# Economics Project

# IIM-A -Day to day economics

# Book report

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- <u>MEDLEY OF GOVERNMENT AND PRIVATE SECTOR.</u>

The private sector is usually composed of organizations that are privately owned and not part of the government. These usually includes corporations (both profit and non-profit), partnerships, and charities.

The public sector is usually composed of organizations that are owned and operated by the government. This includes federal, provincial, state, or municipal governments, depending on where you live.

- Pure public goods

  In economics, a **public good** is a good that is both non-excludable and non-rivalrous in that individuals cannot be effectively excluded from use and where use by one individual does not reduce availability to others. Examples of public goods include fresh air,knowledge, lighthouses, national defense, flood control systems and street lighting.
- Natural monopolies

  A *natural monopoly* is a distinct type of monopoly that may arise when there are extremely high fixed costs of distribution, such as exist when large-scale infrastructure is required to ensure supply. Examples of infrastructure include cables and grids for electricity supply, pipelines for gas and water supply, and networks for rail and underground. These costs are also sunk costs, and they deter entry and exit.

1. **Economies of scale**

With natural monopolies, economies of scale are very significant so that minimum efficient scale is not reached until the firm has become very large in relation to the total size of the market.

Minimum efficient scale (MES) is the lowest level of output at which all scale economies are exploited. If MES is only achieved when output is relatively high, it is likely that few firms will be able to compete in the market.

2. **Public utilities**

Natural monopolies are common in markets for 'essential services' that require an expensive infrastructure to deliver the good or service, such as in the cases of water supply, electricity, and gas, and other industries known as public utilities.

Because there is the potential to exploit monopoly power, governments tend to nationalize or heavily regulate them.

3. **Regulators**

If public utilities are privately owned, as in the UK, since privatization during the 1980s, they usually have their own special regulator to ensure that they do not exploit their monopoly status.

Examples of regulators include, the energy regulator, the telecoms and media regulator. Regulators can cap prices or the level of return gained.

## *CASE : RAILWAYS AS NATURAL MONOPOLY*

*Railways are often considered a typical example of natural monopoly. The very high costs of laying track and building a network, as well as the costs of buying or leasing the trains, would prohibit, or deter, the entry of a competitor.*

*To society, the costs associated with building and running a rival network would be wasteful*

4. **Avoiding wasteful duplication of resources**

The best way to ensure competition, without the need to duplicate the infrastructure, is to allow new train operators to use the existing track; hence, competition has been introduced, without duplication of costs. This is called opening-up the infrastructure.

This approach is frequently adopted to deal with the problem of privatizing natural monopolies and encouraging more competition, such as:

Telecoms, the network is provided by BT

Gas, the network is provided by National Grid (previously Transco)

- Club good

Club goods (also artificially scarce goods) are a type of good in economics, sometimes classified as a subtype of public goods that are excludable but non-rivalries, at least until reaching a point where congestion occurs. These goods are often provided by a natural monopoly. Club goods have artificial scarcity.

1. **Excludability**

In economics, a good or service is called excludable if it is possible to prevent people (consumers) who have not paid for it from having access to it. By comparison, a good or service is non-excludable if non-paying consumers cannot be prevented from accessing it.

2. **Non Rivalry**

A market characteristic where the consumption of a good or a service by an individual does not affect consumption by another individual. For Example, a street play, if one person watches the play, it does not affect the consumption by another person.

- Externalities

In economics, an externality is the cost or benefit that affects a party who did not choose to incur that cost or benefit. A consequence of an economic activity that is experienced by unrelated third parties. A situation in an economic activity where there is a divergence of private benefit(cost) and social benefit(cost).An externality can be either positive or negative.

Pollution emitted by a factory that spoils the surrounding environment and affects the health of nearby residents is an example of a negative externality. An example of a positive externality is the effect of a well-educated labor force on the productivity of a company.

The reason these negative externalities, otherwise known as social costs, occur is that these expenses are generally not included in calculating the costs of production. Production decisions are generally based on financial data and most social costs are not measured that way. As a result, a product that shouldn't be produced, because the total expenses exceed the return, are made because social costs were not considered.

## CASE : NEGATIVE EXTERNALITIES OF NUCLEAR POWER PLANTS

### Overview

*The use of nuclear power as a source of domestic energy has increased significantly over the past decade and is expected to continue to do so in the years to come. These can range from environmental impact, altering to a great extent the balance in the flora and fauna of a region, to causing social problems to do with social consensus and risk perceptions of people living in the vicinity of such a plant.*

### Heat Rejection

*As is with the case of thermal power plants (based on fossil fuels), nuclear power plants require some means by which they can expel heat as part of their condenser system. It also adversely affects the aquatic life of the ecosystem into which heat is rejected. One particular research done showed an average rise in sea level of about 3mm/yr of the Northeast coast of US.*

## Gaseous Emissions

The gaseous emissions from a nuclear power plant can be of different forms and intensities. Nuclear power plants use diesel generators as a means for back-up electric power in case of emergencies. Greenhouse gases, exhaust gases from buildings containing radioactive processes is radioactive in nature. Such exhausts are passed through delay pipes and storage tanks before release into the environment to ensure that radiation levels are in accordance to regulations.

