Economics Class 07

23rd July, 2023 at 9:00 AM

REVISION OF THE PREVIOUS CLASS (9:05 AM)

- **Currency Convertibility** is nothing but converting one currency into another with minimum restrictions.
- Even today, the Indian rupee is only partially convertible:
- The Indian rupee is fully convertible concerning the current account and it is partially convertible concerning the capital account.
- **Current Account convertibility** allows free inflows and outflows of foreign currency for the transactions that will be mentioned in the current account.
- **Capital Account convertibility** means the freedom to convert the rupee into any foreign currency, and foreign currency back into the rupee for capital account transactions.
- **Generation Economic reforms** were done just after the 1991 **Balance of Payment** crisis.
- A BOP crisis arises when the value of imports of any nation becomes too large than the value of its exports.
- They included reforms related to the Financial sector, Industry, MSME, Fiscal and tax reforms, External sector, etc.
- **Second Generation Reforms** reforms were taken after 1999-2000.
- These were difficult to implement and they mainly focussed on:
- **I. Legal reforms- liberalization of labour laws like Rajasthan.**
- India has been known for having strict labour laws.
- The step proved counter-productive as industries went for having **contractual labour** rather than permanent employment.
- Contractual labour is mainly untrained and out of social security benefits- pension, healthcare, etc.
- **II. Factor market reforms- removing administered pricing reforms(removal of subsidies on retail items like petrol, diesel, etc.).**
- Government interference in pricing mechanisms for various commodities distorts the market for private participation.
- Such interferences also increase government deficits.
- **III. Capital account convertibility, etc.**

Answer writing basics:

- For our answer, time & word limits are as important as the content expected in the question.
- We are not expected to write the best possible answer on any topic; our answers must only be better and faster than others.
- We need data to prove/substantiate our point, in all parts of the answer.

Introduction:

- We can either start with a **direct introduction** -defining keyword(s).
- For a **question** like- **How can the market economy be made more inclusive?**
- We can introduce this by defining "Market Economy" and /or "Inclusive".
- We can also go for an **indirect introduction-** background.
- As for the same question, we can introduce it by mentioning that the Market economy and inclusivity/inequality issue have been getting prominent in India since 1991.

Question 2: How did globalization lead to formalization?

- **Approach:**
- We can introduce the answer with a brief background of globalization and formalization, and try to add some relevant data like the recent percentage of formal employment.
- Our answer must have aspects like:
- **Over-tertiarization of the economy-** Globalisation mainly pushed the services sector in India in which not everyone can participate due to high skill requirements.

- **Muted manufacturing** meant that the manufacturing sector could not absorb surplus labour from agriculture.
- **Construction jobs** were created in large numbers, but most of them were informal.
- Globalization caused the creation of a **Gig economy,** which was large but informal.
- **Failure of second-generation reforms- Labor laws** continued to remain strict which held back private companies from creating more formal jobs.

Question 3: How can financial inclusion cause economic/inclusive growth?

- **Approach:**
- We can introduce the answer by defining Financial inclusion and inclusive growth.
- We can add some data to add value, like the approximate percentage of the population having a bank account.
- The answer must have aspects like:
- Financial inclusion/having a bank account can help in savings which can translate into investments that can benefit both the individual/family & the country.
- Bank accounts give access to the benefits of government schemes, formal credit, etc. all of which can be helpful in increasing demand & production.
- We can add examples like relevant government schemes (PM KISAN, etc.)
- Knowing the demand of the question is the most important.
- We are not supposed to bombard the examiner with unrelated or closely related facts but stick to the demand of the question.
- **For example in this question,** informal employment also increased due to disinvestment, privatization, and uneven development.
- However, mentioning the aspects can be avoided here as they are not directly linked with globalization.
- Timely completion of the paper must be prioritized over attempting a few questions in an excellent manner because in any case, we are not going to be awarded more the 55% of the total marks of the question.
- Students must try to avoid definitions until and unless explicitly asked or they are very important.
- As the syllabus is well-defined, most of the questions are going to be on the expected lines.
- Students must be well-prepared with relevant data and quotes. etc for at least the most probable(most in-news)topics.

