13 WORDS **100%** **MATCHING TEXT** 13 WORDS

policy employing central bank's control of the supply of money as an instrument

SA 17.4.23 Macroeconomiics(2).doc (D164309062)

651/683 **SUBMITTED TEXT** 16 WORDS **100%** **MATCHING TEXT** 16 WORDS

any conscious action undertaken by the monetary authorities to change the quantity, availability or cost... of money".

SA slm business eco macro - complete.docx (D44840960)

652/683 **SUBMITTED TEXT** 16 WORDS **100%** **MATCHING TEXT** 16 WORDS

any conscious action undertaken by the monetary authorities to change the quantity, availability or cost... of money".

SA NJ.docx (D45656676)

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653/683	SUBMITTED TEXT	27 WORDS	86%	MATCHING TEXT	27 WORDS

achieving the objectives of general economic policy". Shaw defines monetary policy as "any conscious action undertaken by the monetary authorities to change the quantity, availability or cost... of money".

SA 17.4.23 Macroeconomiics(2).doc (D164309062)

654/683	SUBMITTED TEXT	12 WORDS	87%	MATCHING TEXT	12 WORDS

cheques, bills of exchange, promissory notes, etc., on behalf of its customers.

cheques, bills of exchange, promissory notes etc., on behalf of their customers. (

W https://mu.ac.in/wp-content/uploads/2020/10/Book-No-57-Macro-Economics-S.Y.B.A..pdf

655/683	SUBMITTED TEXT	12 WORDS	87%	MATCHING TEXT	12 WORDS

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656/683	SUBMITTED TEXT	12 WORDS	87%	MATCHING TEXT	12 WORDS

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658/683	SUBMITTED TEXT	15 WORDS	100%	MATCHING TEXT	15 WORDS

are not merely purveyors of money, but also, in an important sense, manufacturers of money.' 5.8

are not merely purveyors of money, but also in an important sense, manufacturers of money." 4

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659/683	SUBMITTED TEXT	15 WORDS	100%	MATCHING TEXT	15 WORDS

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661/683	SUBMITTED TEXT	19 WORDS	90%	MATCHING TEXT	19 WORDS

monetary policy as "any conscious action undertaken by the monetary authorities to change the quantity, availability or cost... of money".

SA slm business eco macro - complete 131218.docx (D45657799)

662/683	SUBMITTED TEXT	15 WORDS	100%	MATCHING TEXT	15 WORDS

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663/683	SUBMITTED TEXT	23 WORDS	69%	MATCHING TEXT	23 WORDS

the RBI to be 'to regulate the issue of bank notes and the keeping of reserve with a view to securing monetary stability

the RBI as being To regulate the Issue of the bank notes and the keeping of reserves with a view of securing monetary stability

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667/683	SUBMITTED TEXT	23 WORDS	100%	MATCHING TEXT	23 WORDS

universal access to banking facilities with at least one basic banking account for every household, financial literacy, access to credit, insurance and pension.

SA final book.docx (D143611479)

668/683	SUBMITTED TEXT	14 WORDS	96%	MATCHING TEXT	14 WORDS

and generally to operate the currency and credit system of the country to its advantage'.

and generally to operate the currency and the credit system of the country to its advantage." . 163 10.3

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672/683	SUBMITTED TEXT	20 WORDS	92%	MATCHING TEXT	20 WORDS

to regulate the issue of bank notes and the keeping of reserve with a view to securing monetary stability in

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India and generally to operate the currency and credit system of the country to its advantage'. The

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Bank rate policy or the discount rate is the rate of interest at which the central bank rediscounts eligible bills of exchange

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of total deposits which commercial banks are required to maintain in the form of cash

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