## Environmental Impact

Perhaps the impact which is easiest to notice is the effect on the environment, particularly in terms of flora and fauna. To start with, the setting up of a nuclear plant requires a large area, preferably situated near a natural water body. This is usually accompanied with clearing of forests which disturbs the natural habitat of several creatures and gradually upsets the ecological balance of the region. Apart from this, due to the heat rejected into the water bodies, there have been significant drops in the populations of several species of fish in certain regions of US.

## Social Impact

Setting up a nuclear power plant in any region does not come without concerns and criticism from a wide variety of people. People in such regions fear the threat of being exposed to unusual levels of radiation. The natural water sources in such places are also doubted to contain plant emissions especially if the plant uses the body of water as a heat sink.

## Gross domestic product

The monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

**GDP = C + G + I + NX**

Where:

"C" is equal to all private consumption, or consumer spending, in a nation's economy

"G" is the sum of government spending

"I" is the sum of all the country's businesses spending on capital

"NX" is the nation's total net exports, calculated as total exports minus total imports. (NX = Exports - Imports)

GDP is commonly used as an indicator of the economic health of a country, as well as to gauge a country's standard of living. Critics of using GDP as an economic measure say the statistic does not take into account the underground economy - transactions that, for whatever reason, are not reported to the government.

# • <u>Budget, deficits and taxation.</u>

- Expenditure
  Expenditure is Payment of cash or cash-
  equivalent for goods or services, or
  a charge against available funds in settlement of
  an obligation as evidenced by an invoice, receipt, voucher,
  or other such document.

**1.Captial Expenditure**

Capital expenditure is spending on assets. It is the purchase of items that will last and will be used time and time again in the provision of a good or service. In the case of the government, examples would be the building of a new hospital, the purchase of new computer equipment or networks, building new roads and so on.

**2.Revenue Expenditure**

Revenue expenditure are expenses incurred in the normal running of the government departments and maintenance of services. In the case of the government, current expenditure would include wages and salaries and expenditure on consumables - stationery, drugs for health service, bandages and so on. The purpose of such expenditure is not to build any capital asset but to assure normal functioning of government machinery.

- Receipts
  Receipts is the money received from taxation, fees, fines, inter-governmental grants or transfers, securities sales, mineral rights and resource rights, as well as any sales that are made.

**1.Capital Receipts**

Capital receipt is the amount received from the sale of assets, shares and debentures. Capital receipt is of non-recurring nature. Capital receipt include borrowing of the government like market loan and short term borrowing.

### 2.Revenue Receipts

These are the incomes which are received by the government from all sources in its ordinary course of governance. These receipts do not create a liability or lead to a reduction in assets.

Revenue receipts are further classified as tax revenue and non-tax revenue, such as, stamp duties, fees, and dividends if any, from public sector undertakings (PSUs).

- Direct taxes

A tax that is paid directly by an individual or organization to the imposing entity. A taxpayer pays a direct tax to a government for different purposes, including real property tax, personal property tax, income tax or taxes on assets. Direct taxes are different from indirect taxes, where the tax is levied on one entity, such as a seller, and paid by another, such a sales tax paid by the buyer in a retail setting.

A direct tax cannot be shifted to another individual or entity.

- Indirect taxes

The term indirect tax can be defined from different views. In the colloquial sense, an indirect tax is the charge that is collected by intermediary (like retail store) from the individual who holds the actual economic burden of the tax (like customer).

Indirect taxes are the charges that are levied on goods and services. Some of the significant indirect taxes include Value Added Tax, Central Sales Tax, Central Excise Duty, Customs Duty, stamp duties and expenditure tax.

Unlike Direct Taxes, Indirect Taxes are not levied on individuals, but on goods and services. Customers indirectly pay this tax in the form of higher prices.

*Case:Kansas city and saint Louis*

*This case study focuses on the cost of services that a city provides. The goal of this paper is to describe spending patterns on government services compared to Kansas City* *and Saint Louis. By presenting Saint Louis' and Kansas City's total expenditures and breaking down the general categories in which these expenditures were made, it is possible to compare them, in some ways, to the expenditures of other, similarly sized cities. For the purposes of this paper, the comparison cities are Tulsa, Oklahoma City, Omaha, Denver, Louisville, and Indianapolis*.

- Laffer curve

Invented by Arthur Laffer, this curve shows the relationship between tax rates and tax revenue collected by governments. The curve suggests that, as taxes increase from low levels, tax revenue collected by the government also increases. It also shows that tax rates increasing after a certain point would cause people not to work as hard or not at all, thereby reducing tax revenue. Eventually, if tax rates reached 100% (the far right of the curve), then all people would choose not to work because everything they earned would go to the government.