ABSOLUTE POVERTY (9:25 AM) :

- It indicates the basic requirements for leading a dignified life (Article 21 of the Constitution).
- Generally, the **food-calorie method** is used as a standard method for measuring poverty.
- Less than 2400 calories per day in rural areas and 2100 calories per day in urban areas are treated as poor.
- Absolute poverty is estimated using a **Poverty Line Basket(PLB).**
- The PLB consists of all necessities required for leading life.
- PLB shows the consumption items needed to have the minimum consumption levels.
- The basket mainly has food items.

GDP CALCULATION (9:55 AM):

- **Nominal GDP:**
- It is the GDP measured at the current year's prices- the value of the goods and services produced in a particular year.
- **For example-** the quantity(Q) of 2022-2023 * prices(P) of 2022-2023= $3.5 Trillion is the nominal GDP of India.
- Nominal GDP growth is not considered to be a very good indicator of economic growth or an increase in productional capacity.
- This is because we can see a growth in nominal GDP even if we see no increased production.
- This increase can be seen in the prices of the goods produced increase due to inflation.

- **For example:**
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Quantity 2021-2022	**Prices 2021-2022(in rupees)**	**Quantity 2022-2023**	**Prices 2022-2023 (in rupees)**
100 Cars	6 lakhs each	100 Cars	7 lakhs each
200 Motorcycles	1 lakh each	200 Motorcycles	1. 5 lakhs
1000 Dairy Milks	10 each	1000 Dairy Milks	15 each
2000 Milk packs	35 each	2000 Milk packs	40 each
Nominal GDP 2021-2022	Rs 80080000	**Nominal GDP 2022-2023**	Rs 100095000

- In the above example, we can see that even if we had the same level of production in 2021-2022 & 2022-2023, we get a higher nominal GDP in 2022-2023.
- The Indian aim of increasing our GDP to $5 trillion talks about increasing nominal GDP.

Real GDP:

- It is the GDP measured at the base year or the constant year prices.
- Real GDP growth indicates whether GDP has increased mainly because of production or not.
- **For example:**
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Quantity 2021-2022	**Prices 2021-2022(in rupees)**	**Quantity 2022-2023**	**Prices 2022-2023(in rupees)**
100 Cars	6 lakhs each	150 Cars	6 lakhs each
200 Motorcycles	1 lakh each	250 Motorcycles	1 lakhs
1000 Dairy Milks	10 each	1100 Dairy Milks	10 each
2000 Milk packs	35 each	2500 Milk packs	35 each
Nominal GDP 2021-2022	Rs 80080000	**Real GDP 2022-2023**	Rs 115098500

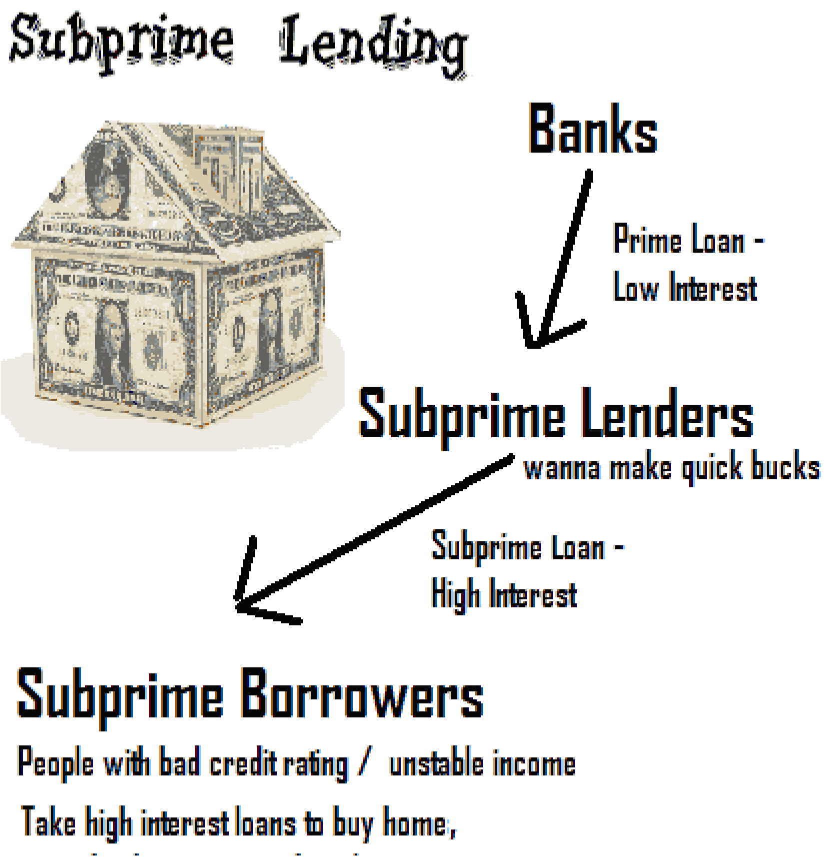
- In the above example, we see that the GDP has increased, even if we are able to control inflation.

Base Year:

- It is the year that is used for making comparisons.
- Base years are selected based on **certain criteria like:**
- I. Availability of data.
- II. Stable Year.
- III. Generally recent years- because some products might not have been produced some decades back.

Sub Prime Crisis 2008:

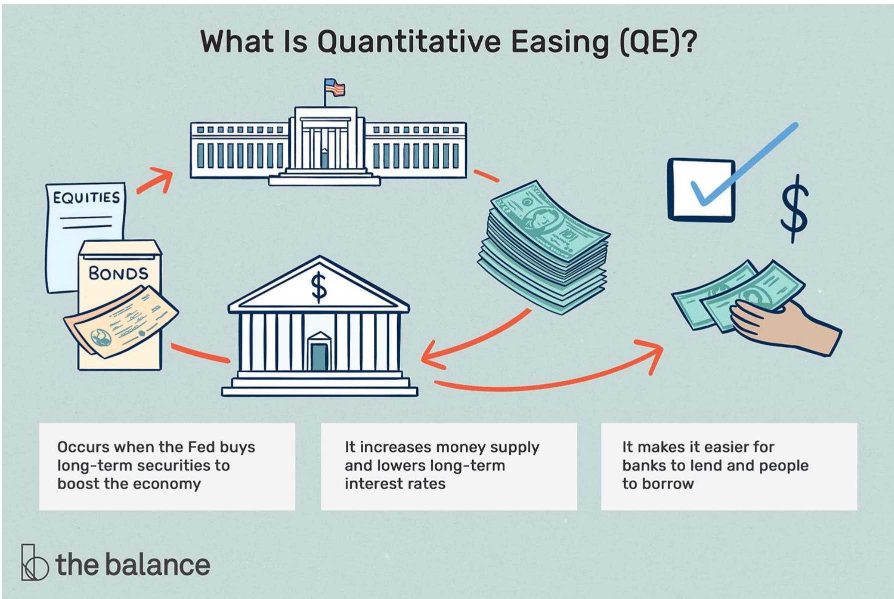
- The crisis was mainly due to the large lending by US banks and financial institutions, even to those individuals who did not have the capacity to pay back.



- Loan chains/cycles were created and the chain/cycle collapsed if the final sub-prime borrower did not pay.
- Due to LPG reforms, India got more vulnerable to the economic crisis based in other nations.

Quantitative Easing:

- It is a bond-buying program that was performed by the Federal Bank of the USA.
- Quantitative easing increased dollar supply in the USA market.



- This was done to revive the US economy after the subprime crisis of 2008.