Research has developed theoretical mathematical models in which a Laffer curve can slope continuously upwards all the way to 100%, though it is not clear whether or when the assumptions on which such mathematical models are based hold in real economies.

- Deficit

Budgetary deficit is simply the excess of public expenditure over public revenue. In economics, a deficit is an excess of expenditures over revenue in a given time period; in more specific cases it may refer to:

- **Government budget deficit**
    a. Deficit spending
    b. Primary deficit, the pure deficit derived after deducting the interest payments
    c. Structural and cyclical deficit, parts of the public sector deficit

- **Income deficit,** the difference between family income and the poverty threshold
- **Trade deficit**, when the value of imports exceed the value of exports
- **Balance of payments deficit,** when the balance of payments is negative.

1. **Revenue Deficit**
   When the net amount received (revenues less expenditures) falls short of the projected net amount to be received. This is the opposite of a revenue surplus, which occurs when the actual amount exceeds the projected amount. A mismatch in the expected revenue and expenditure can result in revenue deficit. Revenue deficit arises when the government's actual net receipts is lower than the projected receipts. On the contrary, if the actual receipts are higher than expected one, it is termed as revenue surplus.
2. **Fiscal Deficit**
   Fiscal deficit is the difference between revenue receipts plus certain non-debt capital receipts and the total expenditure including loans net of repayments.

   Fiscal Deficit = Total Expenditure – (Revenue Receipts + Non-debt Capital Receipts)
   In short, fiscal deficit indicates the total borrowing requirements of the government from all sources. This may also be called Gross Fiscal Deficit (GFD). It measures that portion of government expenditure which is financed by borrowing and drawing down of cash balances.
3. **Primary Deficit**
   It is simply fiscal deficit minus interest payments. Exclusion of interest transactions would, therefore, enable us to see the way the government is currently conducting its financial affairs. Accordingly, Primary deficit is defined as Fiscal Deficit less net interest payments, (that is less interest payments plus interest receipts).
   Net primary deficit is obtained by subtracting ‘Loans and Advances’ from net fiscal deficit. It is also equal to Fiscal Deficit less interest payments plus interest receipts less loans and advances.

- <u>Money, banking, and the stock market.</u>

▪ Bank Run

A bank run occurs in a fractional reserve banking system when a large number of customers withdraw their deposits from a financial institution at the same time and either demand cash or transfer those funds into government bonds, precious metals or stones, or a safer institution because they believe that the financial institution is, or might become, insolvent. As a bank run progresses, it generates its own momentum, in a kind of self-fulfilling prophecy (or positive feedback loop) – as more people withdraw their deposits, the likelihood of default increases, thus triggering further withdrawals. This can destabilize the bank to the point where it runs out of cash and thus faces sudden bankruptcy.

***<u>CASE STUDY : BANK RUN IN INDYMAC BANK ,US .</u>***

*<u>On 11 July 2008, U.S. mortgage lender IndyMac Bank was seized by federal regulators. The bank relied heavily on higher cost, less stable, brokered deposits, as well as secured borrowings, to fund its operations and focused on stated income and other aggressively underwritten loans in areas with rapidly escalating home prices, particularly in California and Florida. A highly stressed institution .IndyMac's capital was being lost to downgrades as the poor quality of their book was revealed. Regulators at the Office of Thrift Supervision (OTS) had allowed the bank to misstate its financial condition, avoiding regulatory intervention .On June 26, Sen. Charles E. Schumer released to the media letters he sent to the regulators, which warned the bank might not be viable. In the days following the release, depositors pulled out approximately 7.5%</u>*

*of the bank's deposits. IndyMac and the OTS regulators who had allowed the bank backdate its books blamed Schumer's letters for the bank's demise. These regulators resigned or were fired amidst a Treasury Department investigation. IndyMac's failure is expected to cost the FDIC more about $9 billion. Uninsured depositors have lost an estimated $270 million.*

## Money and the Banking System

Modern day monetary systems are based on fiat money and are no longer tied to the value of gold. The control of the amount of money in the economy is known as monetary policy. Monetary policy is the process by which a government, central bank, or monetary authority manages the money supply to achieve specific goals. A failed monetary policy can have significant detrimental effects on an economy and the society that depends on it. These include hyperinflation, stagflation, recession, high unemployment, shortages of imported goods, inability to export goods, and even total monetary collapse and the adoption of a much less efficient barter economy.

### Measures taken by the central bank to control money

Governments and central banks have taken both regulatory and free market approaches to monetary policy. Some of the tools used to control the money supply include:

- changing the interest rate at which the central bank loans money to (or borrows money from) the commercial banks
- currency purchases or sales
- increasing or lowering government borrowing
- increasing or lowering government spending
- manipulation of exchange rates
- raising or lowering bank reserve requirements
- regulation or prohibition of private currencies
- taxation or tax breaks on imports or exports of capital into a country

- ## The Stock Market

A stock market or equity market is the aggregation of buyers and sellers (a loose network of economic transactions, not a physical facility or discrete entity) of stocks (shares); these are securities listed on a stock exchange as well as those only traded privately.

Stocks are partitioned in various ways. One common way is by the country where the company is domiciled.Market participants include individual retail investors, institutional investors such as mutual funds, banks, insurance companies and hedge funds, and also publicly traded corporations trading in their own shares.

### 1.Bullish Stock market

A financial market of a group of securities in which prices are rising or are expected to rise. The term "bull market" is most often used to refer to the stock market, but can be applied to anything that is traded, such as bonds, currencies and commodities.

Bull markets are characterized by optimism, investor confidence and expectations that strong results will continue. It's difficult to predict consistently when the trends in the market will change. Part of the difficulty is that psychological effects and speculation may sometimes play a large role in the markets.

### 2.Bearish Stock Market

A market condition in which the prices of securities are falling, and widespread pessimism causes the negative sentiment to be self-sustaining. As investors anticipate losses in a bear market and selling continues, pessimism only grows.

A bear market should not be confused with a correction, which is a short-term trend that has a duration of less than two months.

The use of "bull" and "bear" to describe markets comes from the way the animals attack their opponents. A bull thrusts its horns up into the air while a bear swipes its paws down. These actions are metaphors for the movement of a market. If the trend is up, it's a bull market. If the trend is down, it's a bear market.

- ## Cash Reserve Ratio

Cash reserve Ratio (CRR) is the amount of funds that the banks have to keep with the RBI. If the central bank decides to increase the CRR, the available amount with the banks comes down. The RBI uses the CRR to drain out excessive money from the system.

RBI uses CRR either to drain excess liquidity or to release funds needed for the growth of the economy from time to time. Increase in CRR means that banks have less funds available and money is sucked out of circulation. Thus we can say that this serves duel purposes i.e.

- ensures that a portion of bank deposits is kept with RBI and is totally risk-free,
- Enables RBI to control liquidity in the system, and thereby, inflation by tying the hands of the banks in lending money.

- ## Statutory Liquid Ratio

Statutory liquidity ratio refers amount that the commercial banks require to maintain in the form of gold or govt. approved securities before providing credit to the customers. Here by approved securities we mean, bond and shares of different companies. Statutory Liquidity Ratio is determined and maintained by the Reserve Bank of India in order to control the expansion of bank credit. SLR is used by bankers and indicates the minimum percentage of deposits that the bank has to maintain in form of gold, cash or other approved securities.

- ## Demand For Money

The demand for money is affected by several factors, including the level of income, interest rates, and inflation as well as uncertainty about the future. The way in which these factors affect money demand is usually explained in terms of the three motives for demanding money: the transactions, the precautionary, and the speculative motives.

- Transactions motive: The transactions motive for demanding money arises from the fact that most transactions involve an exchange of money. Hence, as income or GDP rises, the transactions demand for money also rises.

- Precautionary motive: People often demand money as a precaution against an uncertain future. Unexpected expenses, such as medical or car repair bills, often require immediate payment. The need to have money available in such situations is referred to as the precautionary motive for demanding money.
- Speculative motive: Money, like other stores of value, is an asset. The demand for an asset depends on both its rate of return and its opportunity cost. Typically, money holdings provide no rate of return and often depreciate in value due to inflation.

## Money Supply

The total stock of money circulating in an economy is the money supply. The circulating money involves the currency, printed notes, money in the deposit accounts and in the form of other liquid assets.

Valuation and analysis of the money supply help the economist and policy makers to frame the policy or to alter the existing policy of increasing or reducing the supply of money. The valuation is important as it ultimately affects the business cycle and thereby affects the economy.

In India, the Reserve Bank of India follows - M1, M2, M3 and M4 monetary aggregates. M1 and M2 also called narrow money, normally include coins and notes in circulation and other money equivalents that are easily convertible into cash. M2 includes M1 plus short-term time deposits in banks and 24-hour money market funds. M3 includes M2 plus longer-term time deposits and money market funds with more than 24-hour maturity. The exact definitions of the three measures depend on the country. M4 includes M3 plus other deposits. The term broad money is used to describe M3 or M4.

## Mutual fund

An investment vehicle that is made up of a pool of funds collected from many investors for the purpose of investing in securities such as stocks, bonds, money market instruments and similar assets. Mutual funds are operated by money managers, who invest the fund's capital and attempt to produce capital gains and income for the fund's investors. One of the main advantages of mutual funds is that they give small investors access to professionally managed, diversified portfolios of equities, bonds and other securities.

## • Free trade and the world trade organization.

- World Trade Organization

The World Trade Organization (WTO) is an organization that intends to supervise and liberalize international trade. The organization officially commenced on 1 January 1995 under the Marrakech Agreement, replacing the General Agreement on Tariffs and Trade (GATT), which commenced in 1948. The organization deals with regulation of trade between participating countries; it provides a framework for negotiating and formalizing trade agreements, and a dispute resolution process aimed at enforcing participant's adherence to WTO agreements.

### Working Of WTO

Among the various functions of the WTO, these are regarded by analysts as the most important:

1. It oversees the implementation, administration and operation of the covered agreements.
2. It provides a forum for negotiations and for settling disputes.