FEDERAL TIGHTENING (10:40 AM):

- The Federal Bank started to reduce the money supply in the economy. after 2012, once the US economy started improving.
- It was achieved by slowing done the purchasing of bonds.
- It increases interest rates in the USA market.
- Federal tightening can be a triggering factor for the dollar strengthening and associated rupee-value depreciation in India.
- This is because large firms will remove their dollars from India to place them in other safer places like purchasing USA bonds.

Dual-Dilemma:

- It is the dilemma with respect to the focus of monetary policy- whether to focus on growth or inflation.
- Dual dilemmas are generally faced when there is low growth and high inflation.
- Inflation can be controlled by increasing the borrowing interest rates which would reduce the money supply (as explained later with the Repo rate).
- However, higher interest rate makes both individuals and businesses hesitant to take loans for demand and expansion.
- This results in lower economic growth.

MONETARY POLICY (11:15 AM):

- The policy deals with the amount of money supply in the economy.
- In India, it is taken care of by the Reserve Bank of India (RBI).
- Earlier, RBI considered many factors for formulating the monetary policy:
- 1. GDP growth.
- 2. Inflation.
- 3. Rupee convertibility.
- 4. Development- Unemployment & Poverty.
- Monetary policy can be used to inject liquidity- **Expansionary monetary policy,** or to reduce money supply- **Contractionary monetary policy.**
- Later, RBI focussed mainly on 1 & 2 and it was believed that 3 & 4 must be handled by the government and RBI has less control over it.
- It was apparent that focussing on GDP growth would need/cause high inflation and inflation was to be controlled also.

Expansionary monetary policy:

- It focuses on increasing monetary supply and thereby boosting economic growth.
- It involves reducing the interest rates of the banking system through different monetary tools- **Quantitative and qualitative.**

Quantitative tools:

- These tools deal with the money supply in the overall economy.
- **For example:**
- LAF- Liquidity Adjustment Facility- Repo Rate & Reverse Repo Rate.
- Reserve Requirements- Cash Reserve Ratio (CRR), Statutory Liquidity Ratio (SLR).
- Marginal Standing Facility (MSF)
- Standing Deposit Facility (SDF)
- Bank Rate.

Qualitative tools:

- Selective credit controls for specific sectors.
- **For example-** Changing credit policies with respect to agriculture, or any other sector.

Contractionary Monetary Policy:

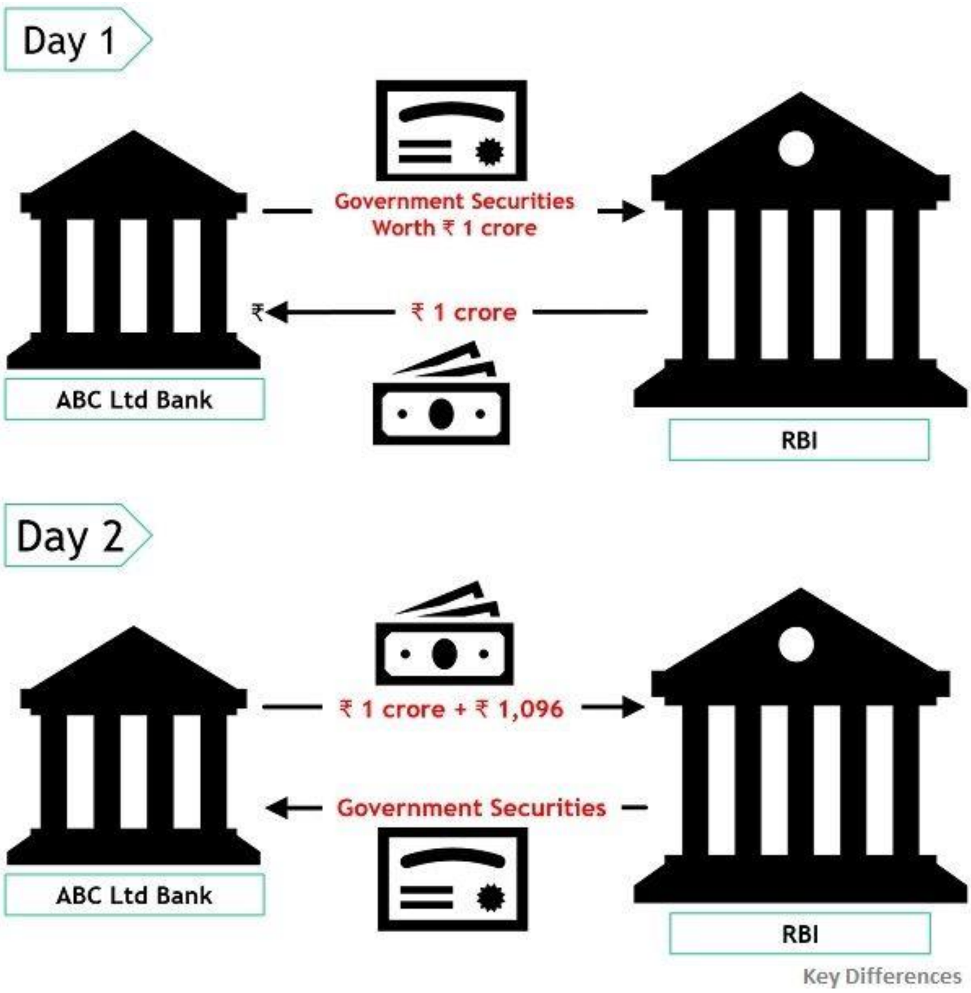
- It focuses on reducing the money supply by increasing interest rates of the banking system with the primary objective of reducing inflation.