Additionally, it is the WTO's duty to review and propagate the national trade policies, and to ensure the coherence and transparency of trade policies through surveillance in global economic policy-making. Another priority of the WTO is the assistance of developing, least-developed and low-income countries in transition to adjust to WTO rules and disciplines through technical cooperation and training.

Finally, the WTO cooperates closely with the two other components of the Bretton Woods system, the IMF and the World Bank.

- Anti-Dumping Duty

A protectionist tariff that a domestic government imposes on foreign imports that it believes are priced below fair market value. In the United States, anti-dumping duties are imposed by the Department of Commerce and often exceed 100%. They come into play when a foreign company is selling an item significantly below the price at which it is being produced. The logic behind anti-dumping duties is to save domestic jobs, although critics argue that this leads to higher prices for domestic consumers and reduces the competitiveness of domestic companies producing similar goods.

Even when a foreign company sells its exports at the same or a higher price than they sell for in the company's home country, the importing country can decide that the exporter is guilty of "dumping" and impose an anti-dumping duty.

- Comparative Advantage

The ability of a firm or individual to produce goods and/or services at a lower opportunity cost than other firms or individuals. A comparative advantage gives a company the ability to sell goods and services at a lower price than its competitors and realize stronger sales margins.

Having a comparative advantage - or disadvantage - can shape a company's entire focus.

- Quota

A government-imposed trade restriction that limits the number, or in certain cases the value, of goods and services that can be imported or exported during a particular time period. Quotas are used in international trade to help regulate the volume of trade between countries. They are sometimes imposed on specific goods and services to reduce imports, thereby increasing domestic production. In theory, this helps protect domestic production by restricting foreign competition.

- Tariff

A tax imposed on imported goods and services. Tariffs are used to restrict trade, as they increase the price of imported goods and services, making them more expensive to consumers. They are one of several tools available to shape trade policy.

Quotas are different than tariffs (or customs), which places a tax on imports or exports in and out of a country. Both quotas and tariffs are protective measures imposed by governments to try to control trade between countries.

- Custom Duties

A tax levied on imports (and, sometimes, on exports) by the customs authorities of a country to raise state revenue, and/or to protect domestic industries from more efficient or predatory competitors from abroad.

Customs duty is based generally on the value of goods or upon the weight, dimensions, or some other criteria of the item (such as the size of the engine, in case of automobiles).

- Subsidies

Subsidies, by means of creating a wedge between consumer prices and producer costs, lead to changes in demand/ supply decisions. Subsidies are often aimed at:

- inducing higher consumption/ production
- offsetting market imperfections including internalisation of externalities;
- Achievement of social policy objectives including redistribution of income, population control, etc.

In WTO terminology, subsidies in general are identified by "boxes" which are given the colours of traffic lights: green (permitted), amber (slow down — i.e. be reduced), red (forbidden).

- The 'green box' subsidies

In order to qualify for the "green box", a subsidy must not distort trade, or at most cause minimal distortion. These subsidies have to be government-funded (not by charging consumers higher prices) and must not involve price support. "Green box" subsidies are therefore allowed without limits, provided they comply with relevant criteria.

- The 'blue box' subsidies

The blue box is an exemption from the general rule that all subsidies linked to production must be reduced or kept within defined minimal ("de minimis") levels. It covers payments directly linked to acreage or animal numbers, but under schemes which also limit production by imposing production quotas or requiring farmers to set aside part of their land.

- <u>Anatomy of inflation.</u>

In economics, inflation is a persistent increase in the general price level of goods and services in an economy over a period of time. When the general price level rises, each unit of currency buys fewer goods and services. Consequently, inflation reflects a reduction in the purchasing power per unit of money – a loss of real value in the medium of exchange and unit of account within the economy.

Negative effects of inflation include an increase in the opportunity cost of holding money, uncertainty over future inflation which may discourage investment and savings, and if inflation is rapid enough, shortages of goods as consumers begin hoarding out of concern that prices will increase in the future. Positive effects include ensuring that central banks can adjust real interest rates (to mitigate recessions), and encouraging investment in non-monetary capital projects.

- Cost Push Inflation

Cost-push inflation occurs when businesses respond to rising production costs, by raising prices in order to maintain their profit margins. Higher costs shift a firm's supply curve upwards and lead to an increase in price. There are many reasons why costs might rise:

- Rising imported raw materials costs perhaps caused by inflation in countries that are heavily dependent on exports of these commodities or alternative by a fall in the value of the pound in the foreign exchange markets which increases the UK price of imported inputs

- Rising labour costs - caused by wage increases which exceed any improvement in productivity. This cause is important in those industries, which are labour-intensive.

- ## Demand Pull Inflation

Demand-pull inflation is likely when there is full employment of resources and short run aggregate supply is inelastic. In these circumstances an increase in AD will lead to a general increase in prices. AD might rise for a number of reasons some of which occur together at the same moment of the economic cycle

- A depreciation of the exchange rate, which increases the price of imports and reduces the foreign price of UK exports. If consumers buy fewer imports, while foreigners buy more exports, AD will rise. If the economy is already at full employment, prices are pulled upwards.
- The rapid growth of the money supply perhaps as a consequence of increased bank and building society borrowing if interest rates are low and consumer confidence is high.
- Faster economic growth in other countries providing a boost to UK exports overseas. Remember that export sales provide an extra flow of income and spending into the UK circular flow. Exports are counted as an injection of AD.

- ## Measures of Inflation

In India, Inflation is measured using WPI (Wholesale Price Index). It is very tedious to track each and every commodity and calculate its price rise. Instead of that an Index of several goods and services is prepared. India's WPI is a weighted-index of 435 commodities. It means price-rise of all commodities will not be treated equally. The price-rise of rice will have more weight-age than price-rise of a Maruti-car. That is because rice is consumed by a very large number of people compared to a Maruti car.

Many other countries like UK, USA, China, etc. use CPI (Consumer Price Index) to measure inflation. This is a more realistic measure because it computes the index based on the increase in actual price paid by the consumer.

## *CASE STUDY : HIKE IN FOOD PRICES :*

*Spiraling prices of onion and other vegetables pushed the wholesale price inflation (WPI) to an eight-month high of 7 per cent in October. Food prices remained elevated, though the rate of increase dropped marginally to 18.19 per cent as compared with 18.4 per cent in September, data showed.*

*Retail prices of onions have quadrupled in some cities over the past three months, serving as a powerful reminder of the impact on consumers. Onion prices jumped by an annual 278.21 per cent in October 2013 as compared with a 78.38 per cent rise in vegetable prices.*

*Protein rich items like egg, meat and fish became costlier by 17.47 per cent against 13.37 per cent in September 2013.*

*Rising food prices had also been reflected by data showing consumer price inflation accelerated more than expected in October, to 10.09 per cent from September's annual pace of 9.84 per cent.*

*The reserve bank governor Raghuram Rajan described the hike in India's food inflation was disturbingly high .*

- Headline Inflation

The raw inflation figure as reported through the Consumer Price Index (CPI) that is released monthly by the Bureau of Labour Statistics. The CPI calculates the cost to purchase a fixed basket of goods as a way of determining how much inflation is occurring in the broad economy. The CPI uses a base year and indexes current year prices based on the base year's values.

The headline figure is not adjusted for seasonality or for the often volatile elements of food and energy prices, which are removed in the Core CPI.

Comparisons of headline inflation are typically made on a year-over-year basis.

- Core Inflation

A measure of inflation that excludes certain items that face volatile price movements. Core inflation eliminates products that can have temporary price shocks because these shocks can diverge from the overall trend of inflation and give a false measure of inflation.

Core inflation is most often calculated by taking the Consumer Price Index (CPI) and excluding certain items from the index, usually energy and food products. Other methods of calculation include the outlier's method, which removes the products that have had the largest price changes.

- Laspeyres Price Index

The Laspeyres price index is an index formula used in price statistics for measuring the price development of the basket of goods and services consumed in the base period. The question it answers is how much a basket that consumers bought in the base period would cost in the current period.

- Open Market Operations

The buying and selling of government securities in the open market in order to expand or contract the amount of money in the banking system. Purchases inject money into the banking system and stimulate growth while sales of securities do the opposite.

The U.S. Federal Reserve's goal in using this technique is to adjust the federal funds rate - the rate at which banks borrow reserves from each other.

- Real Gross Domestic Product

An inflation-adjusted measure that reflects the value of all goods and services produced in a given year, expressed in base-year prices. Often referred to as "constant-price," "inflation-corrected" GDP or "constant dollar GDP".

Real GDP is gross domestic product in constant dollars. In other words, it is a nation's total output of goods and services, adjusted for price changes. Real GDP can be compared to nominal GDP, which is GDP in current dollars, (i.e. the nation's output in actual dollars in a given year). By eliminating the effect of price changes, real GDP allows economists to make useful comparisons of a nation's output and services.

- Repo Rate

Repo rate is the rate at which the central bank lends short-term money to the banks against securities. A reduction in the repo rate will help banks to get money at a cheaper rate. When the repo rate increases, borrowing from the central bank becomes more expensive. It is more applicable when there is a liquidity crunch in the market.

The reverse repo rate is the rate at which banks can park surplus funds with reserve bank, while the repo rate is the rate at which the banks borrow from the central bank. It is mostly done when there is surplus liquidity in the market.