India After 2011 (11:45 AM):

- After 2011, due to the Federal Bank's policies and several internal economic challenges, the Indian rupee started depreciating.
- It led to higher inflation and trade deficits.
- Along with high inflation, the Indian GDP growth rate went below 5 % consecutively for two years.
- This created a dilemma with respect to the focus of the monetary policy.
- The dilemma is mainly with respect to reducing inflation or increasing economic growth.
- **Urjit Patel Commitee** advised focusing on **Inflation Targeting.**
- It was a mechanism under which the RBI had come up with a monetary policy of keeping inflation within an inflation target range.
- The target range is fixed by the government in consultation with RBI for a period of five years.
- As of now, the permissible inflation range is **4+/- 2 %;** which means that the inflation must lie between 2% and 6%.
- RBI can only handle demand-pull inflation and not cost-push inflation and structural factors.
- This led to the formation of a **Monetary Policy Framework.**

Repo Rate:

- Repo rate means "Repurchase Agreement".
- It is the **short-term interest rate** at which RBI lends money to the banks.
- At any given time, the bank may face a credit demand that may be in excess of its deposits.
- In such cases, RBI, being the banker of the banks provides a liquidity adjustment facility.
- Repo operations must take place through buying and selling of government bonds, and an agreement to repurchase them within a short period.
- For example- if a bank wants money from RBI, it will sell government bonds and agree to purchase them back from RBI within a period of 15 days.
- In this case, the bank may sell some of its government securities to the RBI at say 100 rupees and promise to buy those securities back at 106.5 rupees after 15 days.
- Here repo rate will be 6.5%.



- A higher repo rate will mean expensive loans less money will be loaned out by the banks.
- That is because if the banks give out loans at 4% interest, the repo rate is 6.5 % and the banks have taken some funds from RBI to extend as loans.
- Banks must give loans at least 10.5 % (4+ 6.5) so that banks can give 6.5% to RBI and maintain their profit at 4%.
- Banks will find less interested people/companies to take loans at 10.5% than they had when they gave loans at a 4% interest rate.
- So higher repo rate would mean a lesser money supply in the economy, which will pull down the high inflation.
- If there is rupee appreciation, it would mean there are fewer rupees in the market.
- So to control rupee appreciation, RBI should increase rupee circulation in the market, which would be done by decreasing the repo rate.

The topic for the next class is the continuation of the monetary policy