## *CASE STUDY : INCREASE IN REPO RATE BY RBI*

*RBI hiked the repurchase or repo rate, at which it lends short-term funds to banks, to 8%, but said further tightening is unlikely in the near term if consumer price inflation eases.*

*The apex bank retained the cash reserve ratio (CRR), or the amount of deposits banks needs to park with the central bank and on which they earn no interest, at 4%.*

*A majority of the economists who participated in a Bloomberg poll had predicted a status-quo in the repo rate, while a few bet on a 25 basis point rate hike. One basis point is one-hundredth of a percentage point.*

*RBI also said it has decided to undertake monetary policy reviews in a two-monthly cycle. Accordingly, the next policy review is scheduled for 1 April.*

*The central bank said it is critical to address the risks of inflation even as the risks to growth persist.*

*"If policy actions succeed in delivering the desired inflation outcome, real GDP (gross domestic product) growth can be expected to firm up from a little below 5% in 2013-14 to a range of 5-6% in 2014-15, with risks balanced around the central estimate of 5.5%. A pick-up in investment in an environment in which external demand continues to be supportive of export performance could impart an upside to this forecast," the central bank said.*

*To fight inflation, RBI has now hiked the repo rate three times since 4 September when Raghuram Rajan, a former chief economist with the International Monetary Fund, took over as the central bank governor from D. Subbarao.*

# • Boom and bust phenomena

## ▪ Business cycle and Indicators of Boom and Bust

In economics, the term Boom and bust describes a time period characterized by sustained increases in several economic indicators followed by a sharp and rapid contraction. It is in reference to a severe business cycle. The phrase "boom and bust" pertains to capitalism. Times of increased business and investment have collapsed leaving widespread poverty such as the depressions of 1837 and 1857 in the United States "Business leaders such as automaker Paul Hoffman have used the phrase in calling for increased civic responsibility toward taming the business cycle.

## ▪ Indicators of Boom and Bust

"William Forbes uses the phrase in his textbook on finance, in which he identifies credit characteristics of boom and of bust:

1. Indicators of boom include banks extending more credit
   - for domestic consumption activities
   - for "investments" in the commodities, stock, and housing markets
   - and for imports of goods made in developing countries
2. Indicators of bust include banks extending less credit
   - from lower domestic consumption activities and resulting unemployment
   - from fewer investments made
   - from less demand for imports causing companies in developing countries to have trouble paying their loans

## ▪ Fiscal Policies

In economics and political science, fiscal policy is the use of government revenue collection (taxation) and expenditure (spending) to influence the economy. The two main instruments of fiscal policy are changes in the level and composition of taxation and government spending in various sectors. These changes can affect the following macroeconomic variables in an economy:

- Aggregate demand and the level of economic activity;
- The distribution of income;
- The pattern of resource allocation within the government sector and relative to the private sector.

- Monetary Policies

Monetary policy is the process by which the monetary authority of a country controls the supply of money, often targeting a rate of interest for the purpose of promoting economic growth and stability.

Monetary policy is referred to as either being expansionary or contractionary, where an expansionary policy increases the total supply of money in the economy more rapidly than usual, and contractionary policy expands the money supply more slowly than usual or even shrinks it.

It includes reduction of the CRR and SLR by the RBI so that banks are left with more cash on hand per deposit received.

***Case-: monetary and fiscal policy of Pakistan***

*This study investigates the comparative effect of fiscal and monetary policy on economic growth in Pakistan using annual time series data from 1981 to 2009. The cointegration result suggests that both monetary and fiscal policy have significant and positive effect on economic growth. The coefficient of monetary policy is much greater than fiscal policy which implies that monetary policy has more concerned with economic growth than fiscal policy in Pakistan. The implication of the study is that the policy makers should focus more on monetary policy than fiscal to enhance economic growth. However, the combination and harmonization of both monetary and fiscal policy are highly recommended.*

- Stagflation

Stagflation, a portmanteau of stagnation and inflation, is a term used in economics to describe a situation where an inflation rate is high, the economic growth rate slows down, and unemployment remains steadily high. It raises a dilemma for economic policy since actions designed to lower inflation may exacerbate unemployment, and vice versa.

The term is generally attributed to British politician who became Chancellor of the Exchequer in 1970, Iain Macleod, who coined the phrase in his speech to Parliament in 1965.

- Depression

A severe and prolonged downturn in economic activity. In economics, a depression is commonly defined as an extreme recession that lasts two or more years. A depression is characterized by economic factors such as substantial increases in unemployment, a drop in available credit, diminishing output, bankruptcies and sovereign debt defaults, reduced trade and commerce, and sustained volatility in currency values. In times of depression, consumer confidence and investments decrease, causing the economy to shut down.

- Recession

A significant decline in activity across the economy, lasting longer than a few months. It is visible in industrial production, employment, real income and wholesale-retail trade. The technical indicator of a recession is two consecutive quarters of negative economic growth as measured by a country's gross domestic product (GDP); although the National Bureau of Economic Research (NBER) does not necessarily need to see this occur to call a recession.

A result of such a wide-spread global recession, the economies of virtually all the world's developed and developing nations suffered extreme set-backs and numerous government policies were implemented to help prevent a similar future financial crisis.

## *CASE STUDY : INDIAN RECESSION 2013*

*Now, our country is saturated with foreign investments in all those fields opened up by the government. Rest of the world is again in the pre-2008 recession situation and US is about to face election this November. So by June 2013, president of US will have to declare recession .*

*India won't be in the state of recession, but we will take a bigger hit than we took in 2008. Since no new money will be pumped in, the economy won't jump like it did. Both, white and black money in circulation will be hit and inflation will go up.*

*People without jobs will have to work harder to find them or add a few skills (certifications) to show their credibility. And the ones with job will have to work harder and add skills along.*

- Types of Unemployment

  - **Involuntary Unemployment**

Involuntary unemployment occurs when a person is willing to work at the prevailing wage yet is unemployed. Involuntary unemployment is distinguished from voluntary unemployment, where workers choose not to work because their reservation wage is higher than the prevailing wage. In an economy with involuntary unemployment there is a surplus of labour at the current real wage.

  - **Voluntary Unemployment**

Voluntary unemployment exists when people have chosen not to work because they do not feel that wages at the existing equilibrium are high enough to justify them working. They may prefer instead to receive benefits. Classical economists argued that any unemployment remaining in the longterm would be voluntary as the economy would automatically tend towards full-employment.

- **Cyclical Unemployment**

A factor of overall unemployment that relates to the cyclical trends in growth and production that occur within the business cycle. When business cycles are at their peak, cyclical unemployment will be low because total economic output is being maximized. When economic output falls, as measured by the gross domestic product (GDP), the business cycle is low and cyclical unemployment will rise.

Economists describe cyclical unemployment as the result of businesses not having enough demand for labour to employ all those who are looking for work economy.

- **Frictional Unemployment**

Unemployment that is always present in the economy, resulting from temporary transitions made by workers and employers or from workers and employers having inconsistent or incomplete information.

For example, a first-time job seeker may lack the resources or efficiency for finding the company that has the job that is available and suitable for him or her. As a result this person does not take other work, temporarily holding out for the better-paying job.

- # Un-aimed opulence

- Adult Literacy Rate

Literacy is the ability to read and write. The inability to do so is called illiteracy or analphabetism. Adult Literacy is ability of Adults to use language i.e. to read, write, listen and speak. Adult Literacy includes basic literacy, desirable knowledge pertaining to civic needs, personal hygiene, and adopting political and occupational skills. According to the United Nations, Basic Literacy is the ability to read 40 words per minute, write 20 words per minute, and do 2-digit arithmetic. India has over 35 % of the world's total illiterate population. India also has the largest number of illiterate people in the world. Adult literacy rate is the Percentage of persons aged 15 and over who can, with understanding, read and write a short, simple statement about their everyday life.

## *CASE STUDY : BIHAR VS KERALA LITERACY*

*Bihar has significantly raised the literacy rate as per the 2011 census. The literacy rate has risen from 39% in 1991 to 47% in 2001 to 63.8% in 2011.*

*Extensive impoverishment, entrenched hierarchical social divisions and the lack of correlation between educational attainment and job opportunities are often cited in studies of the hurdles literacy programs face in Bihar. Children from "lower castes" are frequently denied school attendance and harassed when they do attend. In areas where there is no discrimination, poor funding and impoverished families means that children often cannot afford textbooks and stationery.*

*On the other hand ,Kerala has the highest literacy rate among the states of India, followed by the state of Mizoram. Kerala topped the Education Development Index (EDI) among 21* *major states in India in year 2006–2007.[143] More than 94% of the rural population has access to primary school within 1 km, while 98% of population benefits one school within a distance of 2 km. An upper primary school within a distance of 3 km is available for more than 96% of the people, whose 98% benefit the facility for secondary education within 8 km.*

- Life Expectancy At Birth

  Life expectancy at birth indicates the number of years a Newborn infant would live if prevailing patterns of mortality at the time of its birth were to stay the same throughout its life. The indicator measures how many years a new-born baby is expected to live on average given current age-specific mortality rates. Life expectancy at birth is an indicator of mortality conditions and, by proxy, of health conditions. . Life expectancy, a basic indicator, is closely connected with health conditions, which are in turn an integral part of development. Life expectancy is included as a basic indicator of health and social development in, among others, the Minimum National Social Data Set endorsed by the United Nations Statistical Commission at its 29th session in 1997, the Human Development Index, the UNDG-CCA indicator set and the OECD/DAC core indicators.

## *CASE STUDY : INDIAN SCENARIO*

*There has been a consistent decline in Infant Mortality Rate (IMR) and Under-Five Mortality Rate (U5MR) in India. The rate of decline in current decade is higher than in the previous.*

*However, based on robust projections, at the current rate of decline, India is unlikely to meet the targets for Millennium*

*Development Goal (MDG)-4, which aims to reduce by two thirds, between 1990 and 2015, the under-five mortality rate.*

*India has realized impressive gains in child survival over the last two decades. However, at the current pace, the country is unlikely to achieve the Millennium Development Goal (MDG) 4 -which aims to reduce Under-Five Mortality (U5MR) by two thirds between 1990 and 2015- unless the related socio-economic; maternal and demographic; and environmental determinants are urgently addressed.*

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